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**Financial Market Crisis Weighing
on Economic Growth
Economic Outlook for 2008 and 2009**

March 2008

Financial Market Crisis Weighing on Economic Growth

Economic Outlook for 2008 and 2009

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Economic Outlook for 2008 and 2009: Financial Market Crisis Weighing on Economic Growth

Economic growth in Austria is set to decelerate to an average 2.1 percent in volume this year. This is primarily the consequence of the international financial crisis that originated from US real estate markets. Scope and duration of that crisis can still not be reliably assessed at present. The projection for GDP growth in 2009 of 1.7 percent is therefore subject to considerable risk. Exports, industrial output and investment are slackening markedly. Private consumption is not gaining momentum, partly because of inflation accelerating to 2.9 percent. While employment this year is rising even faster than expected, the decline in unemployment is likely to reverse as from 2009.

In 2006 and 2007, Austrian real GDP growth attained nearly 3½ percent per year. Activity remained lively also in early 2008, with companies enjoying a high degree of capacity utilisation and job creation remarkably strong. For the first semester, demand and output are thus likely to still rise by 2½ percent above the year-earlier level. Nevertheless, the global economic environment has weakened in a lasting way:

- A slump on real estate markets triggered a severe banking crisis in the USA which has so far not been defused despite massive policy intervention. Economic growth has almost stalled, with a modest 1 percent being expected for 2008 as a whole. A key factor for global demand has thereby ceased to operate.
- This shortfall can hardly be offset by continued lively expansion in the emerging markets which are likewise affected by slower global demand growth even if domestic demand is rising briskly. Growth in China is likely to moderate from 11½ percent in 2007 to 8½ percent in 2009.
- The liquidity and solvency crisis has spilt over to European and Asian financial markets. Credit conditions have deteriorated and business confidence has weakened. In the euro area, the appreciation of the common currency is weighing on activity, a levelling-off not yet being in sight. GDP growth, though exceed-

ing that of the USA, is expected to decelerate to 1.6 percent in 2008 and 1.3 percent in 2009.

Because of the substantial clouding of the external environment, WIFO expects GDP growth to slow also in Austria from the healthy pace observed until early this year. Exports of goods and services are projected to abate to 5 percent annual growth, thereby calming also the 2-year-long boom in manufacturing industry. Already in the cyclical upturn of the last years, investment in machinery and equipment was less buoyant than anticipated; meanwhile, the expansion has virtually come to an end. Somewhat more lively is investment in construction which in the areas of infrastructure and residential building benefits from higher government spending. Even there, though, the momentum that in the last two years had been at the verge of overheating, has slackened significantly.

Private household demand is not able to stabilise overall business activity. Although having expanded unusually slowly over the last seven years, an acceleration can still not be expected, despite higher wage settlements, since nominal income gains are neutralised by higher inflation. Headline inflation will rise to 2.9 percent this year, driven by massive hikes for energy and food, each accounting for about one-third of the year-on-year increase of the overall price level. Net real earnings per employee will therefore edge down by 0.1 percent. The lower income brackets will suffer marked losses in their real income because of their lower gains in nominal wages and the high share of food, housing and energy costs in their consumption basket. Together with the high rate of "perceived inflation" – as prices of daily items rise faster than those of durable consumer goods – this will weigh heavily on consumer spending. The latter is projected to rise by 1.6 percent in volume, and that only under the optimistic assumption of a slight decline in the household saving ratio.

At the beginning of the year, employment growth was unusually strong, with 100,000 new jobs being added from last year. This mirrors the lagged effects of lively business activity around mid-2007 as well as favourable weather conditions which supported construction activity and tourism during the winter season. However, a statistical effect may also be involved: since 1 January last, newly-hired employees have to be registered with the social security administration already before taking up work; for this reason, official employment figures may have jumped in some branches, but the

size of such an effect cannot be quantified. The strong employment gain has been accompanied by a further decline in unemployment. In the course of the year, the cyclical slowdown will also become visible on the labour market. As from the winter 2008-09, seasonally-adjusted jobless figures are likely to head up again. In 2009, registered unemployment is projected to average 224,000, up by 12,000 from this year. The jobless rate is expected at 4.3 percent of the labour force according to Eurostat, or 6.2 percent of the dependent labour force following the conventional national definition.

Owing to the strong momentum of economic activity over the last two years, the general government deficit has been cut by half, but the balance in Maastricht terms still stood at -0.7 percent of GDP in 2007. The imminent cyclical slowdown will dampen revenue growth with a lag, thereby preventing a further reduction of the deficit. The reaction of the budget balance to cyclical variations, i.e., move towards surplus in the upswing and towards deficit in the downturn, is an indispensable element of a stability-oriented fiscal policy.

Since neither the scope nor the duration of the international financial market crisis can be adequately assessed at present, the present projections are subject to a particularly large margin of uncertainty. It is assumed that the slowdown of activity will come to a halt towards the end of this year and give way to a tentative recovery in 2009. GDP growth in 2009 will drop below the projected 1.7 percent, if the liquidity and solvency crisis in the international financial system becomes protracted and the pick-up of the real economy is delayed. However, buoyant activity in Asian emerging markets, which also exhibit high saving ratios, may have a stabilising effect on the global economy.

Vienna, 16 April 2008

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Projections - March 2008

Main results

Percentage changes from previous year

		2004	2005	2006	2007	2008	2009
GDP							
Volume		+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.1	+ 1.7
Value		+ 4.4	+ 3.9	+ 5.1	+ 5.8	+ 4.8	+ 3.9
Manufacturing¹, volume		+ 2.4	+ 3.1	+ 8.8	+ 7.1	+ 3.0	+ 2.8
Wholesale and retail trade, volume		+ 1.1	+ 0.2	+ 1.0	+ 0.7	+ 1.6	+ 1.5
Private consumption expenditure, volume		+ 1.8	+ 2.0	+ 2.1	+ 1.4	+ 1.6	+ 1.6
Gross fixed investment, volume		+ 0.1	+ 0.3	+ 3.8	+ 4.8	+ 2.2	+ 1.8
Machinery and equipment ²		- 1.4	+ 0.7	+ 2.1	+ 6.3	+ 2.0	+ 1.0
Construction		+ 1.3	+ 0.1	+ 5.1	+ 3.7	+ 2.3	+ 2.3
Exports of goods³							
Volume		+ 12.5	+ 3.2	+ 6.8	+ 8.1	+ 5.7	+ 5.7
Value		+ 13.9	+ 5.4	+ 9.5	+ 10.1	+ 6.7	+ 6.2
Imports of goods³							
Volume		+ 11.7	+ 2.8	+ 3.8	+ 8.1	+ 5.8	+ 5.7
Value		+ 12.5	+ 5.9	+ 8.0	+ 9.2	+ 7.3	+ 6.5
Current balance	€ bn	+ 4.94	+ 5.02	+ 6.31	+ 8.27	+ 8.55	+ 8.61
	as a percentage of GDP	+ 2.1	+ 2.0	+ 2.4	+ 3.0	+ 3.0	+ 2.9
Long-term interest rate⁴	percent	4.2	3.4	3.8	4.3	4.1	4.0
Consumer prices		+ 2.1	+ 2.3	+ 1.5	+ 2.2	+ 2.9	+ 2.3
Unemployment rate							
Eurostat definition ⁵	percent	4.8	5.2	4.7	4.4	4.2	4.3
National definition ⁶	percent	7.1	7.3	6.8	6.2	5.9	6.2
Persons in active dependent employment⁷		+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 1.8	+ 0.7
General government financial balance							
according to Maastricht definition							
as a percentage of GDP		- 1.2	- 1.6	- 1.4	- 0.7	- 0.7	- 0.7

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

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

WIFO*Projections - March 2008***Key policy indicators**

	2004	2005	2006	2007	2008	2009
<i>Fiscal policy</i>						
	As a percentage of GDP					
General government financial balance						
according to Maastricht definition	- 1.2	- 1.6	- 1.4	- 0.7	- 0.7	- 0.7
according to National accounts	- 1.3	- 1.7	- 1.5	- 0.8	- 0.8	- 0.8
General government primary balance	+ 1.6	+ 1.3	+ 1.4	+ 2.0	+ 2.0	+ 2.0
<i>Monetary policy</i>						
	Percent					
3-month interest rate	2.1	2.2	3.1	4.3	4.2	3.9
Long-term interest rate ¹	4.2	3.4	3.8	4.3	4.1	4.0
	Percentage changes from previous year					
Effective exchange rate						
Nominal	+ 1.5	- 0.7	+ 0.2	+ 1.1	+ 2.6	± 0.0
Real	+ 1.0	- 1.0	- 0.6	+ 0.8	+ 2.5	± 0.0

¹ 10-year central government bonds (benchmark).

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Projections - March 2008

World economy

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Real GDP						
World	+ 4.9	+ 4.4	+ 4.9	+ 4.7	+ 3.9	+ 3.6
Total OECD	+ 3.1	+ 2.5	+ 2.9	+ 2.4	+ 1.5	+ 1.6
USA	+ 3.6	+ 3.1	+ 2.9	+ 2.2	+ 1.0	+ 1.4
Japan	+ 2.7	+ 1.9	+ 2.4	+ 2.1	+ 1.3	+ 1.3
EU 27	+ 2.5	+ 1.9	+ 3.0	+ 2.9	+ 1.9	+ 1.6
Euro area 15	+ 2.1	+ 1.6	+ 2.8	+ 2.6	+ 1.6	+ 1.3
New member states ¹	+ 5.5	+ 4.7	+ 6.4	+ 6.0	+ 5.3	+ 5.0
China	+ 10.1	+ 10.2	+ 11.1	+ 11.4	+ 9.5	+ 8.5
World trade, volume	+ 10.5	+ 7.2	+ 8.7	+ 5.8	+ 5.3	+ 5.0
Market growth²	+ 9.4	+ 7.5	+ 11.0	+ 7.6	+ 5.8	+ 5.7
Primary commodity prices						
HWWI Index, total	+ 18.5	+ 28.5	+ 19.7	+ 3.7	+ 14	+ 3
Excluding energy	+ 18.1	+ 5.6	+ 22.0	+ 9.5	+ 13	+ 5
Crude oil prices						
Brent, USD per barrel	38.2	54.4	65.1	72.5	95.0	97.0
Exchange rate						
USD per euro	1.243	1.245	1.256	1.371	1.60	1.60

¹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia.

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

WIFO*Projections - March 2008***Private consumption, income and prices**

	2004	2005	2006	2007	2008	2009
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.8	+ 2.0	+ 2.1	+ 1.4	+ 1.6	+ 1.6
Durables	+ 4.0	+ 2.5	+ 1.9	+ 2.5	+ 3.0	+ 2.0
Non-durables and services	+ 1.5	+ 2.0	+ 2.1	+ 1.3	+ 1.4	+ 1.6
Household disposable income	+ 1.9	+ 2.6	+ 2.7	+ 2.2	+ 1.1	+ 1.3
Household saving ratio						
As a percentage of disposable income	8.9	9.3	9.7	10.3	10.1	9.8
	Percentage changes from previous year					
Direct lending to domestic non-banks¹	+ 5.0	+ 4.7	+ 4.5	+ 3.6	+ 3.5	+ 3.5
Inflation rate						
National	2.1	2.3	1.5	2.2	2.9	2.3
Harmonised	2.0	2.1	1.7	2.2	2.9	2.3
Core inflation ²	1.6	1.5	1.3	1.9	2.2	2.1

¹ End of period.² Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

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Productivity

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Total economy						
Real GDP	+ 2.3	+ 2.0	+ 3.3	+ 3.4	+ 2.1	+ 1.7
Employment ¹	+ 0.2	+ 0.8	+ 1.2	+ 2.2	+ 1.1	+ 0.5
Productivity (GDP per employment)	+ 2.2	+ 1.2	+ 2.1	+ 1.2	+ 1.0	+ 1.2
Manufacturing						
Production ²	+ 2.3	+ 3.2	+ 8.8	+ 7.2	+ 3.0	+ 2.8
Employees ³	- 0.6	- 0.8	+ 0.2	+ 2.6	+ 0.3	- 1.2
Productivity per hour	+ 2.1	+ 4.6	+ 8.4	+ 4.2	+ 3.0	+ 4.0
Working hours per day per employee ⁴	+ 0.8	- 0.6	+ 0.2	+ 0.3	- 0.3	± 0.0

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

² Value added, volume.

³ According to Federation of Austrian Social Security Institutions.

⁴ According to 'Konjunkturerhebung' of Statistics Austria.

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Earnings and international competitiveness

Percentage changes from previous year

	2004	2005	2006	2007	2008	2009
Gross earnings per employee ¹	+ 1.8	+ 2.3	+ 2.7	+ 2.7	+ 3.3	+ 3.0
Gross real earnings per employee ¹	- 0.0	+ 0.6	+ 1.1	+ 0.6	+ 0.4	+ 0.7
Net real earnings per employee ¹	- 0.0	+ 1.2	+ 0.5	+ 0.1	- 0.1	+ 0.3
<i>Total economy</i>						
Unit labour costs	- 0.6	+ 1.2	+ 0.4	+ 1.5	+ 2.5	+ 1.8
<i>Manufacturing</i>						
Unit labour costs	- 0.7	- 0.0	- 4.2	- 1.8	+ 0.8	- 0.8
Relative unit labour costs ²						
Vis-à-vis trading partners	+ 2.0	+ 0.8	- 2.4	- 0.4	+ 0.4	- 1.1
Vis-à-vis Germany	+ 2.4	+ 2.6	- 1.5	+ 1.2	+ 0.5	- 0.4
Effective exchange rate - manufactures						
Nominal	+ 1.5	- 0.6	+ 0.2	+ 1.2	+ 2.6	± 0.0
Real	+ 1.1	- 0.9	- 0.5	+ 0.8	+ 2.5	+ 0.1

¹ Employees according to National Accounts definition.

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

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Labour market

Changes from previous year (1,000^s)

	2004	2005	2006	2007	2008	2009	
Demand for labour							
Persons in active employment ¹	+ 25.1	+ 37.2	+ 55.9	+ 66.9	+ 62.0	+ 24.0	
Employees ²	+ 21.1	+ 31.9	+ 51.5	+ 65.5	+ 58.0	+ 22.0	
<i>Percentage changes from previous year</i>	+ 0.7	+ 1.0	+ 1.7	+ 2.1	+ 1.8	+ 0.7	
Nationals	+ 9.2	+ 20.0	+ 35.0	+ 43.6	+ 38.0	+ 12.0	
Foreign workers	+ 11.9	+ 11.9	+ 16.5	+ 21.9	+ 20.0	+ 10.0	
Self-employed ³	+ 4.0	+ 5.3	+ 4.4	+ 1.4	+ 4.0	+ 2.0	
Labour supply							
Population of working age (15 to 64 years)	+ 34.4	+ 15.6	+ 18.5	+ 15.5	+ 19.8	+ 20.2	
(15 to 59 years)	+ 35.6	+ 48.5	+ 52.8	+ 17.0	+ 10.2	+ 13.7	
Labour force ⁴	+ 28.9	+ 45.9	+ 42.4	+ 50.0	+ 52.0	+ 36.0	
Surplus of labour							
Registered unemployed ⁵	+ 3.8	+ 8.8	- 13.5	- 16.9	- 10.0	+ 12.0	
1,000 ^s	243.9	252.7	239.2	222.2	212.2	224.2	
Unemployment rate							
Eurostat definition ⁶	percent	4.8	5.2	4.7	4.4	4.2	4.3
Percent of total labour force ⁵	percent	6.4	6.5	6.1	5.6	5.3	5.5
National definition ^{5,7}	percent	7.1	7.3	6.8	6.2	5.9	6.2
Employment rate							
Persons in active employment ^{1,8}	percent	62.3	62.8	63.6	64.6	65.4	65.6
Total employment (Eurostat) ^{6,8,9}	percent	67.8	68.6	70.2	71.4	72.1	72.3

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

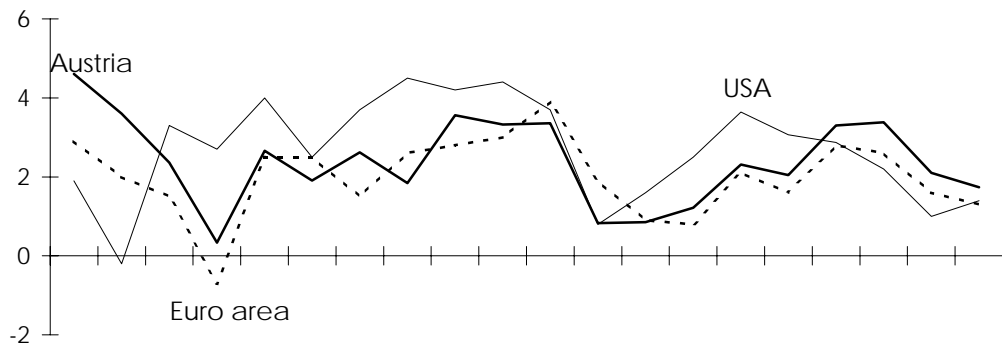
⁵ According to Public Employment Service Austria. ⁶ According to Eurostat Labour Force Survey.

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

⁹ Changed survey method.

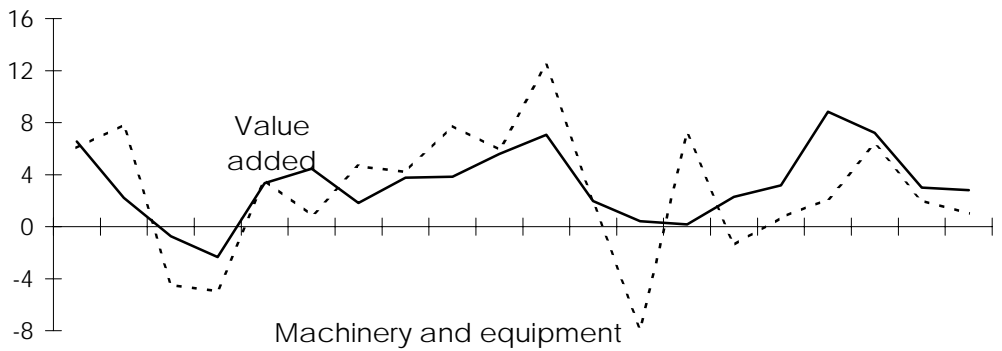
Growth of real GDP

Percent



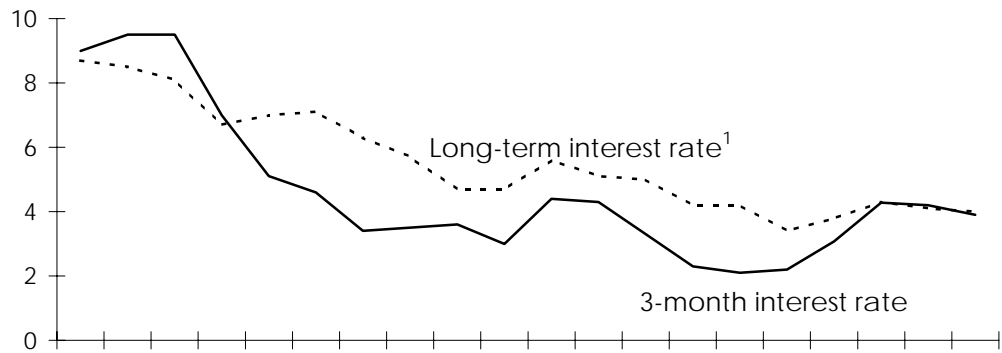
Manufacturing and investment

Percentage changes from previous year, volume



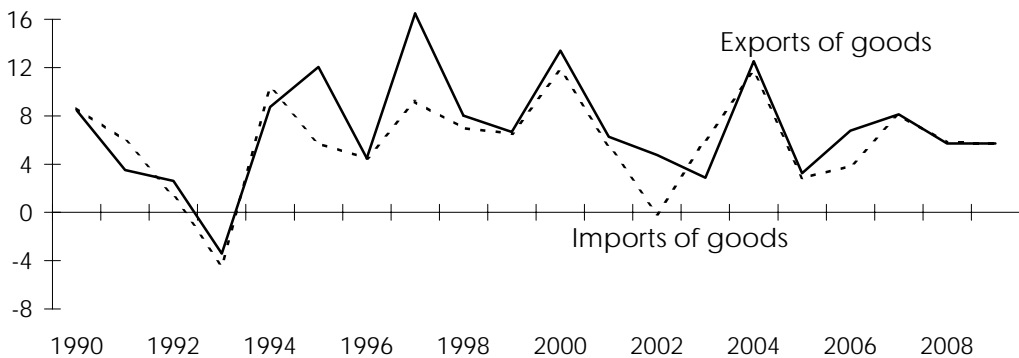
Short-term and long-term interest rates

Percent



Trade

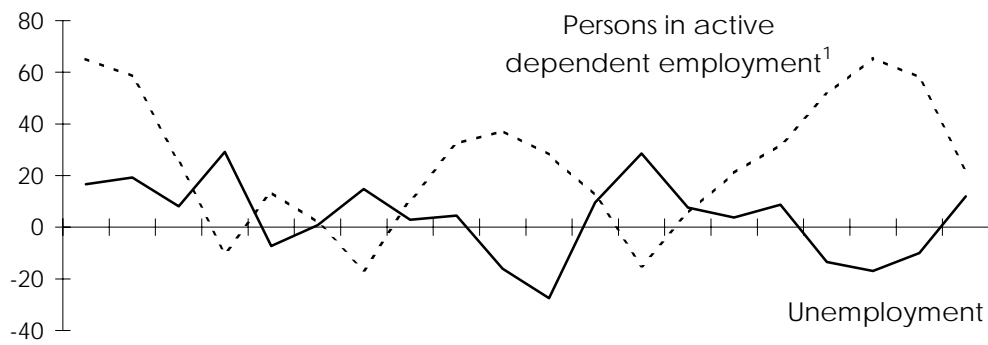
Percentage changes from previous year, volume



¹ 10-year central government bonds (benchmark).

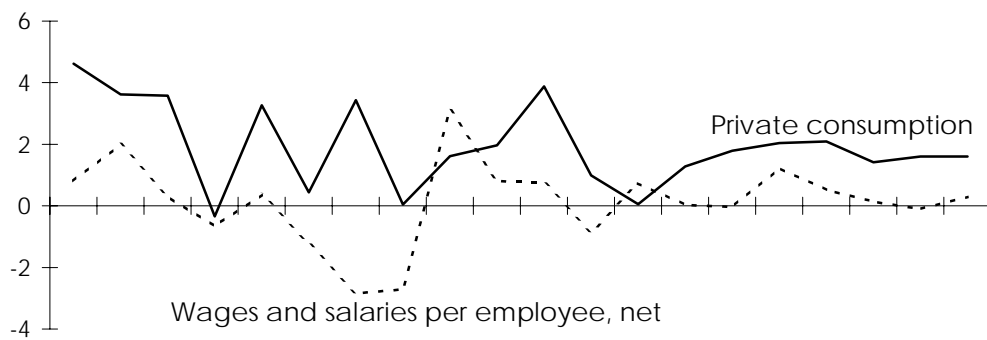
Employment and unemployment

1,000^s from previous year



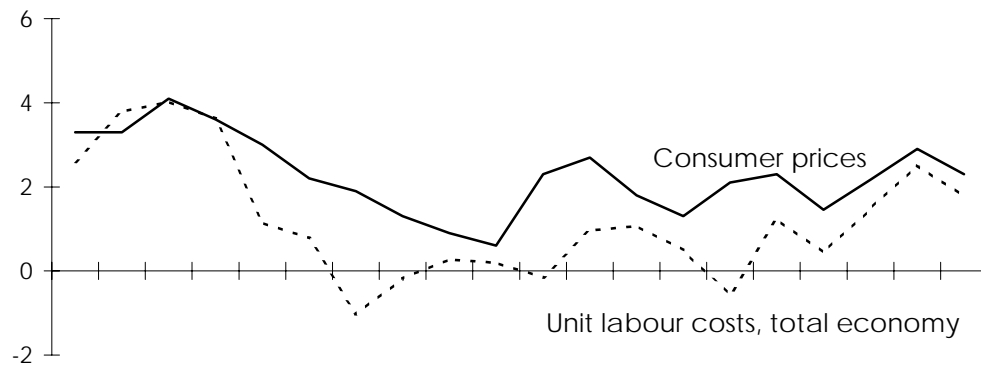
Consumption and income

Percentage changes from previous year, volume



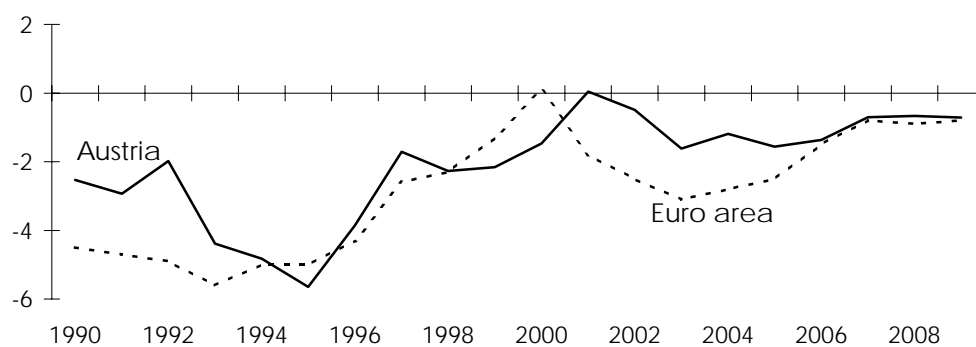
Inflation and unit labour costs

Percentage changes from previous year



General government financial balance

As a percentage of GDP



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

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