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Solid Domestic Demand Set to Last Awhile

Economic Outlook for 2017 and 2018

Solid Domestic Demand Set to Last Awhile. Economic Outlook for 2017 and 2018
Domestic demand is rising swiftly, fuelled by the income tax cuts, which should drive purchases of durable consumer goods well until the middle of 2017. Investment in 2016 was largely concentrated on motor cars, benefitting domestic production to a lesser extent. As the effects of the tax reform taper off and inflation picks up, growth is set to lose some momentum, with high unemployment weighing on consumption and foreign demand rising only moderately. In spite of robust employment growth, job creation cannot keep pace with the access of new labour, keeping the jobless rate on the rise.

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Aggregate demand is currently growing strongly in Austria. Private households translate their income gains from the tax cuts into higher consumption, and companies in many sectors see their situation improving. Yet, only part of the rising demand benefits domestic production, as purchases of motor cars dominated in 2016, which were either imported or available on stock. Moreover, foreign demand from the USA and CEEC 5 (Czech Republic, Hungary, Poland, Slovenia, Slovakia) is slackening; exports are at present mainly sustained by deliveries to the euro area. The overall external environment should brighten somewhat once investment rebounds in the USA and subsidies from the EU Multiannual Financial Framework resume, which strongly impact on the investment cycle of some East-Central European countries.

Exports of tourism services are performing relatively better than those of goods; being less productivity-enhancing, they have a stronger employment effect, but at the same time exert upward pressure on inflation. Austria's inflation rate therefore remains above the euro-area average, though falling below 1 percent in 2016 for the second year in a row. Assuming an increase in the reference price of oil to 57 $ per barrel, headline inflation will climb to 1.7 percent in 2017, implying a stagnation of gross real wages per head. Net wages, which were boosted by the tax cuts in 2016, will be squeezed as soon as fiscal drag resumes. Employment growth strengthened in 2016 from the previous year. At the same time the inflow of workers from the new EU member countries, which had increased substantially with the opening of the labour market, abated, so that the rise in unemployment virtually levelled off. However, in the next few years it will return to an upward trend when the immigrants granted asylum or subsidiary protection status join the labour market.

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	+ 1.5	+ 1.4
Manufacturing		+ 0.3	+ 1.6	+ 1.8	+ 2.0	+ 2.3	+ 2.3
Wholesale and retail trade		– 2.1	+ 2.0	+ 0.6	+ 2.5	+ 2.3	+ 2.0
Private consumption expenditure[1], volume		– 0.1	– 0.3	– 0.0	+ 1.5	+ 1.2	+ 1.1
Consumer durables		– 3.0	+ 0.1	– 0.6	+ 3.2	+ 2.0	+ 1.0
Gross fixed capital formation, volume		+ 2.2	– 0.9	+ 0.7	+ 3.7	+ 2.6	+ 2.0
Machinery and equipment[2]		+ 2.4	– 1.0	+ 3.6	+ 7.0	+ 3.5	+ 2.5
Construction		– 0.9	– 0.1	– 1.2	+ 1.6	+ 1.5	+ 1.3
Exports, volume		+ 0.5	+ 2.3	+ 3.6	+ 2.8	+ 3.0	+ 3.1
Exports of goods		– 0.7	+ 2.2	+ 3.5	+ 2.8	+ 3.0	+ 3.5
Imports, volume		+ 0.7	+ 1.3	+ 3.4	+ 3.7	+ 2.8	+ 2.9
Imports of goods		– 2.0	+ 0.8	+ 4.2	+ 4.5	+ 3.0	+ 3.2
Gross domestic product, value		+ 1.7	+ 2.4	+ 2.9	+ 3.0	+ 2.9	+ 3.0
	billion €	322.54	330.42	339.90	350.22	360.30	371.06
Current account balance	as a percentage of GDP	2.0	2.4	1.8	2.4	2.3	2.3
Consumer prices		+ 2.0	+ 1.7	+ 0.9	+ 0.9	+ 1.7	+ 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	0.6	1.0
General government financial balance, Maastricht definition							
As a percentage of GDP		– 1.4	– 2.7	– 1.0	– 1.6	– 1.5	– 1.1
Persons in active dependent employment[4]		+ 0.6	+ 0.7	+ 1.0	+ 1.5	+ 1.2	+ 1.0
Unemployment rate							
Eurostat definition[5]		5.4	5.6	5.7	6.1	6.2	6.2
National definition[6]		7.6	8.4	9.1	9.1	9.3	9.5

Source: WIFO: 2016 to 2018: forecast. – [1] Including non-profit institutions serving households. – [2] Including weapons systems. – [3] 10-year central government bonds (benchmark). – [4] Excluding parental leave and 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.

By mid-2017, once the effect of the tax cuts wears off, consumer demand will lose momentum. The imminent alignment of company car taxation towards environmental objectives has probably triggered pre-emptive purchases to a substantial degree in 2016, suggesting a tapering of the buying spree for 2017. Investment in machinery and equipment may pick up only little, given the moderate outlook for foreign demand. Construction activity is set to rebound, although rising demand for housing space faces income constraints of many customers and high real estate prices. Against this background, aggregate demand growth, pushing the cyclical growth rate from 1.3 percent in 2016 to 1.7 percent in 2017, may subside to 1.4 percent in 2018. Furthermore, GDP growth in 2017 will be dampened by a calendar effect, i.e., the smaller number of working days, yielding projected annual rates of 1.5 percent each for 2016 and 2017, and of 1.4 percent for 2018.

1. USA: growth to remain resilient as monetary conditions return to normal

Buoyant US growth, which in the first six months of 2016 had slackened somewhat, returned in the third quarter. The unemployment rate has meanwhile dropped to a low at which wage pressure is gradually mounting. The deceleration of export and investment growth is probably the consequence of the marked dollar appreciation. Since the value of the US currency is assumed to remain flat over the forecast period and the Purchasing Managers' Index has recently pointed up, both demand components should soon revive (exports already resumed growing in the third quarter 2016). Overall output growth continues to be fuelled by private consumption, supported by rising wage gains. After the "soft patch" of 2016, GDP growth will again rise above 2 percent in 2017, which is expected to prompt the monetary authorities to raise the key interest rate in several steps.

Table 2: International economy

	Percentage shares 2015: Austria's exports of goods	Percentage shares 2015: World GDP[1]	2013	2014	2015	2016	2017	2018
			GDP volume, percentage changes from previous year					
EU	69.1	16.9	+ 0.2	+ 1.6	+ 2.2	+ 1.8	+ 1.6	+ 1.7
UK	3.2	2.4	+ 1.9	+ 3.1	+ 2.2	+ 2.0	+ 1.4	+ 2.2
Euro area	51.1	12.0	− 0.3	+ 1.2	+ 2.0	+ 1.6	+ 1.5	+ 1.5
Germany	30.0	3.4	+ 0.5	+ 1.6	+ 1.7	+ 1.7	+ 1.5	+ 1.6
Italy	6.3	1.9	− 1.7	+ 0.1	+ 0.7	+ 0.8	+ 0.8	+ 1.0
France	4.5	2.3	+ 0.6	+ 0.6	+ 1.3	+ 1.3	+ 1.4	+ 1.5
CEEC 5[2]	14.1	1.6	+ 1.3	+ 3.2	+ 3.7	+ 2.4	+ 3.0	+ 3.0
Czech Republic	3.6	0.3	− 0.5	+ 2.7	+ 4.5	+ 2.4	+ 2.4	+ 2.6
Hungary	3.3	0.2	+ 2.1	+ 4.0	+ 3.1	+ 1.5	+ 2.6	+ 2.5
Poland	3.2	0.9	+ 1.4	+ 3.3	+ 3.9	+ 2.5	+ 3.5	+ 3.3
USA	6.9	15.8	+ 1.7	+ 2.4	+ 2.6	+ 1.5	+ 2.2	+ 2.1
Switzerland	5.8	0.4	+ 1.8	+ 2.0	+ 0.8	+ 1.6	+ 1.8	+ 1.9
China	2.5	17.3	+ 7.8	+ 7.3	+ 6.9	+ 6.7	+ 6.4	+ 6.1
Total[3]								
PPP-weighted[4]		50.4	+ 3.3	+ 3.8	+ 3.9	+ 3.4	+ 3.4	+ 3.3
Export weighted[5]	84.3		+ 0.7	+ 1.9	+ 2.3	+ 1.9	+ 1.8	+ 1.9
Market growth[6]			+ 1.7	+ 3.5	+ 2.9	+ 2.8	+ 3.0	+ 3.5
Forecast assumptions								
Crude oil prices								
Brent, $ per barrel			108.7	99.0	52.5	45	57	59
Exchange rate								
$ per €			1.328	1.329	1.110	1.11	1.10	1.10
Key interest rate								
ECB main refinancing rate[7], percent			0.6	0.2	0.1	0.0	0.0	0,3
10-year government bonds yield Germany, percent			1.6	1.2	0.5	0.1	0.2	0.8

Source: WIFO. 2016 to 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 2015. – [5] Weighted by shares of Austrian goods exports in 2015. – [6] Real import growth of trading partners, weighted by shares of Austrian goods exports. – [7] Minimum bid rate.

In its latest short-term forecast[1], the OECD expects the new US administration to switch to a course of determined fiscal expansion, boosting GDP growth in 2018 by almost 1 percentage point to 3 percent. This expectation rests upon international financial market developments since the presidential election: the move of many investors away from gold and government bonds towards US shares and the implicit rise in long-term interest rates and the dollar exchange rate signal an improvement in business expectations. Yet, only the next few weeks and months will show which of the fiscal measures announced by Donald Trump will actually be implemented, the more so as part of the Republican Party stands for a rather different policy agenda. Hence, the present forecast does not (yet) anticipate such a fiscal stimulus.

Unlike the OECD, WIFO does not (yet) expect US growth to benefit from fiscal stimulus.

2. "Brexit" will temporarily dampen the UK boom

Contrary to most expectations, the UK economy enjoyed robust growth during the three months following the "Brexit" vote of end-June 2016. Even gross fixed investment, which is highly sensitive to forward-looking expectations, increased. So far, the outcome of the referendum has not damaged the performance of the real economy. However, the depreciation of the pound sterling, which has sent the effective exchange rate back down to the level recorded in the years following the financial market crisis, is likely to rekindle inflation and dampen private consumption in 2017. Foreign trade, on the other hand, stands to benefit from currency devaluation. Investment, and in particular construction, may see a slowdown in 2017, and a re-

Up to 2018, the British economy is set to expand faster than that of the euro area.

[1] OECD, Economic Outlook. Preliminary Version, Paris, November 2016.

bound thereafter. GDP growth is thus projected to abate to the euro-area average in 2017 and pick up subsequently to an annual rate above 2 percent.

3. New EU subsidies will spur investment in the CEEC 5

Out-migration leads to labour shortages and strong wage drift in East-Central Europe.

Some East-Central European countries saw a slackening of investment in 2016, largely because by the end of 2015 the EU subsidies, which play an important role for capital formation in these countries, had been exhausted from the Financial Framework 2007-2013, and no follow-up was yet available in 2016. Investment should rebound in 2017 as soon as the funds from the new Financial Framework 2014-2020 may be called. Private consumption should remain lively since emigration-induced scarcity of labour is driving up wages[2]. Minimum wages in Hungary are to rise by one-quarter over the forecast period, those of higher-qualified workers even by 40 percent. Against this background, GDP growth in the CEEC 5 will temporarily soften to 2.4 percent in 2016, before regaining 3 percent as from 2017.

4. No acceleration of growth in the euro area

Due to relatively better labour market conditions, GDP and private consumption will grow somewhat faster in Germany than in Austria.

Germany's GDP growth is expected to outpace Austria's by some 0.2 percentage points per year over the projection period; in 2017, both countries' growth rates should actually match, due to a relatively stronger negative calendar effect in Germany. Like in the USA, the UK and several East-European countries, low unemployment will lead to higher wage gains; with inflation remaining lower than in Austria, real private consumption and overall output will expand somewhat faster.

The cyclical pattern of the French economy has been very close to that of Austria since 2008, and growth rates may also be similar going forward. No substantial improvement may be expected for the ailing Italian economy. The growth performance of the euro area overall may be comparable with the profile projected for Austria; annual growth rates for the EU 28 should exceed those for the euro area by up to 0.2 percentage points, due to relatively more buoyant conditions in East-Central Europe and the UK.

5. Assumptions underlying the projections

If the ECB terminates its Bond Purchase Programme in 2018, as expected, long-term interest rates will rise by ½ percentage point.

The external assumptions underlying the projections include oil prices, the euro exchange rate against the dollar, the euro area key interest rate and the long-term interest rate in Germany. Oil prices were lower in the last few weeks than assumed in the previous WIFO projections of September 2016. Nevertheless, with the market reaction of a jump in prices after the OPEC agreement on supply cuts of end-November, the earlier price assumption can be kept unchanged. A monthly average of 55 $ per barrel in December will take the annual average for 2016 to 45 $ per barrel. In 2017 and 2018, the reference price is expected to edge up to 57 $ and 59 $, respectively.

The dollar appreciation triggered by portfolio shifts in favour of US shares after the presidential elections is not expected to be sustained; the exchange rate assumption is therefore maintained at 1.10 $ per euro for 2017 and 2018. Concerning monetary policy it is assumed that the ECB will terminate its Bond Purchase Programme in 2018, which will boost euro-area long-term interest rates by about ½ percentage point. The ECB is expected to raise the key interest rates gradually, thereafter.

[2] wiiw, Labour Shortages Driving Economic Growth? Economic Analysis and Outlook for Central, East and Southeast Europe, Vienna, 2016.

6. Lively demand for motor vehicles in Austria in 2016

The strong performance of investment in machinery and equipment as well as of private consumption of durable goods is driven by lively demand for motor cars.

Domestic demand in 2016 is shaped by strong sales of motor cars: until September, private households stepped up car purchases by over 7 percent in volume year-on-year, while overall investment in motor vehicles in the economy jumped by almost 20 percent. The comparatively much smaller gain of gross fixed investment suggests that car dealers to a large extent satisfied demand by cutting their inventories. Accordingly, 2016 saw a marked drop in one-day registrations; moreover, merchandise import growth had gained momentum already in 2015.

Demand for other consumer durables has also rebounded in 2016, albeit not to the same extent as for motor cars. Along with private consumption the household saving ratio is also rising, despite a squeeze in investment income. This can be explained by the income tax cuts which largely benefit middle- and higher-income households: they spend a larger fraction of their income on durable consumer goods than low-income earners, while saving relatively more at the same time. Since the tax cuts have been counter-financed to a lesser extent than originally intended[3], the acceleration of private consumption growth translates into a higher GDP growth rate in 2016.

Table 3: 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	+ 1.2	+ 1.1
Durable goods	– 3.0	+ 0.1	– 0.6	+ 3.2	+ 2.0	+ 1.0
Non-durable goods and services	+ 0.2	– 0.3	+ 0.1	+ 1.3	+ 1.1	+ 1.1
Household disposable income	– 1.9	– 0.1	+ 0.3	+ 2.5	+ 1.4	+ 1.4
	As a percentage of disposable income					
Household saving ratio						
Including adjustment for the change in pension entitlements	7.0	7.0	7.3	8.3	8.5	8.8
Excluding adjustment for the change in pension entitlements	6.2	6.4	6.7	7.6	7.8	8.1
	Percentage changes from previous year					
Direct lending to domestic non-banks (end of period)	– 1.2	+ 0.3	+ 2.0	+ 1.9	+ 1.7	+ 1.3
	Percent					
Inflation rate						
National	2.0	1.7	0.9	0.9	1.7	1.7
Harmonised	2.1	1.5	0.8	0.9	1.7	1.7
Core inflation[2]	2.3	1.9	1.7	1.4	1.6	1.6

Source: WIFO. 2016 to 2018: forecast. – [1] Private households including non-profit institutions serving households. – [2] Excluding energy and unprocessed food (meat, fish, fruits, vegetables).

Due to weak exports, growth of manufacturing output is barely picking up.

In the short run, lively demand for motor vehicles does not benefit domestic manufacturing which is set to advance by 2 percent in 2016, hardly more than in the two previous years. An upswing is also held back by sluggish exports which expanded by no more than 2 percent (up to the third quarter), after +3.5 percent in 2015. A strong performance in the last three months would be required in order to meet the projected annual growth rate of 2.8 percent. Mainly exports to the USA and the CEEC 5

[3] In October 2015, the draft federal budget foresaw a reduction in the current deficit from 1.9 percent of GDP in 2015 to 1.4 percent in 2016 and a structural balance of –0.5 percent of GDP in both years; however, the draft budgetary plan of October 2016 provided for an increase in the current deficit from 1.0 percent of GDP in 2015 to 1.4 percent in 2016 (structural balance +0.1 percent in 2015, –0.9 percent in 2016 or –0.5 percent when allowing for extra spending on refugees and fight against terrorism as one-off measures). While the figures for 2016 are identical in both draft budgetary plans, the ex-post budgetary outturn for 2015 was significantly better than anticipated in autumn of that year. Hence, at unchanged figures for 2015, the deficit for 2016 would have turned out higher.

disappointed in 2016, but the outlook for 2017 is brighter. The drop in exports to the USA should be seen as a statistical payback to the strong gains in 2015 when exports were fuelled by euro depreciation. This effect should gradually fade out, while investment in the USA should recover from its temporary setback. The same holds true for the CEEC 5, where the expiration of the multi-annual EU subsidies programme has been responsible for the weakness of investment. Demand for investment goods and imports should recover in 2017, as soon as the funds from the new subsidies programme may be called.

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	+ 1.5	+ 1.4
Hours worked[1]	– 0.6	+ 0.3	– 0.6	+ 0.7	+ 0.7	+ 0.6
Productivity[2]	+ 0.7	+ 0.3	+ 1.6	+ 0.8	+ 0.8	+ 0.8
Employment[3]	+ 0.5	+ 1.0	+ 0.7	+ 1.2	+ 1.0	+ 0.9
Manufacturing						
Production[4]	+ 0.3	+ 1.6	+ 1.8	+ 2.0	+ 2.3	+ 2.3
Hours worked[5]	– 1.1	– 0.0	+ 0.3	+ 0.8	+ 0.6	+ 0.3
Productivity[2]	+ 1.4	+ 1.6	+ 1.5	+ 1.2	+ 1.7	+ 2.0
Employees[6]	– 0.6	+ 0.3	+ 0.7	+ 0.9	+ 0.5	+ 0.3

Source: WIFO. 2016 to 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).

Commercial and industrial building gathered pace in 2016.

Due to difficult conditions prevailing in many markets, gains in machinery investment remained subdued in 2016. Construction investment, however, posted the first increase in three years. With the cyclical upturn, notably commercial and industrial building gathered pace, benefiting also from government projects for the construction of schools and hospitals (e.g., hospital complex Vienna-North). Higher private net incomes after the tax cuts and a public programme for the creation of new homes should give a boost to residential building over the forecast period.

Booming demand for tourism services creates many jobs and adds to inflation.

More lively than merchandise foreign trade has been the development of tourism exports in 2016. With a volume corresponding to 3 percent of GDP in the first six months of the year, it accounted for the entire current account surplus which for the whole year should equal 2.4 percent of GDP (2015: 1.8 percent). With current account data occasionally being subject to major revisions, figures may change in the next forecasting rounds. The summer season from May to October saw more customer arrivals than ever before in Austria. The lively demand extended also to domestic customers who apparently spent part of their gains from the income tax cuts on holiday travel.

Since higher demand hardly raises productivity in the tourism industry, it has a substantial employment effect, but also exerts upward pressure on service prices. Austria's positive inflation differential of over ½ percentage point vis-à-vis the euro area average is largely due to tourism-related services (restaurants and hotels, package holidays, recreational and cultural services), as in the years before. In addition, housing rents are going up swiftly, while fully and mainly administered prices are also drifting up more strongly than on average in the euro area.

The decline in oil prices and lower wage pressure dampened the inflation rate in 2016.

Overall inflation, however, remained subdued in 2016, the annual average rate remaining below 1 percent for the second time in a row. Part of the explanation is, as in 2015, the low level of commodity prices; another reason is the declining wage pressure, with nominal unit labour cost rising ½ percentage point less than in 2015 and core inflation (according to HCPI) being lower. The factors behind are a pick-up in output growth along with smaller gains in gross nominal wages, reducing real unit labour cost and the wage share once again. External price competitiveness, as measured by the real effective exchange rate, weakened nevertheless slightly, since the euro appreciated not only against the pound sterling, but to a lesser extend also against the Chinese, Russian, Ukrainian and Turkish currencies as well as the Swiss Franc. Austrian exporters gained market shares in the first half of 2016, but for the full year 2016 and the remaining forecast period constant market shares are expected.

Table 5: 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	+ 1.6	+ 1.8
Real[2]						
Gross	– 0.1	– 0.0	+ 0.8	+ 0.5	– 0.1	+ 0.1
Net	– 0.6	– 0.6	+ 0.2	+ 3.0	– 0.2	– 0.3
Wages and salaries per hour worked[1]						
Real, net[2]	+ 0.3	– 0.2	+ 1.7	+ 3.5	+ 0.3	+ 0.2
	Percent					
Wage share, adjusted[3]	68.6	70.2	69.5	69.0	69.1	69.1
	Percentage changes from previous year					
Unit labour costs, nominal[4]						
Total economy	+ 2.1	+ 1.8	+ 1.7	+ 1.2	+ 1.3	+ 1.5
Manufacturing	+ 2.2	+ 0.9	+ 1.2	+ 1.0	+ 0.2	+ 0.1
Effective exchange rate – manufactured goods[5]						
Nominal	+ 1.8	+ 1.2	– 2.7	+ 1.1	– 0.1	+ 0.1
Real	+ 2.2	+ 1.5	– 2.7	+ 1.2	– 0.3	– 0.2

Source: WIFO. 2016 to 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.

Table 6: 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	+ 41.0	+ 57.0	+ 47.0	+ 41.0
Employees[1,2]	+ 21.2	+ 23.8	+ 33.2	+ 52.0	+ 42.0	+ 36.0
National employees	– 8.5	– 8.1	+ 6.3	+ 17.0	+ 9.0	+ 6.0
Foreign employees	+ 29.7	+ 32.0	+ 27.0	+ 35.0	+ 33.0	+ 30.0
Self-employed[3]	+ 8.0	+ 8.0	+ 7.8	+ 5.0	+ 5.0	+ 5.0
Labour supply						
Population of working age						
15 to 64 years	+ 23.5	+ 33.1	+ 52.3	+ 68.9	+ 42.0	+ 35.3
Labour force[4]	+ 55.8	+ 64.0	+ 76.0	+ 60.5	+ 63.0	+ 53.0
Labour surplus						
Unemployed[5]	+ 26.6	+ 32.2	+ 35.0	+ 3.5	+ 16.0	+ 12.0
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	6.1	6.2	6.2
As a percentage of total labour force[5]	6.8	7.4	8.1	8.1	8.3	8.5
As a percentage of dependent labour force[5]	7.6	8.4	9.1	9.1	9.3	9.5
	Percentage changes from previous year					
Labour force[4]	+ 1.4	+ 1.5	+ 1.8	+ 1.4	+ 1.5	+ 1.2
Persons in active dependent employment[1,2]	+ 0.6	+ 0.7	+ 1.0	+ 1.5	+ 1.2	+ 1.0
Unemployed[5]	+ 10.2	+ 11.2	+ 11.0	+ 1.0	+ 4.5	+ 3.2
Persons (in 1,000)	287.2	319.4	354.3	357.8	373.8	385.8

Source: WIFO. 2016 to 2018: forecast. – [1] Excluding persons with 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.

6.1 Labour inflow from eastern Europe slowing down

Labour market access of persons granted asylum and subsidiary protection keeps unemployment rising.

With employment expanding strongly, the labour-supply-driven increase in unemployment of the last four years has lost momentum, but is set to continue in 2017 and 2018. Older workers now tend to stay longer in gainful employment, and the inflow of workers from abroad goes on, a crucial factor of the outlook being the assumption on the access of persons granted asylum and subsidiary protection. Since 2012, the new arrivals were mainly workers from countries that joined the EU in 2004 and 2007 and whose access to the domestic labour market was liberalised in 2011 and 2014, respectively (workers from Hungary 2011-2015 +37,000, from Romania, Slovakia, Poland and Slovenia +53,600). Although the inflow has slackened since 2015, it will still go on due to the persistently wide wage gap between the countries of origin and Austria. In addition, a rising number of persons granted asylum and subsidiary protection from the wave of refugees 2015-16 will join the labour market in the near future, subject to the forecast assumptions on the duration of the asylum procedures.

The sustained increase in unemployment of domestic workers from 2011 to 2015 (+61,700), the population-ageing-induced rise in jobless older workers and deteriorating job opportunities of resident workers from the "traditional" immigration countries (Balkan countries, Turkey) due to immigration from the EU all tend to ossify labour market conditions. The accompanying increase in long-term jobless (from 20 percent of total unemployment in 2013 to 34 percent in 2016) will also prevent the unemployment rate from declining in the next few years.

6.2 Cyclical impulse of tax cuts to fade by mid-2017

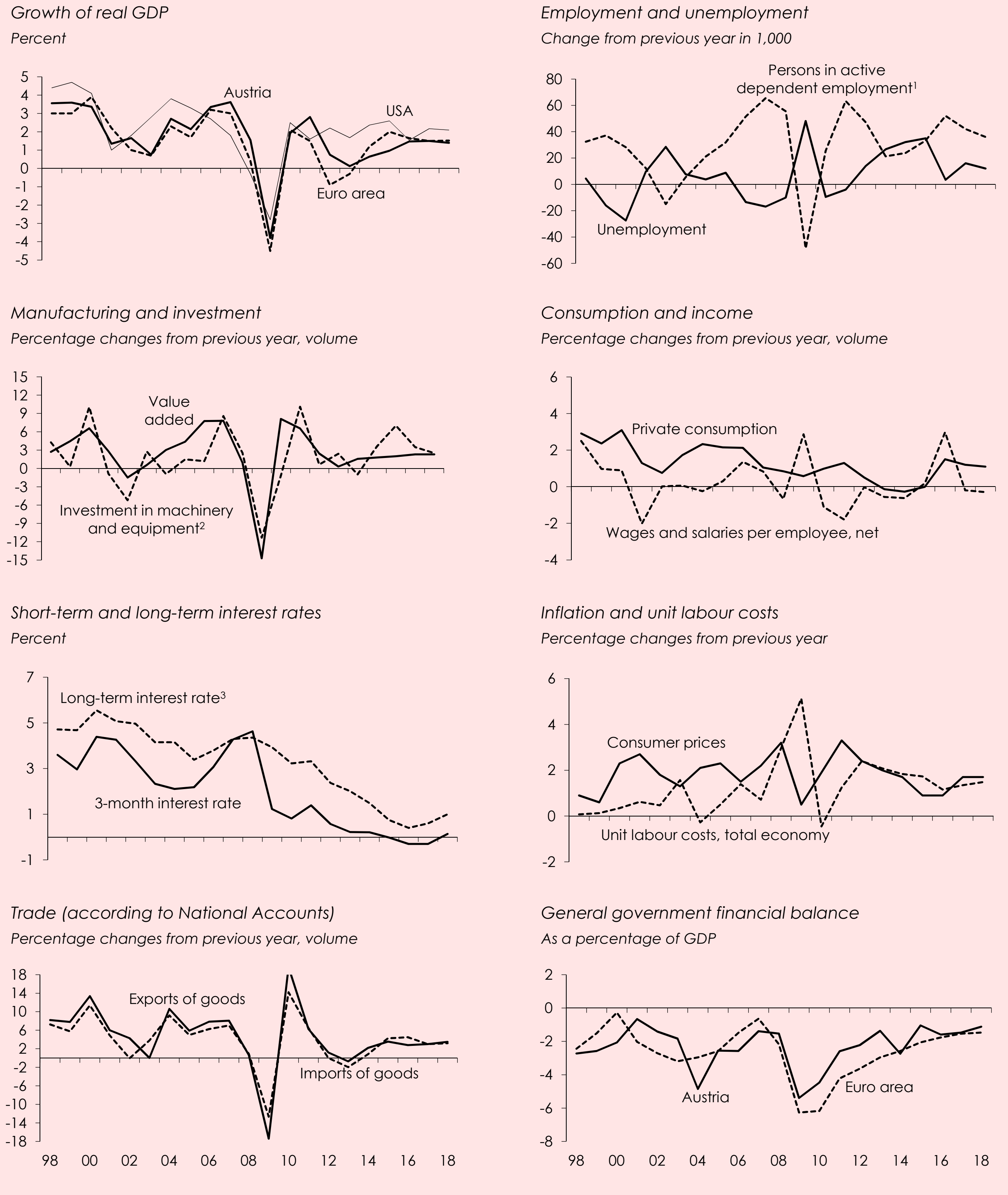
The fading impact of the tax reform and the rising inflation rate will moderate the upswing of private consumption.

The positive impact of the income tax cuts on private consumption will hit a peak in late 2016 and early 2017 when some additional minor tax concessions take effect (increase in the negative income tax and in the child tax allowance). Thereafter, private consumption growth will shift into lower gear, notably as regards durable consumer goods, since labour market conditions will prevent the upswing from becoming self-sustained. The excess supply of labour dampens gains in private earnings. The settlements negotiated in the 2016 autumn wage round (metal workers +1.7 percent; trade workers +1.3 percent) are in line with the assumptions included in the WIFO forecast of last September; however, they imply a real wage loss for 2017, if oil prices rise as expected. Moreover, in view of the immigration-related increase in unemployment since 2012, individual concerns about job security exert a dampening effect on consumption. Although consumer confidence has firmed in the last few months, the indicator remains in the same low territory as during the stagnation of 2012 and onwards. Further factors driving up the saving rate are the disposable income gains after the tax cuts in the earlier part of the forecast period, and later on higher interest income once the extremely expansionary monetary policy has come to an end.

Business surveys signal a strengthening of growth for late 2016 and early 2017.

Apart from the temporary effects of the income tax cut, the regular business surveys signal an acceleration of demand and output growth for the months to come: indeed, the summary index for the assessment of the current situation and the expectations expressed in the WIFO Business Cycle Survey show a clear improvement since last September, extending to all major branches. The WIFO Leading Indicator climbed in November for the eighth consecutive month and suggests an increase in the cyclical component of gross output. The Economic Barometer of the Federal Economic Chamber suggests stability in economic performance and companies giving priority to the replacement of obsolete business equipment over enlargement of productive capacities. Business confidence is highest among large firms and export-oriented companies. Manufacturing output, which accumulated until the third quarter 2016 advanced by only 1.6 percent, should thus gather pace. For an outright cyclical upswing, however, external demand does not appear robust enough; foreign market growth is unlikely to exceed 3.5 percent over the projection horizon.

Figure 1: Indicators of economic performance



Source: WIFO. 2016 to 2018: forecast. – [1] Excluding persons with 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 incremental investment premium fails to stimulate investment behaviour.

In 2017 and 2018, companies that raise their investment spending above the average of the three preceding years are rewarded by an incremental investment premium ("Investitionszuwachsprämie") of 10 to 15 percent of the additional amount spent. The budgetary allocation for the premium is 87.5 million € for each of the two years. If the total amount were to be exhausted and assuming full leverage (i.e., no deadweight losses), the premium would trigger investment corresponding to

1 percent of total annual gross capital formation. Basically, corporate investment decisions are governed by two elements: sales prospects and financing cost. The incremental investment premium is intended to act on the financing cost. The latter, however, is already extremely low as a result of the expansionary monetary policy. Hence, companies that proceed to new investment in response to strengthening demand will hardly need an additional subsidy to the financing cost. Firms, on the other hand, struggling with unfavourable sales prospects will not be encouraged to higher investment by the premium. Overall investment will therefore not receive a major impetus – an expectation confirmed by the earlier experience with such a premium in 2003-04[4]. In the light of the latest results from business surveys, machinery investment is expected to expand at a moderately faster rate.

Investment in motor vehicles will slacken as from 2017, as the alignment of the taxation of company cars towards environmental objectives may have given rise to advance purchases: in the context of the tax reform, the taxable value of company cars was raised from monthly 1.5 percent of the purchase value (so far without CO_2 benchmark) for vehicles emitting more than 130 g CO_2 per km to 2.0 percent of the purchase value. Since the end of 2015, older passenger cars are increasingly replaced by new models of reduced emission, in order to avoid higher taxation. This incentive should become weaker over the projection period since newer cars emit less CO_2 and need to be replaced less frequently. Thus, the average CO_2 emission of newly registered diesel cars was 140 g per km in 2011 (petrol-engine cars: 138 g per km), in 2013 134 g (petrol-engine cars: 130 g), and in 2015 only 126 g per km (petrol-engine cars: 123 g). As from 2017, the CO_2-ceiling (2016: 130 g per km) will be gradually reduced by 3 g per km each year to 118 g per km by 2020. Companies will therefore continue to buy CO_2-compatible company cars in advance, such that the payback of the high number of pre-emptive purchases in 2016 should be spread out in time over the forecast period. Demand should also be sustained by new vehicle purchases by army and police services.

The alignment of the taxation of company cars towards environmental considerations has led to advance purchases that boosted overall investment in motor vehicles.

Table 7: Technical note to the projection of real GDP growth

		2015	2016	2017	2018
Growth carry-over[1]	percentage points	+ 0.1	+ 0.4	+ 0.6	+ 0.5
Growth rate during the year[2]	percent	+ 1.2	+ 1.4	+ 1.6	+ 1.3
Annual growth rate	*percent*	*+ 1.0*	*+ 1.5*	*+ 1.5*	*+ 1.4*
Adjusted annual growth rate[3]	percent	+ 0.9	+ 1.3	+ 1.7	+ 1.4
Calendar effect[4]	percentage points	+ 0.1	+ 0.2	− 0.2	± 0.0

Source: WIFO. 2016 to 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.

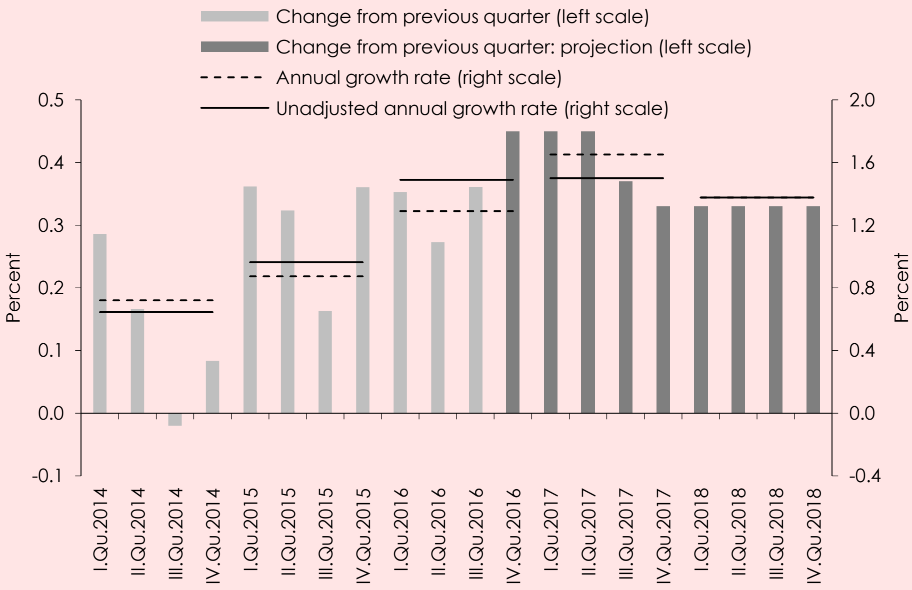
The projected trajectories of investment, output and consumption imply an acceleration of quarterly economic growth (adjusted, against the previous period) to 0.45 percent from late 2016 to mid-2017 (third quarter 2016 +0.35 percent) and a subsequent moderation to 0.30 to 0.35 percent (Figure 2). The adjusted annual growth rate on the basis of the trend-cycle component rises from 1.3 percent in 2016 to 1.7 percent in 2017, abating to 1.4 percent in 2018. Given the higher number of working days in 2016 (leap year and other calendar effects) than in 2015 and the opposite effect in 2017, the unadjusted GDP growth rates are 1.5 percent both for 2016 and 2017 (Table 7).

Due to a calendar effect, the annual GDP growth rate for 2017 will be no higher than in 2016, despite the expected rebound in business activity.

[4] Although an incremental investment premium was granted from end-2002 to end-2004, growth of Austrian investment in machinery and equipment (construction and immaterial investment was excluded from the premium) in 2003-04 trailed the euro-area average by an overall 2.4 percentage points and German investment growth by 2.7 percentage points. After the premium had expired in 2005 and 2006, the negative gap widened to 9 and 15 percentage points respectively.

Figure 2: Cyclical profile Austria

GDP volume, trend-cycle component



Source: WIFO.

6.3 General government balance for 2017 cyclically neutral

As from 2018, the restrictive impact of fiscal drag will recur.

After the tax cuts of 2016, the revenue side of government finances keeps it expansionary stance also in 2017, as the increase in the negative income tax and the child tax allowance bolsters disposable income. The cut of the employer's contribution to the Family Benefit Fund from 4.5 to 4.1 percent of gross wages and salaries (and further to 3.9 percent in 2018) will have a benign effect on employment in sectors where the tax wedge acts as a constraint on growth, due to slow productivity advances despite high capacity utilisation, i.e., in some services branches such as tourism. Public expenditure, on the other hand, follows a restrictive course in 2017, since public consumption growth will slow down. The overall government balance will therefore be cyclically neutral. From today's perspective, the government envisages no further revenue measures for 2018, hence the restrictive effect of fiscal drag will resume. In the event, net wages will expand ½ percentage point p.a. less than gross wages. However, the present assumptions for fiscal policy in 2018 are highly uncertain in view of the general elections due at the time.

Table 8: 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	– 1.0	– 1.6	– 1.5	– 1.1
General government primary balance	1.2	– 0.3	1.3	0.6	0.4	0.6
General government total revenue	49.9	50.0	50.6	49.6	49.5	49.5
General government total expenditure	51.2	52.8	51.6	51.2	50.9	50.6
	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	0.6	1.0

Source: WIFO. 2016 to 2018: forecast. – [1] According to Maastricht definition. – [2] 10-year central government bonds (benchmark).

7. Risks to the forecast

The external scenario underlying the present forecast is subject to a number of risks and unforeseeable shocks. Such risks play only a minor role for 2016, given the large number of infra-annual observations already available and coincident cyclical indicators like business surveys offering reliable information on developments of the real economy in the fourth quarter. Besides, any forecast errors for the last three months would, due to the statistical carry-over, have a stronger impact on the growth projection for 2017 than for 2016. Nevertheless, the GDP estimate for 2016 may change ex-post without affecting the cyclical profile: as of September 2016, the responsibility for UniCredit's business operations in eastern Europe has been transferred from its Vienna branch (Bank Austria AG) to headquarters in Milan. Hence, the bank's earnings from eastern European business operations will in future be attributed to the Italian economy and diminish those in Austria accordingly, unless they had so far been assigned to the local markets. In the National Accounts, the recorded value added of financial services will turn out lower, while on the expenditure side of GDP services exports should be most affected. Compensation of costs for employees remaining in Vienna or a reduction in intermediate consumption would, on the other hand, add to GDP.

Low interest rates, subdued inflation and sluggish demand weigh on financial sector profitability.

For 2017 and even more for 2018, forecast uncertainty is high also from the cyclical perspective. Capital endowment of many European banks remains insufficient. After the financial market crisis, non-performing loans have been written-off too hesitantly and necessary consolidation measures were often postponed. A further problem is the poor co-ordination between monetary and fiscal policy: the low-interest policy of the ECB squeezes banks' interest margins, while the hardly expansionary stance of fiscal policy does little to stimulate output and credit growth. In addition, low inflation delays debt reduction in real terms, dampening new borrowing. The combination of sluggish demand, subdued inflation and low interest rates undermines banks' profitability and equity base. The risk of a self-fulfilling confidence and financial market crisis, as foreshadowed in September 2016 with the problems of Deutsche Bank, is mounting.

Stiff confrontation between the EU and the UK could give rise to financial market turbulence.

As witnessed by the negotiations of CETA, the Free-Trade Agreement with Canada, the political capacity to act of the EU is severely constrained by the special interests of individual member countries or regions. This could give rise to stiff confrontation in the negotiations of UK's withdrawal from the EU and a substantial deterioration of bilateral economic relations, causing a stronger setback to real economic activity than assumed in the current projections. Unexpected turbulence on financial markets may also lead to macroeconomic distortions. A particular risk relates to a settlement on the British financial sector, since uncertainty about the future statute in the EU of this important provider of foreign exchange[5] may put further downward pressure on the pound sterling.

A reversal of labour migration towards eastern Europe would provide relief for the Austrian labour market. Lower oil prices or a shift of fiscal policy towards expansion could raise GDP growth above the projected path.

Strong wage gains in the East-Central European countries as a consequence of an emigration-induced shortage of labour may lead to a reversal of migration flows that could provide relief for the Austrian labour market. Such a reversal would depend on whether structural or cyclical considerations have dominated the decisions of immigrants. In the event of the latter, a substantial number of workers may be prompted to return to their country of origin. If structural motives had been the dominant factor (integration into a more affluent society), labour shortage and the catching-up of wages will hardly be reason enough for a return.

Private consumption and GDP growth could turn out somewhat stronger than projected in the current scenario, if the hike in oil prices triggered by the latest OPEC decision were to be short-lived (e.g., due to lacking credibility of the move) and real income gains would ipso facto be somewhat higher. Likewise, GDP growth would benefit from a more expansionary stance of fiscal policy, possibly politically motivated by the approaching general elections. Finally, the upbeat results from current business surveys hold the possibility of a positive surprise for output growth in 2017, driven either by capacity-enhancing investment or a stronger-than expected revival of exports.

[5] In 2015, financial and insurance services contributed a surplus of 3 percent of GDP to the British current account which recorded an overall deficit of around 5 percent of GDP.