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Strong Stimulus from World Trade Fuelling Economic Activity in Austria

Economic Outlook for 2017 and 2018

Strong Stimulus from World Trade Fuelling Economic Activity in Austria. Economic Outlook for 2017 and 2018
The acceleration of world trade growth originating from East Asia has reached Austria in 2017. In addition, exports benefitted from clearing the investment backlog in East-Central Europe. While the external stimulus may ease somewhat in 2018, private consumption will continue to provide firm support to business activity. In spite of GDP growth projected at a solid 2.4 percent in 2017 (+2.6 percent when adjusted for calendar effects) and 2.0 percent in 2018, unemployment will likely remain rather high, as many vacancies are not filled by domestic jobseekers. The general government deficit narrows markedly in the current year, even if the fiscal stance on the revenue side remains expansionary.

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In early 2017, Austria's GDP growth recorded the highest rate in six years, benefitting from a benign combination of external factors. First, China's demand for imports has picked up since 2016, which provided stimulus not only to its East Asian neighbours and commodity exporters like Russia, but also to advanced economies like Austria (mainly via supplies to German companies), since domestic manufacturers of machinery and other investment goods are closely integrated into global value chains. Second, the investment backlog in East-Central Europe caused by delays in the disbursement of EU subsidies in 2016 is gradually being cleared. Indeed, Austrian exports are currently advantaged on several fronts, as investment in early 2017 has rebounded strongly also in the USA, with positive repercussions for Austrian manufacturers.

These benign incentives are expected to last for the remainder of the current year, as companies are highly satisfied with their current business situation and optimistic for the months to come. Beyond 2017, investment behaviour in East-Central Europe should return to normal, and policy in the USA looks set to favour tax cuts rather than embarking on large-scale investment projects. It is also doubtful whether the investment boom in China will continue; information received in recent months suggests that the momentum of world trade has weakened. For this reason, the pace of growth in Austria is expected to decelerate over the forecast period.

Overall, demand and output will nevertheless remain on a firm upward path in 2018, thanks to robust domestic demand. Although the stimulating effects of the tax cuts on private consumption are wearing off, the decline in unemployment will strengthen disposable income and demand of private households. It would nevertheless be too soon to sound the all-clear for the labour market, since the bulk of the newly created jobs will not be filled by the domestic labour reserve. The inflow of foreign workers is unabated notably from those East-Central European countries for which access to the Austrian labour market has been liberalised in 2011 and 2013. Older and low-qualified jobseekers remain longer on the unemployment register and add to the structural component of unemployment.

Table 1: Main results

		2013	2014	2015	2016	2017	2018
		Percentage changes from previous year					
Gross domestic product, volume		+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 2.4	+ 2.0
Manufacturing		+ 0.3	+ 1.6	+ 1.8	+ 1.6	+ 4.8	+ 4.0
Wholesale and retail trade		− 2.1	+ 2.0	+ 0.6	+ 2.1	+ 2.5	+ 2.3
Private consumption expenditure[1], volume		− 0.1	− 0.3	− 0.0	+ 1.5	+ 1.4	+ 1.5
Consumer durables		− 3.0	+ 0.1	− 0.6	+ 3.1	+ 2.5	+ 1.0
Gross fixed capital formation, volume		+ 2.2	− 0.9	+ 0.7	+ 3.4	+ 3.2	+ 2.4
Machinery and equipment[2]		+ 2.4	− 1.0	+ 3.6	+ 7.5	+ 4.5	+ 3.5
Construction		− 0.9	− 0.1	− 1.2	+ 1.4	+ 1.8	+ 1.3
Exports, volume		+ 0.5	+ 2.3	+ 3.6	+ 1.6	+ 4.2	+ 3.6
Exports of goods		− 0.7	+ 2.2	+ 3.5	+ 1.2	+ 4.9	+ 4.0
Imports, volume		+ 0.7	+ 1.3	+ 3.4	+ 3.1	+ 3.4	+ 3.1
Imports of goods		− 2.0	+ 0.8	+ 4.2	+ 3.3	+ 4.0	+ 3.3
Gross domestic product, value		+ 1.7	+ 2.4	+ 2.9	+ 2.8	+ 3.9	+ 3.7
	billion €	322.54	330.42	339.90	349.34	363.12	376.46
Current account balance	as a percentage of GDP	2.0	2.4	1.9	1.7	2.2	2.3
Consumer prices		+ 2.0	+ 1.7	+ 0.9	+ 0.9	+ 1.8	+ 1.7
Three-month interest rate	percent	0.2	0.2	− 0.0	− 0.3	− 0.3	− 0.1
Long-term interest rate[3]	percent	2.0	1.5	0.7	0.4	0.7	1.2
General government financial balance according to Maastricht definition							
As a percentage of GDP		− 1.4	− 2.7	− 1.1	− 1.6	− 0.7	− 0.5
Persons in active dependent employment[4]		+ 0.6	+ 0.7	+ 1.0	+ 1.6	+ 1.8	+ 1.4
Unemployment rate							
Eurostat definition[5]		5.4	5.6	5.7	6.0	5.7	5.6
National definition[6]		7.6	8.4	9.1	9.1	8.6	8.4

Source: WIFO. 2017 and 2018: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapons systems. – [3] 10-year central government bonds (benchmark). – [4] Excluding persons in valid employment contract receiving child care benefit or being in military service. – [5] As a percentage of total labour force, Labour Force Survey. – [6] As a percentage of dependent labour force, unemployed persons according to Public Employment Service Austria.

The general government deficit will turn out significantly lower in 2017 than last year. Major reasons are higher GDP growth, one-off factors related to the tax reform (anticipation effects 2015 which dampened capital gains tax revenues in 2016) and to retirement benefits (lump-sum payment of 100 € per head in 2016), the phasing out of subsidies for banks in distress, and a further decline in debt service cost. On the revenue side, the fiscal stance remains expansionary in 2017, since part of the tax cuts have taken effect only this year and the employers' contribution to the Family Burden Equalisation Fund has been lowered. For 2018, a major uncertainty relates to the general election carried forward to October 2017; it is likely that, in the first instance, a provisional budget will extrapolate current expenditure trends.

The forecast risks for GDP growth are on balance upward bound. The "Initiative 20,000" could make a contribution towards reducing structural unemployment, while the "Employment Bonus" may trigger additional investment. Moreover, the positive stimulus to foreign trade may last longer than assumed in the projection. On the other hand, the global situation holds a number of downside risks, such as the "Brexit" negotiations or the high stock market values worldwide, where a downward correction may unsettle the fragile European financial sector. Looming military conflicts in the Middle East pose a risk to oil prices since Iran is in control of large parts of daily crude oil shipments.

1. Incentives from China stimulate world trade growth

World trade, having been sluggish for years, picked up markedly in spring 2016, starting from East Asia and extending to the emerging markets in South America and Eastern Europe (Russia) later in the year. As shown in a recent survey by Oxford Economics[1], the rebound in global trade probably originated from China, where import growth accelerated from 1.2 percent in the second quarter of 2016 (seasonally adjusted, from the previous period) to 3.0 percent in the third and 5.4 percent in the fourth quarter. One-third of the stronger world trade momentum is directly attributed to higher demand from China, and one-fifth to stronger growth in other Asian emerging markets as an indirect effect of higher Chinese imports. In addition, the recovery of raw material prices from early 2016 to November (when OPEC decided to cut oil supplies) and hence the cyclical revival in commodity-exporting countries, notably in Russia, is largely an indirect effect of stimulus from China. Overall, up to 70 percent of the pick-up in global trade growth since mid-2016 is explained by direct and indirect incentives from China.

Table 2: International economy

	Percentage shares 2016		2013	2014	2015	2016	2017	2018
	Austria's exports of goods	World GDP[1]	GDP volume, percentage changes from previous year					
EU	69.4	16.7	+ 0.2	+ 1.6	+ 2.2	+ 1.9	+ 2.2	+ 1.9
UK	3.1	2.3	+ 1.9	+ 3.1	+ 2.2	+ 1.8	+ 1.5	+ 1.9
Euro area	51.6	11.8	− 0.3	+ 1.2	+ 2.0	+ 1.8	+ 2.1	+ 1.8
Germany	30.5	3.3	+ 0.5	+ 1.6	+ 1.7	+ 1.9	+ 1.8	+ 1.9
Italy	6.4	1.9	− 1.7	+ 0.1	+ 0.8	+ 0.9	+ 1.5	+ 1.3
France	4.1	2.3	+ 0.6	+ 0.9	+ 1.1	+ 1.2	+ 1.6	+ 1.6
CEEC 5[2]	14.1	1.6	+ 1.4	+ 3.2	+ 3.9	+ 2.6	+ 3.8	+ 3.1
Czech Republic	3.7	0.3	− 0.5	+ 2.7	+ 4.5	+ 2.4	+ 3.3	+ 2.6
Hungary	3.3	0.2	+ 2.1	+ 4.0	+ 3.1	+ 2.0	+ 3.7	+ 2.5
Poland	3.0	0.9	+ 1.4	+ 3.3	+ 3.9	+ 2.6	+ 4.1	+ 3.5
USA	6.7	15.5	+ 1.7	+ 2.4	+ 2.6	+ 1.6	+ 2.2	+ 2.0
Switzerland	5.9	0.4	+ 1.8	+ 2.0	+ 0.8	+ 1.3	+ 1.3	+ 1.8
China	2.5	17.8	+ 7.8	+ 7.3	+ 6.9	+ 6.7	+ 6.3	+ 6.2
Total[3]								
PPP-weighted[4]		50.0	+ 3.3	+ 3.8	+ 3.9	+ 3.5	+ 3.6	+ 3.4
Export weighted[5]	84.5		+ 0.7	+ 1.9	+ 2.3	+ 2.0	+ 2.2	+ 2.1
Market growth[6]			+ 1.6	+ 3.6	+ 3.1	+ 3.1	+ 4.9	+ 4.0
Forecast assumptions								
Crude oil prices								
Brent, $ per barrel			108.7	99.0	52.5	43.7	51.0	51.0
Exchange rate								
$ per €			1.328	1.329	1.110	1.107	1.10	1.10
Key interest rate								
ECB main refinancing rate[7], percent			0.6	0.2	0.6	0.2	0.1	0.0
10-year government bonds yields Germany, percent			1.6	1.2	1.6	1.2	0.5	0.1

Source: WIFO. 2017 and 2018: forecast. – [1] PPP-weighted. – [2] Czech Republic, Hungary, Poland, Slovenia, Slovakia. – [3] EU, USA, Switzerland, China. – [4] Weighted by GDP at purchasing power parities in 2016. – [5] Weighted by shares of Austrian goods exports in 2016. – [6] Real import growth of trading partners, weighted by shares of Austrian goods exports. – [7] Minimum bid rate.

1.1 Buoyant investment in the USA

Investment in machinery and equipment, construction activity and exports all strengthened substantially in the USA in the first quarter of 2017. However, the positive stimulus was more than offset by weaker consumption and the run-down of inventories, such that GDP growth was muted. Reasons for sluggish private consumption may be real income losses due to energy cost hikes early this year and delays in

[1] Slater, A., Szendrei, V., China-commodity nexus at the heart of global upturn, Oxford Economics, Global Researching Briefing, June 2017.

the refund of tax payments. The regularly disappointing growth performance in the first quarter during the last few years is, however, also due to deficiencies in the seasonal adjustment method that are being eliminated only gradually. Assuming strong catching-up effects for the second quarter, the projection of annual GDP growth of 2.2 percent for 2017 can be maintained.

The future policy stance in the USA may be less growth-supportive, but rather more profit-oriented.

In its semi-annual Economic Outlook of November 2016, the OECD expected the new US administration to adopt a deliberately expansionary fiscal policy stance that would boost GDP growth in 2018 by nearly one percentage point to an annual rate of 3 percent[2]. Underlying this projection were developments on financial markets in the wake of the presidential election: the shift of many investors from gold and government bonds towards US stock market titles and the accompanying rise in long-term interest rates and the dollar signalled greater confidence in the short-term business outlook. However, the dollar appreciation has been entirely corrected since, the interest rate hike in part, and only the rise in share prices has been sustained. This suggests that market participants assess the future policy stance as being less growth-supportive, but rather more profit-oriented[3]. Indeed, the investment in new infrastructure is deemed to prove substantially lower than announced earlier, while the administration may substantially cut corporate taxes and proceed towards financial market deregulation. With a view to the high uncertainty surrounding the US economic policy, WIFO still does not factor a positive fiscal stimulus into its forecast for US GDP growth in 2018.

1.2 Sterling depreciation dampens UK private consumption

The devaluation of the pound sterling in 2016 is increasingly adding to UK inflation and dampened private consumption in the first quarter of 2017. Otherwise, the British economy has posted solid growth since the "Brexit"-Referendum of June 2016. Even gross fixed capital formation that is largely determined by forward-looking expectations has kept an upward trend.

The result of the latest parliamentary election in the UK makes an eventual "hard Brexit" less likely.

Exports should profit from the fall in the sterling exchange rate. The outcome of the general election of 8 June 2017 gave no single party a majority in the Lower House and has thus led to greater political instability in the UK. Financial market reactions have nevertheless been neutral or even slightly positive so far – possibly because investors now consider the event of a "hard Brexit" with severe economic disruptions less likely, given the weakening of the ruling Conservative Party.

1.3 New EU subsidies revive investment in the CEEC 5

Worker emigration is causing labour shortages in East-Central Europe, driving wages strongly upwards.

Investment slackened in some East-Central European countries in 2016, mainly because EU subsidies from the Financial Framework 2007-2013 had been exhausted by the end of 2015 and new subsidies had not yet come on stream in 2016. Such subsidies play a crucial role for investment in the countries concerned. Since the beginning of 2017, investment is picking up again as further subsidies from the Financial Framework 2014-2020 can be called. In Hungary, gross fixed capital formation slumped in 2016 (–15.5 percent); the deferral of projects was made up in the first quarter of 2017, with a rebound of +28 percent year-on-year. A similar, though slightly smoother profile was observed in the Czech Republic. Investment in Poland sagged in 2016 and remained flat in early 2017.

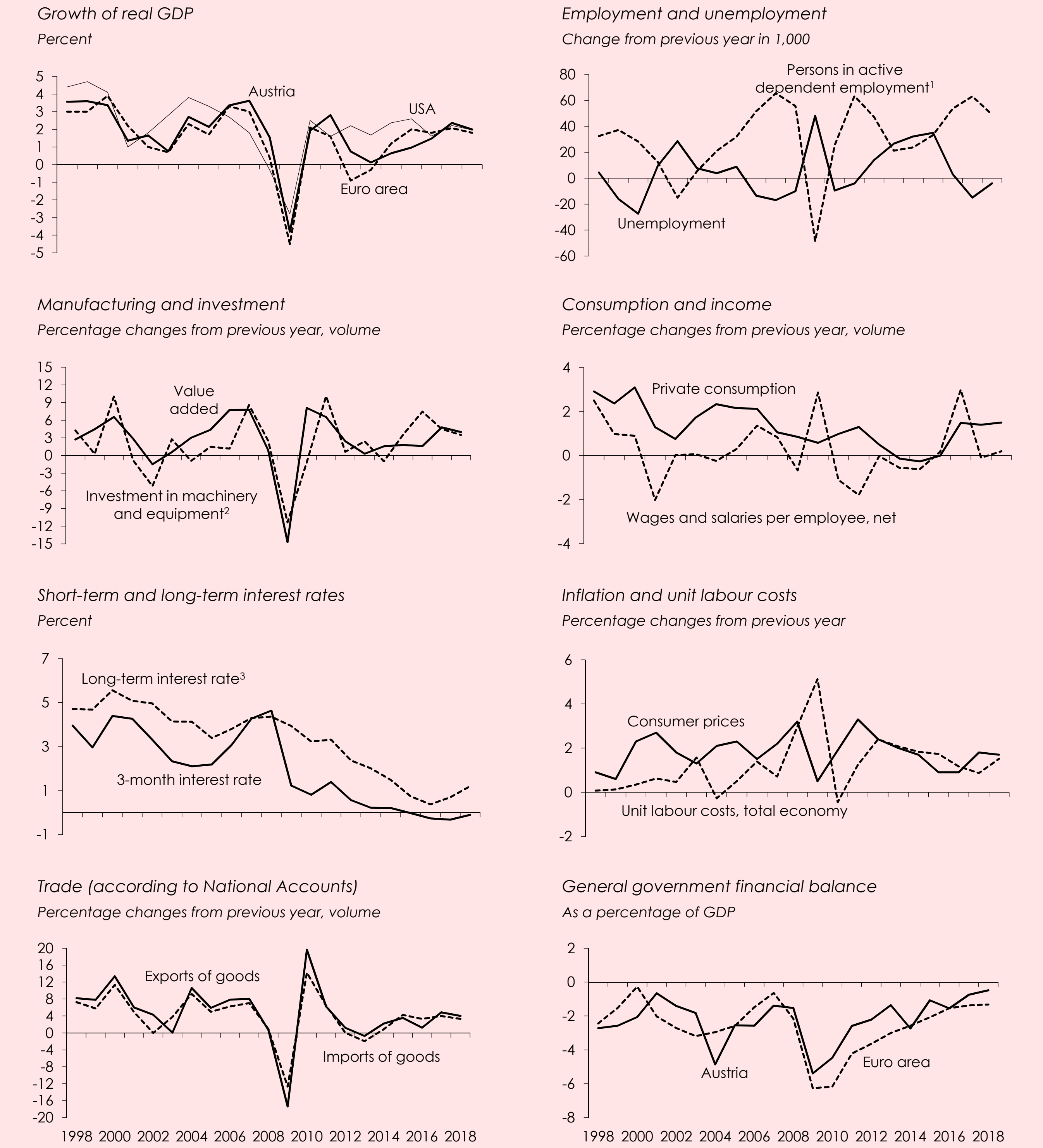
Apart from the recovery of investment, GDP growth in the CEEC 5 will be driven by lively private consumption, backed by higher wages due to declining unemployment, which is partly a result of worker emigration. Hungary plans to raise minimum wages by some 25 percent over the projection period, which will provide further stimulus to consumption. Besides buoyant internal demand, East-Central Europe stands to benefit from the rebound in international trade. Against this background,

[2] The latest revision (OECD, Economic Outlook. Preliminary Version, Paris, June 2017) moderates the policy stimulus to +0.7 percentage points and an annual growth rate of 2.5 percent.

[3] The Economist Espresso, 22 May 2017, https://espresso.economist.com/f8e918489f1e0a81ff11312f4d0630c1.

WIFO revises its growth forecast for the CEEC 5 significantly upward to 3.8 percent in 2017.

Figure 1: Indicators of economic performance



Source: WIFO. 2017 and 2018: forecast. – [1] Excluding persons in valid employment contract receiving child care benefit or being in military service, and unemployed persons in training; break in 2007-08 due to changes in the employment statistics. – [2] Including weapons systems. – [3] 10-year central government bonds (benchmark).

The industrial areas in central Europe have enjoyed substantial foreign trade gains already in early 2017.

In the euro area, GDP growth of 0.6 percent in the first quarter of 2017 slightly exceeded the average for the last few years. The industrial regions in central Europe profited from strengthening global trade and the removal of bottlenecks for investment in East-Central Europe. Hence, in Germany, Italy and Austria, the pick-up in

GDP growth was driven by exports. Likewise, imports advanced strongly, given the close cross-border supply linkages. In France, business activity remained comparatively moderate. For the euro area overall, the GDP growth forecast warrants a slight upward correction.

2. Assumptions underlying the forecast

The termination of the ECB's Asset Purchase Programme will raise long-term interest rates by ½ percentage point.

The external assumptions include the future trend of oil prices, the euro/dollar exchange rate, the key interest rate in the euro area and the long-term interest rate in Germany. After the OPEC decision of end-November 2016 to cut oil production, the reference price for crude oil rose sharply and hovered around 55 $ per barrel until March 2017, before easing again, largely due to an increase in US supply of shale oil. For 2017 and 2018, we expect an average oil price of 51 $ per barrel. The appreciation of the dollar to a rate below 1.05 $ per euro, brought about by portfolio shifts in favour of US shares after the presidential election, has been corrected in the last few weeks, suggesting an average exchange rate of 1.10 $ per euro for 2017 and 2018. As regards monetary policy it is assumed that the ECB's Asset Purchase Programme will expire in 2018, driving up euro area long-term interest rates by around ½ percentage point. The ECB will subsequently raise its key intervention rate gradually, albeit less than assumed so far, given the persistently low rate of core inflation prevailing in the euro area.

3. Austria: GDP growth reaches six-year high

Manufacturing production and merchandise exports benefit from lively global trade.

In early 2017, Austria recorded the highest rate of real GDP growth in six years, i.e., +0.7 percent quarter-on-quarter (+0.6 percent when calculated on the basis of Eurostat guidelines) and +2.3 percent year-on-year (+2.0 percent after adjustment for the number of working days). The higher momentum was generated by the export-oriented manufacturing sector, with merchandise exports and manufacturing output both exceeding the WIFO projection of March 2017.

Strong export gains are the result of a sustained acceleration of world trade growth since the middle of 2016. While Austrian exporting companies, due to their specialisation in machinery and industrial equipment, had hardly benefitted from the consumption-driven upswing in Germany since 2013, output soon reacted to the stimulus from the emerging markets. That stimulus from Asia has meanwhile spread too many other regions, thereby broadening and prolonging its impact on the domestic economy. In addition, Austria's foreign trade is taking advantage from the removal of investment bottlenecks in the CEEC 5 since early 2017.

The pace of world trade expansion may ease somewhat over the forecast horizon. Observers are wary of continued strong stimulus from China and rather expect a counter-cyclical response from the Chinese government to a potential overheating of the economy, which may dampen the global exchange of goods. Moreover, the shale oil production in the USA is obviously setting limits to the upward drift of oil prices that goes hand in hand with stronger growth in Asia, and thereby also to the implicit "growth dividend" for commodity-exporting countries. On balance, the Austrian economy stands to benefit from a fall in oil prices, even if it means a slackening of demand from Russia. In view of the strengthening industrial activity in the emerging markets and the brightening external environment, the present forecast revises up the outlook for foreign trade and manufacturing output from the last round in March.

Lively construction activity is set to moderate gradually.

Construction activity also posted a healthy increase in the first quarter of 2017, benefitting from clement weather conditions in February and March. However, according to the WIFO Business Cycle Survey, expectations are less upbeat than the assessment of current conditions, and the remainder of the year will likely see a payback of the output gains carried forward for weather reasons. In 2018, the likely turnaround towards rising interest rates will dampen activity. Also, the "residential building campaign" announced by the federal government is making little headway. Although the "residential investment bank" has meanwhile been established, none of the 30,000 additional dwellings planned have been created so far, due to the pending registration procedure with the European Commission[4]. Also in the context of the second "residential building package" providing for the creation of a total 10,000 housing units by a subsidiary of the Federal Real Estate Agency (Bundesimmobiliengesellschaft BIG), construction of no more than one-fifth of the overall number of dwellings has been started and only 600 units have been completed. The strong increase in real estate prices increasingly acts as an obstacle for non-profit building agencies. Overall, the number of residential building permits granted has nevertheless reached a comparatively high level.

Table 3: Expenditure on GDP

Volume (chain-linked series)

	2015	2016	2017	2018	2015	2016	2017	2018
	Billion € (reference year 2010)				Percentage changes from previous year			
Final consumption expenditure	222.51	226.08	229.07	232.18	+ 0.6	+ 1.6	+ 1.3	+ 1.4
Households[1]	160.24	162.61	164.89	167.36	– 0.0	+ 1.5	+ 1.4	+ 1.5
General government	62.32	63.52	64.23	64.85	+ 2.1	+ 1.9	+ 1.1	+ 1.0
Gross capital formation	73.20	75.40	77.62	79.50	+ 0.5	+ 3.0	+ 2.9	+ 2.4
Gross fixed capital formation	70.37	72.75	75.05	76.84	+ 0.7	+ 3.4	+ 3.2	+ 2.4
Machinery and equipment[2]	24.39	26.21	27.39	28.35	+ 3.6	+ 7.5	+ 4.5	+ 3.5
Construction	31.70	32.13	32.71	33.14	– 1.2	+ 1.4	+ 1.8	+ 1.3
Other investment[3]	14.32	14.53	15.11	15.55	+ 0.6	+ 1.4	+ 4.0	+ 3.0
Domestic demand	297.21	303.78	309.50	314.52	+ 0.8	+ 2.2	+ 1.9	+ 1.6
Exports	172.38	175.22	182.65	189.29	+ 3.6	+ 1.6	+ 4.2	+ 3.6
Travel	13.24	13.44	13.59	13.72	+ 4.5	+ 1.5	+ 1.1	+ 1.0
Minus Imports	159.00	163.90	169.51	174.70	+ 3.4	+ 3.1	+ 3.4	+ 3.1
Travel	6.30	6.32	6.39	6.42	– 0.3	+ 0.3	+ 1.0	+ 0.5
Gross domestic product	310.47	315.07	322.52	328.93	+ 1.0	+ 1.5	+ 2.4	+ 2.0
Value	339.90	349.34	363.12	376.46	+ 2.9	+ 2.8	+ 3.9	+ 3.7

Source: WIFO. 2017 and 2018: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapon systems. – [3] Mainly intellectual property products (research and development, computer programmes, copyrights).

Table 4: Productivity

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year					
Total economy						
Real GDP	+ 0.1	+ 0.6	+ 1.0	+ 1.5	+ 2.4	+ 2.0
Hours worked[1]	– 0.6	+ 0.3	– 0.6	+ 0.9	+ 1.3	+ 0.9
Productivity[2]	+ 0.7	+ 0.3	+ 1.6	+ 0.6	+ 1.1	+ 1.1
Employment[3]	+ 0.5	+ 1.0	+ 0.7	+ 1.2	+ 1.4	+ 1.1
Manufacturing						
Production[4]	+ 0.3	+ 1.6	+ 1.8	+ 1.6	+ 4.8	+ 4.0
Hours worked[5]	– 1.1	– 0.0	+ 0.3	+ 0.5	+ 1.3	+ 0.6
Productivity[2]	+ 1.4	+ 1.6	+ 1.5	+ 1.1	+ 3.5	+ 3.4
Employees[6]	– 0.6	+ 0.3	+ 0.7	+ 1.0	+ 1.4	+ 1.0

Source: WIFO. 2017 and 2018: forecast. – [1] Total hours worked by persons employed, National Accounts definition. – [2] Production per hour worked. – [3] Employees and self-employed, National Accounts definition (jobs). – [4] Gross value added, volume. – [5] Total hours worked by employees. – [6] National Accounts definition (jobs).

The tourism sector can expect a successful summer season.

The tourism industry is looking back on a somewhat disappointing winter season 2016-17. Poor snow conditions in many ski resorts dampened demand, mainly from foreign customers. Expectations for the current summer season are nevertheless positive, as in a recent survey almost two-thirds of the accommodation facilities sampled expect higher earnings than last year. The sector should benefit not only from benign income and employment conditions of domestic households, but also

[4] This procedure is required since the government guarantee for the bank may contain state-aid elements.

from the fragile political situation in some alternative holiday destinations like Turkey, Tunisia and Egypt. Heightened danger of terrorist attacks in European capitals may, however, weaken demand for city breaks.

Table 5: Gross value added

At basic prices

	2015	2016	2017	2018	2015	2016	2017	2018
	Billion € (reference year 2010)				Percentage changes from previous year			
Volume (chain-linked series)								
Agriculture, forestry and fishing	3.99	4.18	4.23	4.30	+ 0.4	+ 4.9	+ 1.2	+ 1.5
Manufacturing including mining and quarrying	56.65	57.67	60.44	62.85	+ 1.5	+ 1.8	+ 4.8	+ 4.0
Electricity, gas and water supply, waste management	8.15	7.91	8.31	8.43	+ 1.2	− 2.9	+ 5.0	+ 1.5
Construction	16.18	16.36	16.67	16.91	− 1.1	+ 1.1	+ 1.9	+ 1.4
Wholesale and retail trade	34.80	35.55	36.44	37.27	+ 0.6	+ 2.1	+ 2.5	+ 2.3
Transportation	15.02	14.96	15.03	15.18	+ 0.3	− 0.4	+ 0.5	+ 1.0
Accommodation and food service activities	13.20	13.48	13.64	13.79	+ 1.0	+ 2.1	+ 1.2	+ 1.1
Information and communication	9.53	9.57	9.66	9.85	+ 1.5	+ 0.4	+ 1.0	+ 2.0
Financial and insurance activities	11.49	11.53	11.51	11.83	+ 0.7	+ 0.4	− 0.2	+ 2.8
Real estate activities	26.49	27.02	27.67	28.29	+ 1.1	+ 2.0	+ 2.4	+ 2.2
Other business activities[1]	26.13	26.64	27.54	28.15	+ 0.9	+ 1.9	+ 3.4	+ 2.2
Public administration[2]	47.81	48.38	48.91	49.30	+ 0.8	+ 1.2	+ 1.1	+ 0.8
Other service activities[3]	7.62	7.67	7.72	7.77	− 0.5	+ 0.7	+ 0.6	+ 0.6
Total gross value added[4]	276.94	280.79	287.47	293.51	+ 0.8	+ 1.4	+ 2.4	+ 2.1
Gross domestic product at market prices	310.47	315.07	322.52	328.93	+ 1.0	+ 1.5	+ 2.4	+ 2.0

Source: WIFO. 2017 and 2018: forecast. – [1] Professional, scientific and technical activities; administrative and support service activities (NACE M and N). – [2] Including defence, compulsory social security, education, human health and social work activities (NACE O to Q). – [3] Arts, entertainment and recreation; other service activites; activities of households (NACE R to U). – [4] Before deduction of subsidies and attribution of taxes on products.

Higher production in crop farming raises value added in the agricultural sector.

In spring 2017, the farm sector had to struggle with difficult conditions for flowering plants, even if they were somewhat better than last year. Output in crop farming should turn out higher than in 2016, mainly owing to extended production areas for maize, soybeans and potatoes; however, the current heat wave is a risk factor. Animal production may decline overall: the key sector of milk production is expected to stagnate, while the slight increase in poultry production will not completely offset losses in other areas.

3.1 Turnaround of consumer confidence backs private consumption

Business activity in Austria continues to receive solid support from private consumption expenditure. The reduction of the tax burden with the income tax reform of 2016 encouraged consumer spending that had been flat for the last four years. Consumption growth has gathered pace and may have peaked in late 2016, notably as far as durable consumer goods are concerned. Additional minor tax cuts from the 2016 reform have taken effect at the beginning of 2017, such as raises in the negative income tax and the child tax allowance. Although the initial impact of the tax reform will fade away during 2017, private household spending should stay on a stable upward path given the sustained improvement in consumer sentiment.

Consumer confidence had started deteriorating when the euro-area crisis put an end to the cyclical upswing of 2010-11, hitting a low by November 2015. Since that time, sentiment has brightened, and more clearly so in recent months. In April 2017, upbeat expectations exceeded the pessimistic ones for the first time since August 2011. In May 2017, optimism substantially gained further ground, matching the level observed in Germany where confidence had been consistently higher than in Austria since end-2013, given the more favourable trend in employment and private income. Major reasons for the improvement are the tax reform itself and the cyclical recovery, especially the better labour market situation.

Table 6: Private consumption, income and prices

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year, volume					
Private consumption expenditure[1]	− 0.1	− 0.3	− 0.0	+ 1.5	+ 1.4	+ 1.5
Durable goods	− 3.0	+ 0.1	− 0.6	+ 3.1	+ 2.5	+ 1.0
Non-durable goods and services	+ 0.2	− 0.3	+ 0.1	+ 1.3	+ 1.3	+ 1.6
Household disposable income	− 1.9	− 0.1	+ 0.3	+ 2.3	+ 1.6	+ 1.6
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	7.0	7.0	7.3	8.2	8.3	8.4
Excluding adjustment for the change in pension entitlements	6.2	6.4	6.7	7.4	7.5	7.6
	Percentage changes from previous year					
Direct lending to domestic non-banks (end of period)	− 1.2	+ 0.3	+ 2.0	+ 1.8	+ 2.0	+ 2.8
	Percent					
Inflation rate						
National	2.0	1.7	0.9	0.9	1.8	1.7
Harmonised	2.1	1.5	0.8	1.0	2.0	1.7
Core inflation[2]	2.3	1.9	1.7	1.5	1.9	1.7

Source: WIFO. 2017 and 2018: forecast. – [1] Private households including non-profit institutions serving households. – [2] Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

Table 7: Earnings, international competitiveness

	2013	2014	2015	2016	2017	2018
	Percentage changes from previous year					
Wages and salaries per employee[1]						
Nominal, gross	+ 1.9	+ 1.7	+ 1.7	+ 1.4	+ 1.8	+ 2.3
Real[2]						
Gross	− 0.1	− 0.0	+ 0.8	+ 0.5	± 0.0	+ 0.6
Net	− 0.6	− 0.6	+ 0.2	+ 3.0	− 0.1	+ 0.2
Wages and salaries per hour worked[1]						
Real, net[2]	+ 0.3	− 0.2	+ 1.7	+ 3.3	+ 0.0	+ 0.5
	Percent					
Wage share, adjusted[3]	68.6	70.2	69.5	69.2	68.6	68.3
	Percentage changes from previous year					
Unit labour costs, nominal[4]						
Total economy	+ 2.1	+ 1.8	+ 1.7	+ 1.2	+ 0.9	+ 1.5
Manufacturing	+ 2.2	+ 0.9	+ 1.2	+ 1.0	− 1.0	− 0.4
Effective exchange rate – manufactured goods[5]						
Nominal	+ 1.8	+ 1.2	− 2.7	+ 1.1	− 0.1	+ 0.4
Real	+ 2.2	+ 1.5	− 2.7	+ 1.3	− 0.1	− 0.0

Source: WIFO. 2017 and 2018: forecast. – [1] National Accounts definition. – [2] Deflated by CPI. – [3] Compensation of employees as a percentage of national income, adjusted for the change in the share of employees in total employment from base year 1995. – [4] Labour costs in relation to productivity (hourly compensation per employees divided by GDP per employed persons' hours worked). – [5] Weighted by exports and imports, real value adjusted by relative HCPI.

The fading of the tax reform incentives on private consumption is increasingly offset by the improvement in labour market conditions.

In addition, the more upbeat assessment of their personal financial situation, consumers have also turned more optimistic on the general economic conditions since mid-2016, especially on "unemployment expectations over the next 12 months". The latter item has largely shaped consumer confidence in the past years. Until the end of 2015, the risk of unemployment had been rated increasingly higher; since that time, pessimism has waned and the appetite for higher spending has become broad-based. While the incentives deriving from the tax reform to buy durable consumer goods are gradually wearing off, private demand should nevertheless maintain a solid upward path in 2018, supported by favourable income developments.

3.2 Companies share optimism across all sectors

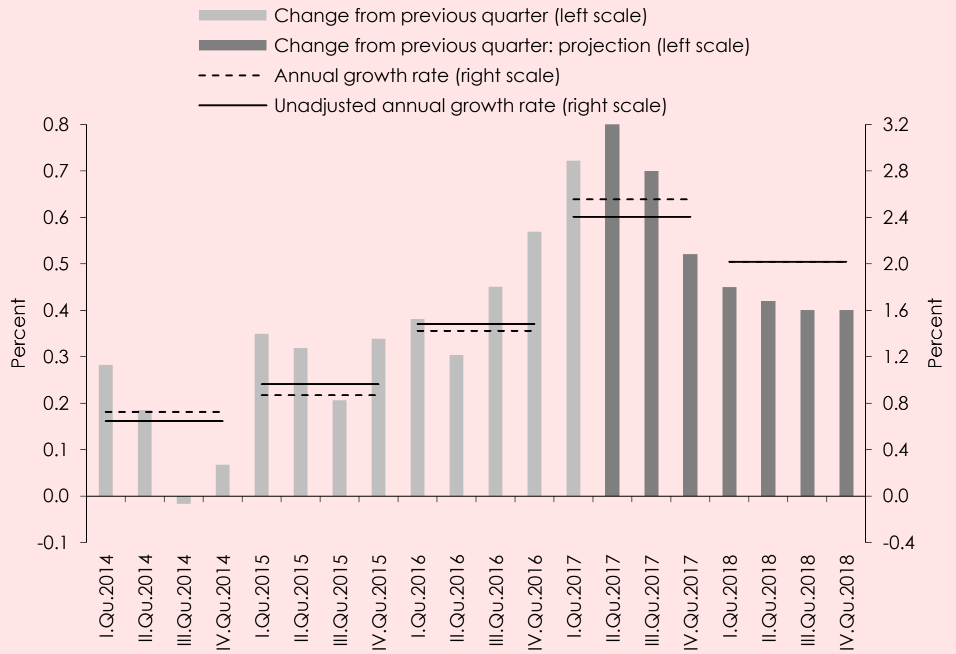
According to the Business Barometer compiled by the Austrian Economic Chambers, the investment boom may have passed its peak.

Not just private households, but also Austrian companies are highly optimistic about current business conditions and the short-term outlook. On both accounts, the opinions expressed in the regular WIFO Business Cycle Survey have improved substantially since September 2016 and across all sectors. Manufacturing and service companies are equally satisfied with present and expected developments, whereas construction firms rate the present situation far better than future prospects. Growth of construction output is expected to abate over the forecast horizon, while manufacturing and service production should maintain a high momentum in the months to come. According to the Business Barometer compiled by the Austrian Economic Chambers, firms' expectations have reached a six-year high.

One out of four companies in the sample plan to step up investment over the next twelve months. Yet, forward-looking expectations are less upbeat than judgements on the current situation, suggesting that the investment cycle may have passed its peak. While firms cite replacement of outdated equipment as the major motive for investment, almost half of the respondents plan to create new production facilities in the next twelve months.

Figure 2: Cyclical profile Austria

GDP volume, trend-cycle component



Source: WIFO.

The lively GDP growth recorded in early 2017 should have continued in the second quarter and is expected to extend into the third quarter, at a rate of ¾ percent respectively from the previous period. With the advance of exports and investment set to decelerate, GDP growth will moderate in late 2017 and early 2018 to a quarterly rate of ½ percent, and further to 0.4 percent in the second half of 2018 (Figure 2). This corresponds to an increase in the adjusted annual growth rate on the basis of the trend-cycle component from 1.4 percent in 2016 to 2.6 percent in 2017, decelerating to 2.0 percent in 2018. Since 2017 has fewer working days than 2016, the (unadjusted) growth rate for 2017 is only 2.4 percent (Table 8); for 2018, there are no calendar effects, influencing the comparison with 2017.

Table 8: Technical note to the projection of real GDP growth

		2015	2016	2017	2018
Growth carry-over[1]	percentage points	+ 0.1	+ 0.4	+ 0.7	+ 0.9
Growth rate during the year[2]	percent	+ 1.2	+ 1.7	+ 2.8	+ 1.7
Annual growth rate	*percent*	*+ 1.0*	*+ 1.5*	*+ 2.4*	*+ 2.0*
Adjusted annual growth rate[3]	percent	+ 0.9	+ 1.4	+ 2.6	+ 2.0
Calendar effect[4]	percentage points	+ 0.1	+ 0.1	– 0.2	± 0.0

Source: WIFO. 2017 and 2018: forecast. – [1] Impact of year-earlier growth dynamics on growth in the current year. Equals the annual growth rate in the current year, if the level of GDP in the current year remains constant from the fourth quarter of the previous year; trend-cycle component. – [2] Reflects the growth dynamics during a calendar year. Equals the year-on-year growth rate for the fourth quarter; trend-cycle component. – [3] Trend-cycle component. – [4] Impact of the annual number of working days and the leap day.

3.3 Employment grows swiftly and unemployment recedes

The early part of 2017 has seen the strongest advance in employment since 2011 and the most significant fall in unemployment since 2010. In the first five months, the number of persons in dependent active employment rose by 63,100 year-on-year (compared with +53,700 for the whole year 2016); the number of unemployed declined by 10,700 from the year-earlier period (whole year 2016 +3,000). The drop in jobless Austrian nationals observed since 2016 accelerated markedly this year: from January to May, 11,500 fewer persons of Austrian nationality were registered as unemployed than one year ago, such that close to one-fifth of the cumulated increase in unemployment of domestic workers since 2012 has been reversed. Since April 2017, unemployment among foreign workers has started to decline, too.

Rising structural unemployment inhibits a more substantial retreat of the jobless rate.

However, unemployment among workers from the earlier immigration wave, i.e., from Turkey and former Yugoslavia, has hardly declined so far; among the over-50-year-olds it even increased further. For this group it remains difficult to gain a foothold in the labour market, since the inflow of (often younger and better qualified) workers from East-Central Europe is unabated. Hence, the labour market is left with structural problems, even though overall unemployment has started heading down. The massive increase in labour supply, the ageing of the working-age population and the implementation of reforms to the retirement system contribute towards the ossification of unemployment. Major risks of long-term unemployment are the lack of qualifications, advanced age and health constraints. The share of long-term unemployed persons has increased from 20 to 35 percent since 2013 and is set to rise further with the retreat of cyclical (short-term) unemployment. A persistent element of uncertainty derives from the access of recognised asylum seekers and persons entitled to subsidiary protection to the Austrian labour market.

3.4 Fuel prices, tourism services and housing cost are driving inflation

Higher oil prices raise the inflation rate for 2017 to slightly below 2 percent.

Since the beginning of 2017, the annual rate of inflation has accelerated to an average of a good 2 percent. The key determinant was the base effect of crude oil prices: the latter hit a low of under 30 € per barrel in January 2016 and followed an upward trend in the course of the year. They received further impetus, when OPEC members in mid-November agreed on supply cuts. Since March 2017, the reference price has eased again, as the USA raised its supply of shale oil. Whereas in April 2017, oil prices were one-third higher than one year earlier, the positive gap narrowed to only one-tenth in May 2017. Hence, due to the increase during 2016 and the assumed stability of oil prices for the rest of 2017, the base effect is diminishing, such that consumer prices overall will rise by less than 2 percent on annual average 2017.

Additionally, upward pressure remains vivid in the two areas that have pushed Austria's inflation rate above the international average for some years: tourism-related services (restaurants and hotels, package holidays, recreational and cultural services) and housing (actual rentals paid by tenants). In both fields, demand factors play a decisive role: rising demand for tourism services can hardly be accommodated by productivity gains and drives up production cost via positive employment effects. Higher demand for housing, for its part, largely concentrates on urban centres and raises there the price of land. This complicates the supply of affordable housing space and reinforces the imbalance between supply and demand in the housing market.

Table 9: Labour market

	2013	2014	2015	2016	2017	2018
	Change from previous year in 1,000					
Demand for labour						
Persons in active employment[1]	+ 29.2	+ 31.8	+ 42.5	+ 60.1	+ 71.0	+ 57.0
Employees[1,2]	+ 21.2	+ 23.8	+ 33.2	+ 53.7	+ 63.0	+ 49.0
National employees	– 8.5	– 8.1	+ 6.3	+ 17.7	+ 20.0	+ 16.0
Foreign employees	+ 29.7	+ 32.0	+ 27.0	+ 36.0	+ 43.0	+ 33.0
Self-employed[3]	+ 8.0	+ 8.0	+ 9.3	+ 6.4	+ 8.0	+ 8.0
Labour supply						
Population of working age 15 to 64 years	+ 23.5	+ 33.1	+ 52.3	+ 65.8	+ 42.0	+ 35.3
Labour force[4]	+ 55.8	+ 64.0	+ 77.5	+ 63.1	+ 56.0	+ 53.0
Labour surplus						
Unemployed[5]	+ 26.6	+ 32.2	+ 35.0	+ 3.0	– 15.0	– 4.0
Unemployed persons in training	+ 6.9	+ 1.8	– 10.2	+ 2.1	+ 6.0	+ 3.0
	Percent					
Unemployment rate						
As a percentage of total labour force (Eurostat)[6]	5.4	5.6	5.7	6.0	5.7	5.6
As a percentage of total labour force[5]	6.8	7.4	8.1	8.1	7.6	7.5
As a percentage of dependent labour force[5]	7.6	8.4	9.1	9.1	8.6	8.4
	Percentage changes from previous year					
Labour force[4]	+ 1.4	+ 1.5	+ 1.8	+ 1.5	+ 1.3	+ 1.2
Persons in active dependent employment[1,2]	+ 0.6	+ 0.7	+ 1.0	+ 1.6	+ 1.8	+ 1.4
Unemployed[5]	+ 10.2	+ 11.2	+ 11.0	+ 0.8	– 4.2	– 1.2
Persons (in 1,000)	287.2	319.4	354.3	357.3	342.3	338.3

Source: WIFO. 2017 and 2018: forecast. – [1] Excluding persons in valid employment contract receiving child care benefit or being in military service. – [2] According to the Organisation of Austrian Social Security. – [3] According to WIFO, including liberal professions and unpaid family workers. – [4] Persons in active employment plus unemployed. – [5] According to Public Employment Service Austria. – [6] Labour Force Survey.

3.5 Government budget for 2017 keeps expansionary stance from the revenue side

Due to the upcoming parliamentary election, the fiscal stance for 2018 is still uncertain.

While the major part of the tax reform took effect already in 2016 with the cut in income tax rates, the increase in the negative income tax and in the child tax allowance will dampen wage and income tax revenues only as from 2017; also, the modified tax schedule will impact on receipts from assessed income tax only with a time lag. Likewise, the cut in the employer's contribution rate to the Family Burden Equalisation Fund (Familienlastenausgleichsfonds) from 4.5 to 4.1 percent (and to 3.9 percent in 2018) of the wage bill will encourage job creation in branches where the tax wedge acts as a barrier to employment due to small productivity gains at high degrees of capacity utilisation (mainly in the service sector). Private disposable income will thus continue to benefit from fiscal incentives in 2017. On the other hand, the one-off payment by banks in exchange for the substantial cut in the stability levy will boost government revenues in 2017 (and lower them in 2018) beyond what had been assumed in the WIFO forecast three months ago. On the expenditure side, government finances are rather geared towards restriction. Public consumption rises less in 2017 than in the two previous years since extra spending on refugees will taper off. The budgetary effect of the one-off payment of 100 € for each retiree in December 2016 had implication on the budget in 2016. Unlike the forecast of last March, the present revision does not expect any further subsidies for ailing banks being necessary in 2017. However, additional spending will arise from higher public sector employment caused by a number of measures already decided, e.g., related to public security and integration of refugees, Austria's upcoming presidency in the EU Council, the 1 billion € transfer to universities and the dedicated allocation for the National Foundation (Nationalstiftung).

Table 10: Fiscal and monetary policy – key figures

	2013	2014	2015	2016	2017	2018
	As a percentage of GDP					
Fiscal policy						
General government financial balance[1]	– 1.4	– 2.7	– 1.1	– 1.6	– 0.7	– 0.5
General government primary balance	1.2	– 0.3	1.3	0.5	1.1	1.2
General government total revenue	49.9	50.0	50.6	49.5	49.4	49.3
General government total expenditure	51.2	52.7	51.7	51.1	50.2	49.7
	Percent					
Monetary policy						
Three-month interest rate	0.2	0.2	– 0.0	– 0.3	– 0.3	– 0.1
Long-term interest rate[2]	2.0	1.5	0.7	0.4	0.7	1.2

Source: WIFO. 2017 and 2018: forecast. – [1] According to Maastricht definition. – [2] 10-year central government bonds (benchmark).

In view of the parliamentary election carried forward to October 2017, federal government finances in 2018 will start from a provisional budget extrapolating current expenditure trends. By mid-2018 at the latest, the new government will have to submit a regular budget. From today's perspective, no new revenue measures should be expected (apart from the further cut in the employer's contribution to the Family Burden Equalisation Fund and the sizeable reduction in the banks' stability levy), implying that the restrictive impact of fiscal drag will resume (growth of net wages will lag 0.4 percentage points behind that of gross wages). Finally, the average interest burden on outstanding public debt and thus current debt service cost should continue to decline over the entire forecast period.

4. Risks to the forecast

Labour market policy measures may give additional momentum to the cyclical recovery.

Home-made risk factors emanate from the uncertainties surrounding the implementation schedule for the government programme of early 2017, particularly in view of the imminent parliamentary election. The "employment bonus" would mainly boost companies' equity capital and incomes of the self-employed, thereby potentially mobilising additional investment; the "Initiative 20,000" for long-term unemployed of advanced age could raise employment and make inroads into structural unemployment, with positive repercussions on private consumption and GDP growth in 2018. The unusually optimistic responses in the latest business surveys also show that the domestic forecast risks in the present benign economic context are on the whole upward bound. However, there are a number of imponderables on the external front.

Hard confrontation between the EU and the UK in the "Brexit" negotiations may give rise to financial market turbulence.

As witnessed by the negotiations for the free-trade agreement with Canada, the EU has only limited political capacity to act since the particular interests of individual member countries or regions dominate. Moreover, the political situation in the UK has become more unstable after the recent general elections. Against this background, the negotiations on the British withdrawal from the EU may give rise to hard confrontation and a severe deterioration of EU-UK economic relations – a scenario not (yet) factored into this forecast. A special risk relates to the negotiations on the British financial sector, since uncertainty about the future role in the EU of this important foreign exchange earner may exert further downward pressure on the pound sterling.

The threat of military conflicts in the Middle East is a risk for oil prices.

In the event of a military conflict between Iran and Israel or the USA, which under President Trump adopt an increasingly aggressive appearance in international affairs, Iran may block the Strait of Hormuz, the pivotal shipping route for oil supply from the Middle East. In the event, an oil price shock would hit particularly Europe and Asia; to what extent US shale oil production may provide a safety net in that case, is more than uncertain.