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External Demand Unable to Secure Export-driven Recovery

Economic Outlook for 2014 and 2015

External Demand Unable to Secure Export-Driven Recovery. Economic Outlook for 2014 and 2015

A further slackening of global trade in the last few months is holding back an export-led recovery in the euro area as well as in Austria. Since many countries have not yet digested the repercussions of the financial market crisis, also domestic demand remains feeble, unlike in the USA. In Austria, real GDP is expected to grow by a modest 0.8 percent in the current year, picking up to 1.2 percent in 2015.

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JEL-Codes: E32, E66 • **Keywords:** Business Cycle, Economic Outlook, Forecast

For definitions of terms used, see "Methodological Notes and Short Glossary", <http://www.wifo.ac.at/wwadocs/form/WIFO-BusinessCycleInformation-Glossary.pdf> • All staff members of the Austrian Institute of Economic Research contribute to the Economic Outlook. • Cut-off date: 5 September 2014.

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ISSN 1605-4709 • © Austrian Institute of Economic Research 2014

Impressum: Herausgeber: Karl Aiginger • Chefredakteur: Michael Böheim (Michael.Boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellingner, Ilse Schulz, Tatjana Weber • Medieninhaber (Verleger) und Redaktion: Österreichisches Institut für Wirtschaftsforschung • 1030 Wien, Arsenal, Objekt 20 • Tel. (+43 1) 798 26 01-0 • Fax (+43 1) 798 93 86 • <http://bulletin.wifo.ac.at> • Verlags- und Herstellungsort: Wien

In 2013, world trade strengthened moderately, stimulating Austria's foreign trade. Yet, the cyclical recovery foretold by positive sentiment indicators failed to gain ground, partly because international demand fell back sharply due to the retreat of foreign capital from many emerging markets. In addition, internal demand in the euro area has been subdued since the recession of 2012-13. Private indebtedness has hardly come down since the onset of the financial market crisis and is still constraining consumption and investment in many countries. While the further relaxation of monetary policy by the ECB is easing restrictions on credit supply, it does not address the weakness of demand. Thus, for the euro area the projection for GDP growth has to be taken down from the last revision in late June 2014, to 0.8 percent on annual average 2014 and 1.1 percent in 2015, while for the USA it is kept unchanged at 2.2 percent and 3.1 percent, respectively.

Against this background, Austria's foreign trade will expand less than expected in summer. Investment is withheld by poorer sales prospects, affecting in particular purchases of machinery and business equipment which is set to remain flat in the current year. In the manufacturing sector, both employment and hours worked per capita are declining. In the services branches, job creation is mainly driven by a rising number of part-time jobs. For the overall economy, the total number of hours worked is stagnating, hence projected real GDP growth of 0.8 percent in 2014 and 1.2 percent in 2015 is entirely driven by productivity gains. Employment of domestic workers keeps declining, with supply falling for demographic reasons. The rate of unemployment will climb to just below 9 percent of the dependent labour force (national definition) over the forecast horizon. Headline inflation, projected at 1.8 percent, remains relatively high in view of the weak business conditions, squeezing real purchasing power together with a rising tax burden. As a result, private consumption

keeps advancing only gradually. The cyclical slowdown is weighing also on public finances, although the further fall in interest rates is providing relief on the expenditure side. A major risk for the business outlook derives from a potential worsening of the crisis in Ukraine and relations with Russia. On the other hand, the recovery may receive fresh momentum if the new European Commission were to take decisive measures to stimulate business activity.

Table 1: Main results

		2010	2011	2012	2013	2014	2015
		Percentage changes from previous year					
GDP							
Volume		+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 0.8	+ 1.2
Value		+ 3.2	+ 4.9	+ 2.6	+ 2.0	+ 2.4	+ 2.8
Manufacturing ¹ , volume		+ 7.6	+ 8.3	+ 1.1	+ 1.3	+ 0.8	+ 2.5
Wholesale and retail trade, volume		+ 2.2	+ 1.3	- 1.7	- 1.4	± 0.0	+ 1.0
Private consumption expenditure, volume		+ 2.0	+ 0.8	+ 0.5	- 0.2	+ 0.4	+ 0.8
Gross fixed investment, volume		- 1.4	+ 8.5	+ 1.6	- 0.8	+ 0.9	+ 1.5
Machinery and equipment		+ 2.1	+ 14.3	+ 2.1	- 3.5	± 0.0	+ 2.0
Construction		- 3.9	+ 2.5	+ 2.5	+ 1.2	+ 1.7	+ 1.0
Exports of goods ²							
Volume		+ 13.6	+ 8.1	+ 0.8	+ 3.1	+ 2.3	+ 3.5
Value		+ 16.7	+ 11.3	+ 1.5	+ 1.8	+ 1.8	+ 4.0
Imports of goods ²							
Volume		+ 11.7	+ 8.6	- 1.3	+ 0.9	+ 1.7	+ 3.5
Value		+ 16.5	+ 15.3	+ 0.7	- 1.0	+ 0.7	+ 4.0
Current balance	billion €	+ 9.74	+ 4.90	+ 7.33	+ 8.45	+ 7.63	+ 8.30
As a percentage of GDP		+ 3.4	+ 1.6	+ 2.4	+ 2.7	+ 2.4	+ 2.5
Long-term interest rate ³	percent	3.2	3.3	2.4	2.0	1.5	1.3
Consumer prices		+ 1.9	+ 3.3	+ 2.4	+ 2.0	+ 1.8	+ 1.8
Unemployment rate							
Eurostat definition ⁴	percent	4.4	4.2	4.3	4.9	5.0	5.2
National definition ⁵	percent	6.9	6.7	7.0	7.6	8.4	8.8
Persons in active dependent employment ⁶		+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.6
General government financial balance according to Maastricht definition							
As a percentage of GDP		- 4.5	- 2.5	- 2.6	- 1.5	- 2.9	- 1.9

Source: WIFO, 2014, 2015: forecast. – ¹ Value added, including mining and quarrying. – ² According to Statistics Austria. – ³ 10-year central government bonds (benchmark). – ⁴ According to Eurostat Labour Force Survey. – ⁵ According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – ⁶ Excluding parental leave, military service.

1. Rebound of world trade ending abruptly

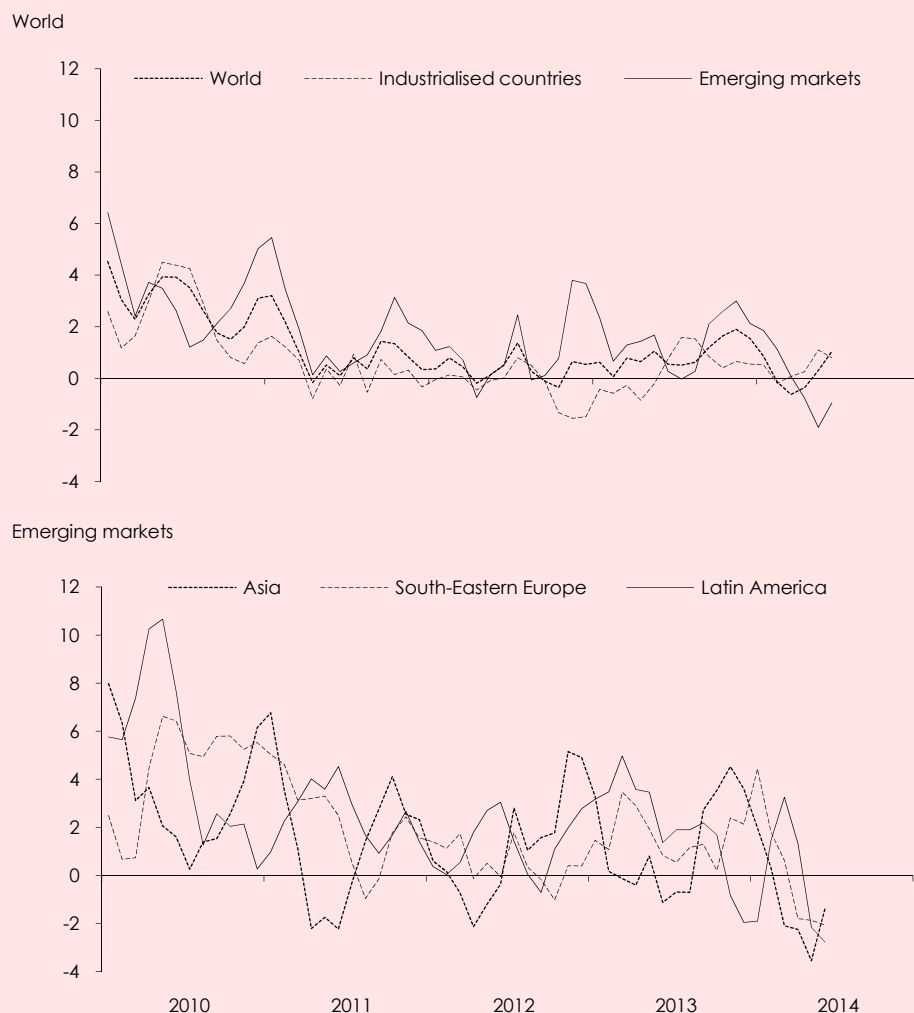
In the course of 2013, growth of world trade regained momentum. Against the background of a solid recovery in the USA and the mitigation of the refinancing crisis in a number of euro area countries, a moderate export-led upswing seemed to take hold also in Austria. Yet, the upward trend has come to a halt, as import demand of many emerging markets has slackened markedly and simultaneously around the globe (Figure 1), such as in major economies like India, Brazil and Russia. The common cause of this decline has probably been the drain of foreign capital that these countries faced after the announced change in the US monetary policy stance and which gave rise to significant interest rate hikes and in some instances to the introduction of new controls of capital transactions. In Russia, the cyclical slump was reinforced by the sanctions imposed by the USA and the EU in the context of the Ukraine conflict. WIFO has therefore lowered its projection for world trade growth to rates of 3.5 percent and 4.0 percent for 2014 and 2015, respectively.

The retreat of foreign capital from the emerging market economies constrains their import capacity via exchange rate changes and higher interest rates.

Since business activity in the USA can rely on robust internal demand, it is less exposed to the slackening of global trade than the export-oriented economies in Europe. In Austria, the rebounding foreign trade growth has clearly lost strength in the current year.

Figure 1: Volume imports of goods, seasonally adjusted

3-month moving average, change from previous period in percent



Source: CPB.

2. Diverging monetary policy stance in the advanced economies

Over the forecast horizon, monetary incentives provided by the Central Banks of the USA (Fed), the UK (Bank of England) and the euro area (ECB) promise to be very different: the Fed started to gradually reduce its bond purchases in early 2014, due to be phased out completely by October 2014. Financial markets should by now have priced this move into current interest rates, causing no further market turbulence. Given the return to normal of the inflation rate and the decline of the unemployment rate, the Fed is likely to raise its key interest rate in 2015, for the first time since 2008, a move to be followed by the Bank of England. While real estate prices in London have skyrocketed, higher interest rates – apart from the desired curb of asset prices – may also put a strain on business activity. This trade-off highlights the lack of field-tested macro-prudential instruments. In contrast to the Anglo-American Central Banks, the ECB is further relaxing the monetary reins, in view of the risk of deflation in the euro area. Commercial banks are offered refinancing operations in two

In the face of deflation risks, monetary policy in the euro area is being relaxed further, while in the USA and the UK it is gradually being tightened.

tranches, directly tied to lending to the corporate sector (Targeted Long-Term Refinancing Operations – TLTRO). In addition, the ECB will buy mortgage bonds and asset-backed securities from the banks. While these measures aim at improving credit supply, they do not address the sluggishness of demand. Since the announcement of further expansionary measures, the euro has steadily lost ground against the dollar. On annual average, the exchange rate is projected at 1.35 \$ per € for 2014 and 1.30 \$ per € for 2015.

3. USA: cyclical boom at lower growth rates

Activity in the USA suffered an unexpected setback in the first quarter 2014, attributed mainly to severe winter conditions. Due to the sound economic fundamentals, the temporary decline in GDP was quickly made up by catching up of investment and higher exports in the second quarter. The jobless rate fell from a peak of 10 percent in October 2009 to 6.1 percent in August 2014. GDP growth has so far been lower than in earlier periods of cyclical upturn, for several reasons: productivity growth has probably moved to a slower pace, as the "shale gas revolution" has not equalled the strong and widespread productivity gains triggered by the innovations in information technology during the 1990s. Moreover, and unlike in most EU member countries, the financial market crisis has further lowered the labour force participation rate. The forecast for GDP growth in the USA remains unchanged at 2.2 percent for 2014 and 3.1 percent for 2015.

The business cycle upswing in the USA is grounded in solid domestic demand.

4. Japan: cyclical profile shaped by tax increase

The increase in the VAT rate from 5 percent to 8 percent as of 1 April 2014 is shaping the cyclical profile in Japan: strong pre-emptive buying in the first quarter was followed by a slump in demand in the subsequent period. A similar pattern is to be expected for the second semester 2015, when the VAT rate will be raised further to 10 percent in October 2015. The demand shortfall in the second quarter 2014 was stronger than anticipated, leading to a downward revision of the GDP growth projection to 0.9 percent for 2014 and 0.8 percent for 2015.

Japan's VAT rate, having been raised from 5 percent to 8 percent in the current year, is to ratchet up to 10 percent in 2015.

Table 2: World economy

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
<i>Real GDP</i>						
World	+ 5.2	+ 3.9	+ 3.2	+ 3.2	+ 3.1	+ 3.5
USA	+ 2.5	+ 1.6	+ 2.3	+ 2.2	+ 2.2	+ 3.1
Japan	+ 4.7	- 0.5	+ 1.5	+ 1.5	+ 0.9	+ 0.8
EU 28	+ 2.0	+ 1.6	- 0.4	+ 0.1	+ 1.3	+ 1.4
Euro area 18	+ 1.9	+ 1.6	- 0.7	- 0.4	+ 0.8	+ 1.1
CEEC 5 ¹	+ 2.6	+ 3.2	+ 0.7	+ 1.2	+ 2.9	+ 2.6
China	+ 10.4	+ 9.3	+ 7.7	+ 7.7	+ 7.3	+ 7.3
World trade, volume	+ 14.4	+ 6.8	+ 2.1	+ 2.3	+ 3.5	+ 4.0
Market growth ²	+ 14.5	+ 7.6	+ 1.3	+ 1.9	+ 3.5	+ 3.5
<i>Primary commodity prices³</i>						
HWWI index, total	+ 28.9	+ 28.6	- 2.8	- 1.9	± 0	± 0
Excluding energy	+ 31.9	+ 19.2	- 14.4	- 6.1	- 4	- 1
<i>Crude oil prices</i>						
Brent, \$ per barrel	79.5	111.3	111.6	108.7	110	110
<i>Exchange rate</i>						
\$ per euro	1.327	1.392	1.286	1.328	1.35	1.30

Source: WIFO. 2014, 2015: forecast. – ¹ Czech Republic, Hungary, Poland, Slovakia, Slovenia. – ² Real import growth of goods of trading partners weighted by Austrian export shares. – ³ Dollar.

The massive stimulative action taken by the Chinese authorities since 2009, whereby real GDP growth was maintained above 9 percent p.a. until 2011, gave rise to substantial misallocation of resources, excess capacity and over-indebtedness, increasingly weighing on domestic demand. Public policy measures will again be needed in order to even match the lower growth rates of the last few years. In spring 2014, new investment in railway infrastructure and subsidised homebuilding was decided. An easing of regulations concerning the relationship between credit volume and bank deposits stimulated bank lending. While this is boosting business activity, it further increases financial market risks. WIFO maintains its projection for Chinese real GDP growth of 7.3 percent each in 2014 and 2015.

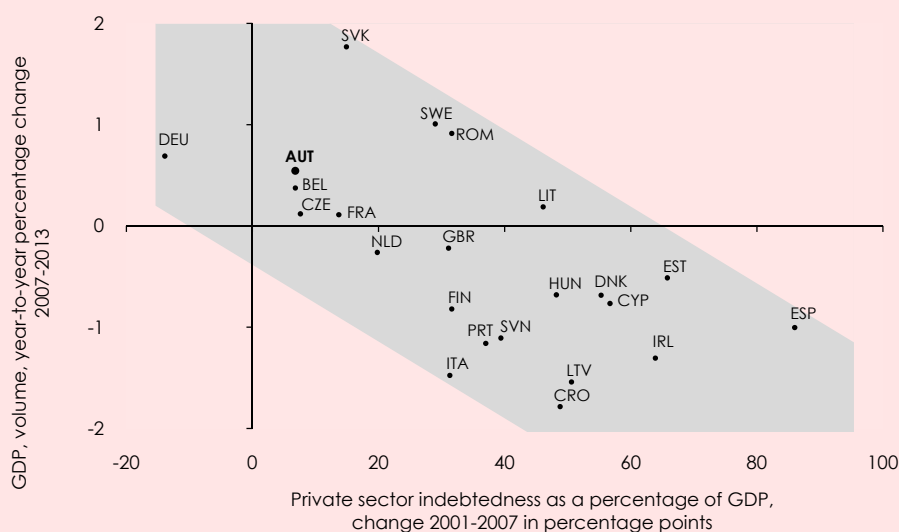
In China, even the reduced growth target will not be met without additional measures by the public authorities.

5. Euro-area: internal demand remains weak

The response of the ECB to the refinancing crisis of several euro-area countries, i.e., its pledge to assume the role of lender of last resort, put an end to the recession in the euro area in 2013. Yields on 10-year government bonds have fallen since to between 0.9 percent (Germany) and 3.0 percent (Portugal; Greece 5.6 percent). Yet, for a marked cyclical recovery to set in, internal demand remains too weak. The often important amounts needed to service the debt taken on before the financial market crisis and that has later proved difficult to sustain, act as a constraint on private consumption and investment spending alike. The extent to which private debt rose during the years before the financial market crisis is negatively correlated with growth of demand and output after the crisis: the higher the debt accumulated by the private sector, the more the debt service cost is weighing on growth (Figure 2).

Continued high private debt is seriously constraining growth of private consumption and investment in many countries.

Figure 2: Private sector indebtedness and GDP growth in the EU



Source: European Commission (MIP Scoreboard). Excluding Bulgaria, Greece and Poland (outliers), Luxembourg and Malta (no data available).

In the USA and the UK, debt reduction since the financial market crisis proceeded more quickly than in the euro area, because their insolvency legislation is more debtor-friendly and households were able to consolidate their asset position earlier. Moreover, governments of the two countries allowed public debt to rise relatively more in the early stage of the recovery, whereas the latter was choked off in the euro area by the prevailing policy of austerity. Among the countries hit by the refinancing crisis, private debt has fallen significantly only in Spain so far, where it had risen most before the crisis. Currently, debt reduction is further inhibited by the extremely low inflation, rendering real interest rates for many households and companies rather high. Thus, euro-area GDP is expected to grow by only 0.8 percent in 2014, edging up to +1.1 percent in 2015. The projection for the EU 28 is relatively

higher, at +1.3 percent and +1.4 percent respectively, due to the anticipated above-average growth in the UK and the eastern European member countries.

6. Austria: slackening world trade dampening exports

The Austrian economy is, like others, affected by the slackening of global demand. Instead of the hoped-for acceleration, export growth is abating in 2014. The conflict in Ukraine has so far played a minor role in this regard, the main reason being lower imports of emerging markets in general: exports to non-EU countries barely increased in the first half of 2014 (+0.6 percent in nominal terms), with only the deliveries to the USA being buoyant (+6.0 percent in value). Exports to the euro area, whose export-oriented economies also feel the slowdown of global demand, were also sluggish (+0.4 percent in value), due to second-round effects. Exports to the UK (+11.6 percent in value) and to the five CEECs (+5.0 percent in value) were more dynamic, reflecting the stronger business activity in these countries. Total merchandise export growth will turn out distinctly weaker in 2014 (+2.3 percent) than expected so far.

The retarding factors for export growth should subside over the forecast period, provided the absence of renewed financial market turbulence and of any aggravation of the Ukraine conflict. Thus, intra-European trade should revive; exports to non-euro-area countries should also benefit from a declining euro exchange rate. Austria's export growth is therefore expected to pick up to an annual rate of 3.5 percent in 2015.

The current account surplus, projected at 2.4 percent and 2.5 percent of GDP for 2014 and 2015 respectively, will be lower than in 2013 (2.7 percent of GDP). The reason is not a revised assessment of merchandise trade prospects, but rather a weaker income balance, which remains negative due to lower returns from Austrian foreign direct investment. Moreover, the balance of labour earnings will turn negative, notably as a result of the opening of the Austrian labour market for workers from Romania and Bulgaria and of the rising number of commuters from eastern neighbouring countries.

6.1 Investment being withheld

Investment in machinery and equipment received a boost due to a strong expansion of investment in transport equipment in early 2014, when the imminent hike of the car registration tax as from 1 March triggered massive advance purchases. In the further course of the year, buying is set to become more subdued. Investment in other machinery and equipment continued to fall in the current year. Overall, investment in machinery and equipment is projected to remain flat on annual average, before picking up to +2.0 percent in 2015. Even if long-term interest rates are extremely low and may ease further in 2015 under the impact of expansionary monetary policy, the appetite for investment will remain weak given the unfavourable sales prospects.

Like in Germany, the rather lively investment in construction at the beginning of the year was driven by mild weather conditions. For the whole year 2014, construction output is expected to gain 1.7 percent. However, results of the regular WIFO Business Cycle Survey foreshadow a slowdown of activity. The number of building permits issued in the first quarter was lower than one year ago. In 2015, construction investment is thus likely to rise by only 1.0 percent.

Indicators of business confidence and incoming orders in manufacturing do not suggest an upturn of activity, but rather continued stagnation. Manufacturing output is projected to edge up by 0.8 percent on annual average 2014. The anticipated pick-up to +2.5 percent in 2015 is driven by strengthening exports and investment. However, the momentum will not suffice to raise demand for labour, since productivity growth in manufacturing remains strong (+3.3 percent in 2015; for the overall economy +1.1 percent). Prices for investment goods are flat, those for merchandise exports are still easing slightly in 2014.

Weaker imports of the emerging market economies are weighing on Austrian exports directly and via third-country effects, particularly in the euro area.

The current account surplus will remain below 3 percent of GDP over the forecast horizon.

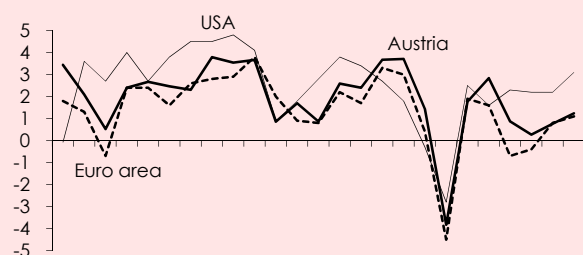
Lower sales prospects hold back private investment, despite further declining interest rates.

Sluggish demand rather than structural factors put a constraint on manufacturing output.

Figure 3: Indicators of economic performance

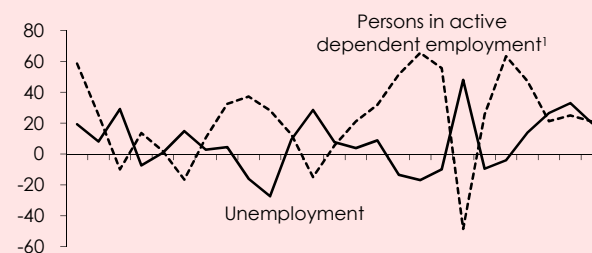
Growth of real GDP

Percent



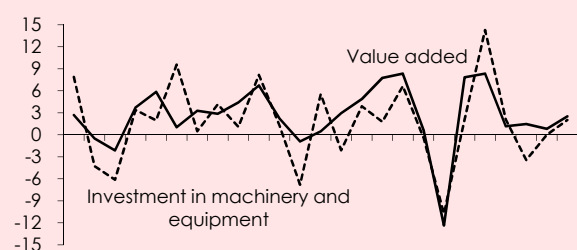
Employment and unemployment

1,000 from previous year



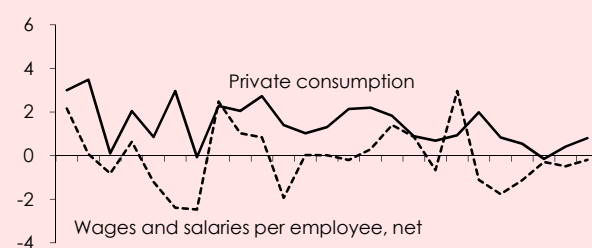
Manufacturing and investment

Percentage changes from previous year, volume



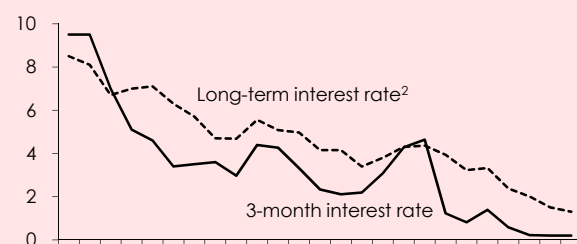
Consumption and income

Percentage changes from previous year, volume



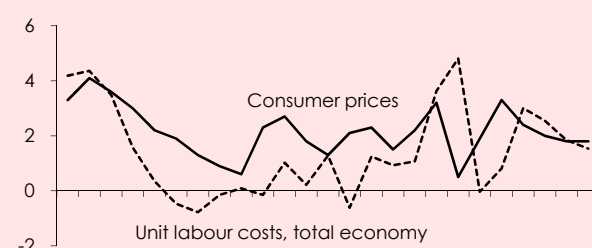
Short-term and long-term interest rates

Percent



Inflation and unit labour costs

Percentage changes from previous year



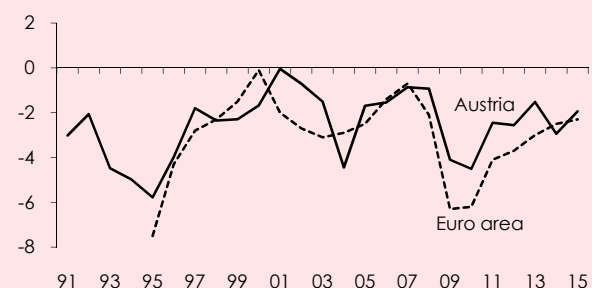
Trade

Percentage changes from previous year, volume



General government financial balance

As a percentage of GDP



Source: WIFO. 2014, 2015: forecast. – ¹ Excluding parental leave, military service, and unemployed persons in training. – ² 10-year central government bonds (benchmark).

6.2 Services branches sustaining employment

Total hours worked in manufacturing are declining on account of receding employment and fewer per-capita working hours. Overall employment growth in the economy (2014 +0.7 percent, 2015 +0.6 percent) is supported by job creation in the service sector where, however, new hiring goes hand in hand with shorter average working hours (more part-time jobs, shorter working hours for full-time workers, e.g., via cuts in overtime hours). The total number of hours worked in the economy is likely

GDP growth is entirely driven by productivity gains, while total hours worked remain flat.

to remain flat over the forecast horizon, such that GDP growth is entirely generated by productivity gains.

The slackening demand for labour goes along with an unabated increase in labour supply, pushing the unemployment rate up to slightly below 9 percent by 2015. With the domestic population of working age shrinking, the expansion of labour supply and employment is generated by inflow of labour from abroad, including cross-border commuters. In addition, labour supply is growing in the age-group of 50 and above, due to strong age cohorts in this bracket and the restrictions being introduced on early retirement.

The inflow of foreign labour more than offsets the decrease in domestic labour supply.

Table 3: Labour market

	2010	2011	2012	2013	2014	2015
	Changes from previous year, in 1,000					
<i>Demand for labour</i>						
Persons in active employment ¹	+ 35.0	+ 69.9	+ 50.1	+ 27.9	+ 31.0	+ 26.0
Employees ²	+ 25.5	+ 63.3	+ 47.2	+ 21.2	+ 25.0	+ 21.0
Percentage changes from previous year	+ 0.8	+ 1.9	+ 1.4	+ 0.6	+ 0.7	+ 0.6
Nationals	+ 5.8	+ 25.7	+ 9.0	- 8.5	- 7.0	- 5.0
Foreign workers	+ 19.7	+ 37.7	+ 38.1	+ 29.7	+ 32.0	+ 26.0
Self-employed ³	+ 9.5	+ 6.6	+ 2.9	+ 6.7	+ 6.0	+ 5.0
<i>Labour supply</i>						
Population of working age						
15 to 64 years	+ 17.3	+ 31.3	+ 18.0	+ 23.5	+ 5.8	+ 8.1
15 to 59 years	+ 4.9	+ 11.7	+ 22.3	+ 27.2	+ 5.6	+ 1.7
Labour force ⁴	+ 25.5	+ 65.8	+ 64.0	+ 54.5	+ 64.0	+ 46.0
<i>Surplus of labour</i>						
Registered unemployed ⁵	- 9.5	- 4.1	+ 13.9	+ 26.6	+ 33.0	+ 20.0
In 1,000	250.8	246.7	260.6	287.2	320.2	340.2
Unemployed persons in training ⁵	in 1,000	73.2	63.2	66.6	73.5	80.5
In percent						
<i>Unemployment rate</i>						
Eurostat definition ⁶	4.4	4.2	4.3	4.9	5.0	5.2
As a percentage of total labour force ⁵	6.2	6.0	6.2	6.8	7.5	7.8
National definition ^{5,7}	6.9	6.7	7.0	7.6	8.4	8.8
<i>Employment rate</i>						
Persons in active employment ^{1,8}	65.7	66.6	67.2	67.4	67.9	68.3
Total employment ^{6,8}	71.7	72.1	72.5	72.3	72.7	73.1

Source: WIFO. 2014, 2015: forecast. – ¹ Excluding parental leave, military service. – ² According to Federation of Austrian Social Security Institutions. – ³ According to WIFO. – ⁴ Persons in active employment plus unemployment. – ⁵ According to Public Employment Service Austria. – ⁶ According to Eurostat Labour Force Survey. – ⁷ As a percentage of total labour force, excluding self-employed. – ⁸ As a percentage of population of working age (15 to 64 years).

Table 4: Productivity

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.8	+ 2.8	+ 0.9	+ 0.3	+ 0.8	+ 1.2
Hours worked ¹	- 0.1	+ 2.3	- 0.0	- 0.8	± 0.0	+ 0.1
Productivity per hour	+ 1.9	+ 0.5	+ 0.9	+ 1.1	+ 0.8	+ 1.1
Employment ²	+ 0.7	+ 1.8	+ 1.4	+ 0.7	+ 0.9	+ 0.8
<i>Manufacturing</i>						
Production ³	+ 7.8	+ 8.3	+ 1.2	+ 1.5	+ 0.8	+ 2.5
Hours worked ¹	+ 1.6	+ 1.4	+ 0.6	- 1.2	- 1.0	- 0.8
Productivity per hour	+ 6.1	+ 6.9	+ 0.6	+ 2.7	+ 1.8	+ 3.3
Employees ¹	- 1.3	+ 1.7	+ 1.1	- 0.0	- 0.2	- 0.1

Source: WIFO. 2014, 2015: forecast. – ¹ According to National Accounts definition. – ² Dependent and self-employed according to National Accounts definition. – ³ Value added, volume.

6.3 Sluggish expansion of private consumption

The critical situation on the labour market and the falling working hours put a brake on wage growth per capita. Gross nominal earnings per head are projected to rise by 1.7 percent in 2014 and 2.0 percent in 2015, at a slower pace than over the two

Inflation and a high tax burden are squeezing private purchasing power.

years before. While at the same time inflation is set to edge down to 1.8 percent in 2014, the rate is still rather high in view of the lacklustre business activity and also when compared with the euro area average. This inflation gap is explained mainly by the relatively stronger price increases for services and food in Austria. Apart from the higher price pressure, private purchasing power is also squeezed by a rising tax burden, including fiscal drag: between 2009 and 2013, the tax burden on the average wage climbed by 1.2 percentage points to a ratio of 49.1 percent (according to OECD, "Taxing Wages"). Net real wages will therefore decrease further over the projection period. Fragile labour market conditions and modest income growth are undermining the purchasing power of private households. Thus, the index of consumer confidence has been heading down in recent months. Private consumption, having edged down in 2013, will rebound tentatively, +0.4 percent in 2014 and +0.8 percent in 2015. Demand for durable consumer goods is unlikely to recover before 2015.

Table 5: Earnings and international competitiveness

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Gross earnings per employee ¹	+ 0.9	+ 1.8	+ 2.4	+ 2.1	+ 1.7	+ 2.0
Gross real earnings per employee ²	- 0.9	- 1.4	- 0.1	+ 0.1	- 0.1	+ 0.2
Net real earnings per employee ²	- 1.1	- 1.8	- 1.1	- 0.3	- 0.5	- 0.2
Unit labour costs						
Total economy	- 0.0	+ 0.8	+ 3.0	+ 2.5	+ 1.8	+ 1.5
Manufacturing	- 6.9	- 3.0	+ 3.0	+ 1.9	+ 1.0	- 0.4
Effective exchange rate, manufactures						
Nominal	- 2.9	+ 0.1	- 1.7	+ 1.8	+ 1.1	- 0.2
Real	- 3.2	+ 0.5	- 1.7	+ 2.1	+ 1.3	- 0.3

Source: WIFO. 2014, 2015: forecast. – ¹ Employees according to National Accounts definition. – ² Deflated by CPI.

Table 6: Private consumption, income and prices

	2010	2011	2012	2013	2014	2015
	Percentage changes from previous year					
Private consumption expenditure	+ 2.0	+ 0.8	+ 0.5	- 0.2	+ 0.4	+ 0.8
Durables	+ 1.6	+ 1.8	+ 0.6	- 2.2	- 0.5	+ 0.5
Non-durables and services	+ 2.0	+ 0.7	+ 0.5	+ 0.1	+ 0.5	+ 0.8
Household disposable income	- 0.5	- 1.3	+ 1.1	- 1.0	+ 0.1	+ 1.0
	As a percentage of disposable income					
Household saving ratio ¹	8.9	6.7	7.4	6.6	6.3	6.5
Household saving ratio ²	8.4	6.4	7.0	6.2	5.9	6.1
	Percentage changes from previous year					
Direct lending to domestic non-banks ³	+ 2.9	+ 2.7	+ 0.0	- 1.2	+ 1.3	+ 1.9
	Percentage changes from previous year					
Inflation rate						
National	1.9	3.3	2.4	2.0	1.8	1.8
Harmonised	1.7	3.6	2.6	2.1	1.7	1.8
Core inflation ⁴	1.2	2.8	2.3	2.3	2.0	1.9

Source: WIFO. 2014, 2015: forecast. – ¹ Including adjustment for the change in net equity of households in pension fund reserves. – ² Excluding adjustment for the change in net equity of households in pension fund reserves. – ³ End of period. – ⁴ Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

6.4 Lower interest rates relieving somewhat the strain on government budgets

The financial support for distressed banks, planned at € 4.4 billion for 2014 (of which € 4 billion for Hypo Alpe-Adria-Bank International AG), put a burden on government budgets. For 2015, a further € 1 billion of deficit-increasing aid is likely to be required.

Apart from one-off receipts from the bilateral tax agreement with Liechtenstein (2014 € 0.5 billion), the budget balanced will be relieved by additional revenues resulting from the Tax Amendment Act 2014 ("Abgabenänderungsgesetz"), estimated at € 0.7 billion for 2014 and € 1.1 billion in 2015, by cuts of discretionary expenditure and in social retirement spending, as well as by the low interest rates. In view of the subdued cyclical outlook, the projection for the general government deficit (in the Maastricht definition) is barely changed at 2.9 percent of GDP for 2014.

A major risk for the projection of the general government deficit relates to the potential need for additional subsidies to banks in distress, beyond the amounts included in the budget. In addition, a lowering of the tax burden on labour would raise the deficit, unless it goes hand in hand with expenditure cuts or with tax increases elsewhere. While cuts in income tax or social security charges would not only have positive effects on job creation in the long run, but may also raise demand, employment and tax revenues in the short term, these revenue effects would be rather small compared with the shortfall caused by the tax cuts.

Structural budget cuts and lower interest payments will counteract the cyclically-induced increase in the general government deficit.

The necessary reduction of the tax burden on labour must go along with an increase in other taxes or with cuts in public expenditure.

Table 7: Key policy indicators

	2010	2011	2012	2013	2014	2015
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	- 4.5	- 2.5	- 2.6	- 1.5	- 2.9	- 1.9
Structural budget balance	- 3.2	- 2.4	- 1.8	- 1.2	- 0.9	- 0.7
General government primary balance	- 1.8	+ 0.2	+ 0.0	+ 1.0	- 0.4	+ 0.6
	In percent					
<i>Monetary policy</i>						
3-month interest rate	0.8	1.4	0.6	0.2	0.2	0.2
Long-term interest rate ²	3.2	3.3	2.4	2.0	1.5	1.3
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	- 2.7	+ 0.2	- 1.5	+ 1.7	+ 1.0	- 0.3
Real	- 3.0	+ 0.6	- 1.6	+ 2.0	+ 1.4	- 0.4

Source: WIFO. 2014, 2015: forecast. - ¹ 10-year central government bonds (benchmark).

6.5 Ukraine crisis a cyclical risk, new European Commission an opportunity

In response to the crisis in Ukraine, the EU on 1 August 2014 adopted measures which curb exchanges with Russia in the areas of financial services, armament and oil technology. In the EU member countries, transactions in securities of the largest Russian banks have been terminated, thereby substantially reducing their refinancing capacity. Whereas restrictions on trade in arms and high technology concern clearly defined areas, the measures targeting the financial sector hurt the Russian economy at large, by complicating corporate financing and raising the cost of investment. Austrian banks operating in eastern Europe, already struggling with depreciation of corporate assets, bad loans and compulsory conversion of foreign currency loans, may be adversely affected by the sanctions and compelled to tighten credit.

A rebound of business activity in the euro area is a pre-condition for foreign trade and investment gaining strength in Austria. For this to occur, internal demand would have to pick up, a prospect not confirmed by current sentiment indicators. Wage increases in Germany, notably the introduction of a minimum wage in 2015, and a step-up of public investment may provide positive incentives. Moreover, the new formation of the European Commission may offer an opportunity for growth-stimulating initiatives to be taken.

The repercussions of the conflict with Russia on domestic business activity have so far been minor, but may rise in the future.

A rebound of internal demand in the euro area may trigger a new investment cycle in Austria.