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Heightened Cyclical Risks

Economic Outlook for 2005 and 2006

April 2005

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Heightened Cyclical Risks

Economic Outlook for 2005 and 2006

The short-term business outlook in the euro area is surrounded by considerable uncertainty. Recent gains in exports and profits have so far not translated into higher investment and consumer spending. High oil prices constitute a further risk element. Owing to the positive incentives from the tax reform, the Austrian economy is performing better than the euro area as a whole. GDP is projected to expand at a steady 2¼ percent p.a. in 2005 and 2006. The rate of unemployment is nevertheless unlikely to decline, given the massive increase in labour supply.

Economic growth in Austria is expected to edge up to around 2¼ percent in 2005 and keep the same pace in 2006. The expansion is driven mainly by private consumption and construction activity. Private households, benefiting from tax cuts and rising employment this year, should spend at least part of their net income gains on consumer goods. Construction will also grow notably faster than last year, as suggested by the high order volumes in civil engineering and some segments of the building sector. However, stimulus from foreign demand is set to slacken with global growth shifting into lower gear. Also investment in machinery and equipment will decelerate from last year when spending was upward biased by the imminent expiry of the investment tax premium ("Investitionszuwachsprämie"). Overall, economic growth in Austria is likely to outpace that in the euro area both this year and next.

The cyclical risks in the euro area have mounted significantly over the last months. The already cooling boom from the external side has spurred domestic demand only to a limited extent so far. In spite of sharply rising profits, investment in the euro area is lacking momentum. Large companies are reducing their debt and employment levels, while private households, growing more sceptical about their situation notably in Germany, restrain their spending on residential building and current consumption. This is the key factor for the sluggishness of activity in the euro area.

The major retarding element for business activity in Europe is not the high euro exchange rate: exports are performing strongly, and weak internal demand is not related to the euro exchange rate. Neither can high oil prices be taken for the main obstacle, since the USA and the Asian economies are growing fast despite the high oil price. Nor is activity being held back by the monetary regime in the euro area, which has followed an expansionary stance since 2001, albeit not to the same degree as in the USA. Substantial differences exist with regard to fiscal policy and real estate prices. In the USA and the UK, the distinctly expansionary budgetary stance, together with swiftly rising real estate prices, have lent firm support to domestic demand. In the euro area, the course of budgetary policy has been broadly neutral, with rising deficits being tolerated in the face of persistently sluggish activity. Unlike in the Anglo-Saxon countries, real estate prices remained flat in most euro area member states, providing little stimulus for residential construction and consumption.

Among the risks to the present projections one should include the oil price rather than the euro exchange rate. The former is the main determinant of headline inflation, which in 2004 rose to an average 2.1 percent in Austria, some ½ percentage point being accounted for by higher oil prices. A further acceleration to a rate of 2.5 percent should be expected for 2005, driven by higher prices for energy, housing and cigarettes. Underlying this projection is the assumption of an average price of \$ 44 per barrel of crude oil (Brent) in 2005. Next year, inflation should abate markedly to a rate of 1.8 percent, with energy prices assumed receding and administered prices broadly stable.

Employment has already reacted significantly to the cyclical recovery. In 2004, the number of economically active employees increased by 21,000. For 2005 and 2006, gains of more than 25,000 per year are expected, the bulk of them in full-time jobs, and particularly for commercial services, trade and health services. In spite of the healthy increase, the rate of unemployment is unlikely to decline, remaining at 7.1 percent (or 4.5 percent on Eurostat definitions). The main reason is a massive increase in labour supply: the domestic labour force is growing for demographic reasons, a high number of people acquiring Austrian nationality and as a consequence of the pension reform; additional foreign labour is coming mainly from Germany, the

effects of the social reforms ("Hartz IV") further reinforcing the inflow. At the same time, the number of Austrians working in Germany is steadily declining.

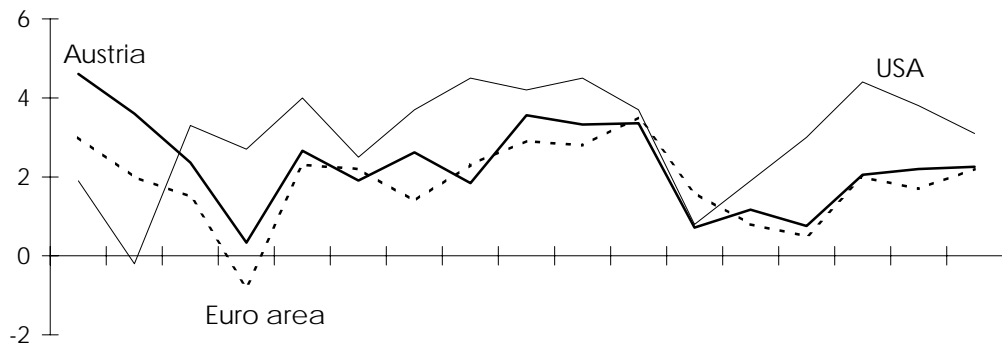
The second stage of the tax reform will raise the general government deficit to around 2 percent of GDP in 2005. High receipts from VAT and corporate tax at the beginning of the year and rising inflation are bringing within reach the government target of keeping the deficit below 2 percent of GDP. In 2006, net government borrowing should decline somewhat, as foreseen in the stability programme. While the expiry of the investment premium will have a positive impact on the government balance, the tax reform carries shortfalls in income and corporate tax revenues.

Vienna, 6 April 2005

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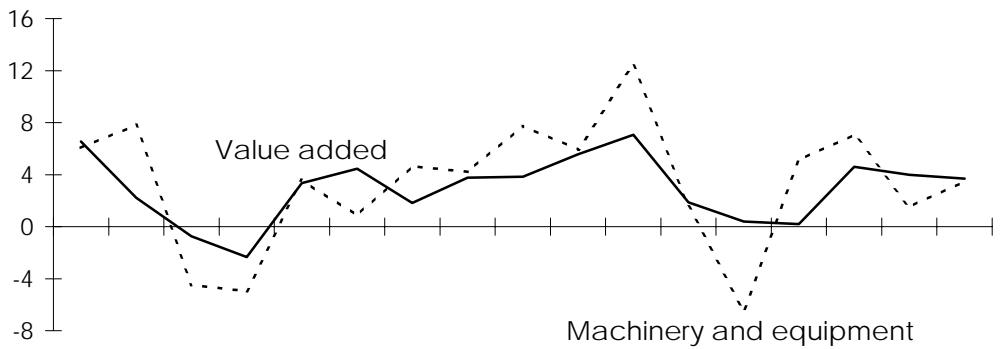
Growth of real GDP

Percent



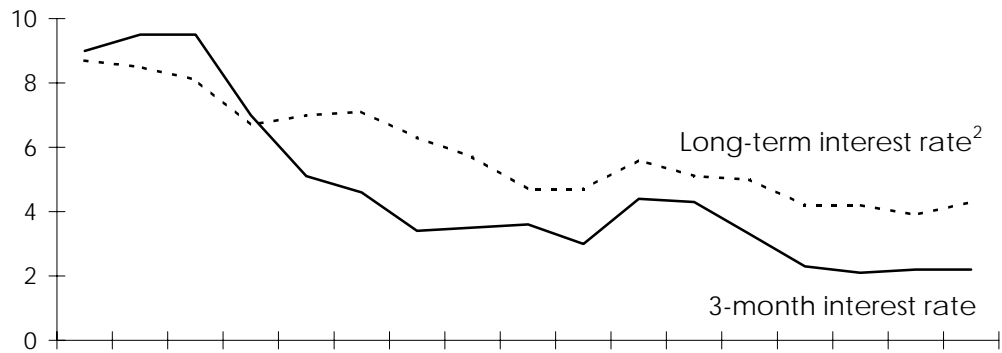
Manufacturing and investment

Percentage changes from previous year, volume



Short-term and long-term interest rates

Percent



Trade

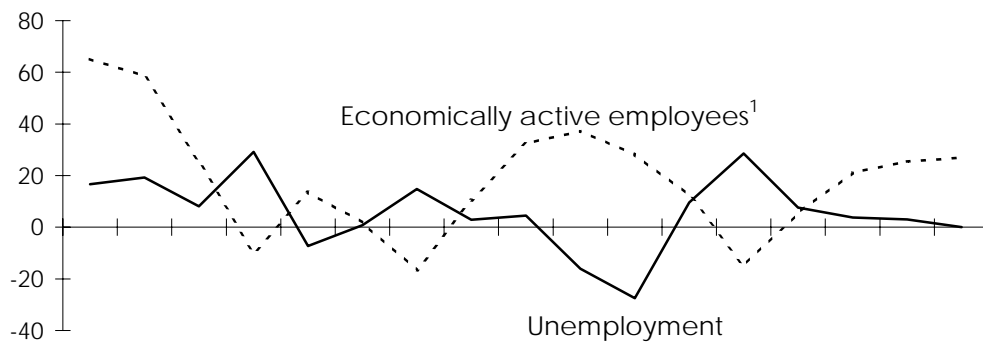
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

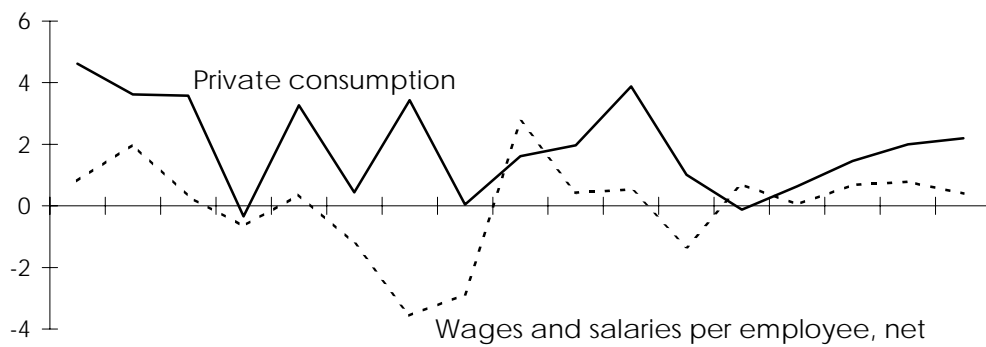
Employment and unemployment

1,000^s from previous year



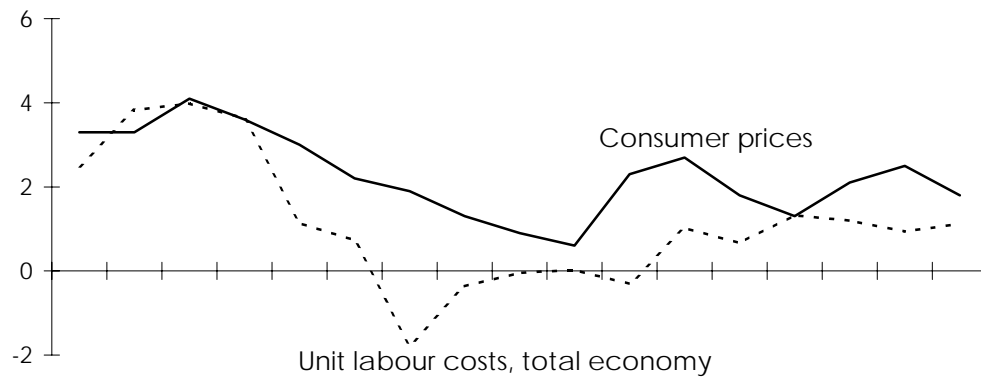
Consumption and income

Percentage changes from previous year, volume



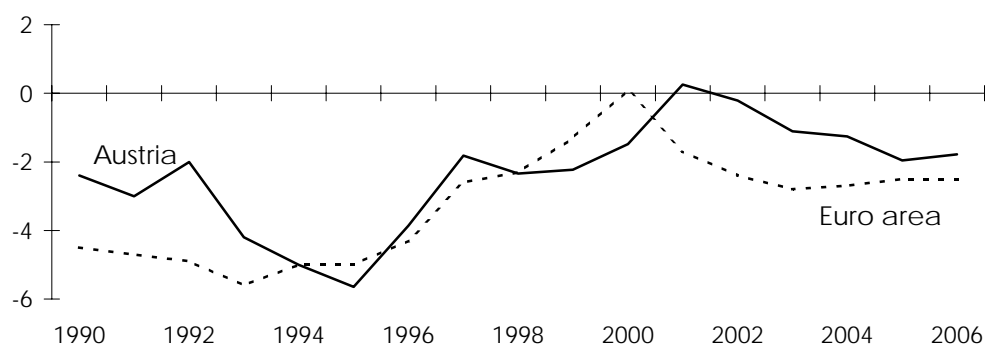
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



¹ Excluding parental leave, military service, and unemployed persons in training.

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Projections - March 2005

Main results

Changes from previous year

		2001	2002	2003	2004	2005	2006
GDP							
Volume		+ 0.7	+ 1.2	+ 0.8	+ 2.0	+ 2.2	+ 2.3
Value		+ 2.5	+ 2.5	+ 2.3	+ 3.9	+ 4.5	+ 3.9
Manufacturing¹, volume		+ 2.2	+ 0.5	+ 0.2	+ 4.8	+ 4.0	+ 3.7
Wholesale and retail trade, volume		+ 2.4	+ 2.2	+ 0.4	+ 1.2	+ 2.2	+ 2.4
Private consumption expenditure, volume		+ 1.0	- 0.1	+ 0.6	+ 1.5	+ 2.0	+ 2.2
Gross fixed investment, volume		- 2.1	- 3.4	+ 6.2	+ 3.8	+ 1.8	+ 2.7
Machinery and equipment ²		+ 1.6	- 6.5	+ 5.1	+ 7.1	+ 1.5	+ 3.5
Construction		- 5.0	- 0.8	+ 7.0	+ 1.1	+ 2.0	+ 2.0
Exports of goods³							
Volume		+ 6.3	+ 4.3	+ 2.5	+ 12.2	+ 6.0	+ 7.0
Value		+ 6.5	+ 4.2	+ 1.9	+ 13.0	+ 6.5	+ 7.5
Imports of goods³							
Volume		+ 5.5	+ 0.3	+ 6.8	+ 8.4	+ 6.0	+ 7.1
Value		+ 5.0	- 2.0	+ 5.0	+ 10.4	+ 6.8	+ 7.8
Current balance	€ bn	- 4.13	+ 0.75	- 1.11	- 1.25	- 1.59	- 1.09
	as a percentage of GDP	- 1.9	+ 0.3	- 0.5	- 0.5	- 0.6	- 0.4
Long-term interest rate⁴	percent	5.1	5.0	4.2	4.2	3.9	4.3
Consumer prices		+ 2.7	+ 1.8	+ 1.3	+ 2.1	+ 2.5	+ 1.8
Unemployment rate							
Eurostat definition ⁵	percent	3.6	4.2	4.3	4.5	4.5	4.5
National definition ⁶	percent	6.1	6.9	7.0	7.1	7.1	7.1
Economically active employees⁷		+ 0.4	- 0.5	+ 0.2	+ 0.7	+ 0.8	+ 0.9
General government financial balance							
	according to Maastricht definition						
	as a percentage of GDP	+ 0.3	- 0.2	- 1.1	- 1.3	- 2.0	- 1.8

¹ Value added, including mining and quarrying. ² Including other products. ³ According to Statistics Austria.

⁴ 10-year central government bonds (benchmark). ⁵ According to Eurostat Labour Force Survey. ⁶ According to Labour Market Service, percent of total labour force excluding self employed. ⁷ Excluding parental leave, military service, and unemployed persons in training.

WIFO*Projections - March 2005***Key policy indicators**

	2001	2002	2003	2004	2005	2006
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	+ 0.3	- 0.2	- 1.1	- 1.3	- 2.0	- 1.8
according to National accounts	+ 0.1	- 0.4	- 1.3	- 1.4	- 2.1	- 1.9
General government primary balance	+ 3.7	+ 3.0	+ 1.9	+ 1.6	+ 0.9	+ 1.0
<i>Monetary policy</i>						
	Percent					
3-month interest rate	4.3	3.3	2.3	2.1	2.2	2.2
Long-term interest rate ¹	5.1	5.0	4.2	4.2	3.9	4.3
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.0	+ 1.4	+ 3.8	+ 1.2	+ 1.0	- 0.6
Real	+ 0.3	+ 0.6	+ 2.8	+ 0.9	+ 1.4	- 0.7

¹ 10-year central government bonds (benchmark).

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Projections - March 2005

World economy

Percentage changes from previous year

	2001	2002	2003	2004	2005	2006
Real GDP						
Total OECD	+ 1.1	+ 1.6	+ 2.2	+ 3.6	+ 2.7	+ 2.6
USA	+ 0.8	+ 1.9	+ 3.0	+ 4.4	+ 3.8	+ 3.1
Japan	+ 0.2	- 0.3	+ 2.4	+ 2.6	+ 1.5	+ 1.8
EU 25	+ 1.7	+ 1.1	+ 0.9	+ 2.4	+ 2.0	+ 2.3
EU 15	+ 1.7	+ 1.0	+ 0.8	+ 2.2	+ 1.9	+ 2.2
Euro area	+ 1.6	+ 0.8	+ 0.5	+ 2.0	+ 1.7	+ 2.2
Germany	+ 0.8	+ 0.1	- 0.1	+ 1.6	+ 1.2	+ 1.6
New members ¹	+ 2.4	+ 2.4	+ 3.8	+ 5.0	+ 4.6	+ 4.1
China	+ 7.3	+ 8.0	+ 9.1	+ 9.5	+ 8.8	+ 8.3
World trade, volume	+ 0.3	+ 3.3	+ 4.1	+ 9.0	+ 7.2	+ 7.1
Market growth²	+ 2.4	+ 1.8	+ 4.4	+ 8.7	+ 6.5	+ 6.5
Primary commodity prices						
HWWA Index, total	- 8	- 5	- 4	+ 18	+ 6	- 2
Excluding energy	- 3	- 6	- 6	+ 18	+ 1	+ 6
Crude oil prices						
Average import price (cif) for OECD countries	23.6	24.1	28.4	37.8	44.0	39.0
Exchange rate						
USD per euro	0.896	0.945	1.131	1.243	1.34	1.28

¹ Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.

² Real import growth of trading partners weighted by Austrian export shares.

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Projections - March 2005

Private consumption, income and prices

	2001	2002	2003	2004	2005	2006
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.0	- 0.1	+ 0.6	+ 1.5	+ 2.0	+ 2.2
Durables	- 0.1	- 2.4	+ 3.6	+ 4.4	+ 3.8	+ 3.5
Non-durables and services	+ 1.2	+ 0.1	+ 0.3	+ 1.1	+ 1.8	+ 2.0
Household disposable income	+ 0.1	+ 0.2	+ 1.5	+ 1.6	+ 2.3	+ 2.1
Household saving ratio						
As a percentage of disposable income	7.6	7.8	8.9	9.2	9.6	9.6
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 3.5	+ 1.2	+ 1.6	+ 5.0	+ 5.2	+ 4.8
	Percentage changes from previous year					
Inflation rate						
National	2.7	1.8	1.3	2.1	2.5	1.8
Harmonised	2.3	1.7	1.3	2.0	2.4	1.7
Core inflation ²	2.3	2.0	1.3	1.6	2.1	1.7

¹ End of period.

² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

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Projections - March 2005

Productivity

Percentage changes from previous year

	2001	2002	2003	2004	2005	2006
Total economy						
Real GDP	+ 0.7	+ 1.2	+ 0.8	+ 2.0	+ 2.2	+ 2.3
Employment ¹	+ 0.6	- 0.1	+ 0.1	+ 1.0	+ 0.8	+ 0.9
Full-time equivalent	+ 0.4	+ 0.1	+ 0.0	+ 0.8	+ 0.7	+ 0.8
Productivity (GDP per employment)	+ 0.1	+ 1.3	+ 0.7	+ 1.1	+ 1.4	+ 1.4
Full-time equivalent	+ 0.3	+ 1.1	+ 0.7	+ 1.2	+ 1.5	+ 1.4
Manufacturing						
Production ²	+ 1.9	+ 0.4	+ 0.2	+ 4.6	+ 4.0	+ 3.7
Employees ³	+ 0.2	- 2.5	- 1.7	- 0.6	- 0.8	- 0.4
Productivity per hour	+ 2.1	+ 3.4	+ 1.6	+ 4.7	+ 4.6	+ 4.1
Working hours per day per employee ⁴	- 0.4	- 0.5	+ 0.3	+ 0.5	+ 0.2	± 0.0

¹ Dependent and self-employed according to National Accounts definition.

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

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Projections - March 2005

Earnings and international competitiveness

Percentage changes from previous year

	2001	2002	2003	2004	2005	2006
Gross earnings per employee ¹	+ 1.3	+ 2.1	+ 2.0	+ 2.2	+ 2.3	+ 2.5
Full-time equivalent	+ 1.6	+ 1.9	+ 2.1	+ 2.4	+ 2.5	+ 2.7
Gross real earnings per employee ¹	- 0.6	+ 0.9	+ 0.5	+ 0.2	- 0.2	+ 0.7
Net real earnings per employee ¹	- 1.3	+ 0.7	+ 0.0	+ 0.7	+ 0.8	+ 0.4
<i>Total economy</i>						
Unit labour costs	+ 1.0	+ 0.7	+ 1.3	+ 1.2	+ 0.9	+ 1.1
<i>Manufacturing</i>						
Unit labour costs	+ 1.1	- 0.6	- 0.5	- 3.1	- 2.1	- 1.4
Relative unit labour costs ²						
Vis-à-vis trading partners	- 0.9	- 0.6	+ 1.4	- 0.6	- 0.8	- 2.5
Vis-à-vis Germany	- 0.6	- 0.4	- 0.1	- 0.1	- 0.9	- 2.2
Effective exchange rate - manufactures						
Nominal	+ 0.9	+ 1.3	+ 3.7	+ 1.2	+ 1.0	- 0.6
Real	+ 0.5	+ 0.8	+ 2.9	+ 1.0	+ 1.5	- 0.6

¹ Employees according to National Accounts definition.

² In a common currency; minus sign indicates improvement of competitiveness.

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Projections - March 2005

Labour market

Changes from previous year (1,000^s)

	2001	2002	2003	2004	2005	2006
Demand for labour						
Economically active employment ¹	+ 13.9	- 11.6	+ 8.5	+ 25.1	+ 29.0	+ 30.9
Employees ²	+ 12.4	- 15.0	+ 5.5	+ 21.1	+ 25.5	+ 26.9
<i>Percentage changes from previous year</i>	+ 0.4	- 0.5	+ 0.2	+ 0.7	+ 0.8	+ 0.9
Nationals	+ 3.0	- 20.1	- 10.4	+ 9.2	+ 15.5	+ 16.7
Foreign workers	+ 9.5	+ 5.1	+ 15.9	+ 11.9	+ 10.0	+ 10.2
Self-employed ³	+ 1.5	+ 3.4	+ 3.0	+ 4.0	+ 3.5	+ 4.0
Labour supply						
Population of working age (15 to 64 years)	+ 27.5	+ 27.0	+ 30.1	+ 14.9	+ 1.2	+ 8.6
(15 to 59 years)	- 13.8	- 1.2	+ 13.3	+ 17.4	+ 31.3	+ 38.9
Labour force ⁴	+ 23.5	+ 17.0	+ 16.1	+ 28.9	+ 32.0	+ 30.9
Surplus of labour						
Registered unemployed ⁵	+ 9.6	+ 28.5	+ 7.7	+ 3.8	+ 3.0	± 0.0
1,000 ^s	203.9	232.4	240.1	243.9	246.9	246.9
Unemployment rate						
Eurostat definition ⁶	percent	3.6	4.2	4.3	4.5	4.5
Percent of total labour force ⁵	percent	5.5	6.2	6.3	6.4	6.4
National definition ^{5,7}	percent	6.1	6.9	7.0	7.1	7.1
Employment rate						
Economically active employment ^{1,8}	percent	63.3	62.8	62.6	62.9	63.4
Total employment (Eurostat) ^{6,8,9}	percent	-	-	-	67.5	68.0

¹ Excluding parental leave, military service, and unemployed persons in training. ² According to Federation of Austrian Social Security Institutions. ³ According to WIFO. ⁴ Economically active employment plus unemployment.

⁵ According to Labour Market Service. ⁶ According to Eurostat Labour Force Survey.

⁷ Percent of total labour force excl. self-employed. ⁸ Percent of population of working age (15 to 64 years).

⁹ Changed survey method.

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