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# Cyclical Boom to Continue – Substantial Improvement on the Labour Market

## Economic Outlook for 2007 and 2008

**The strong cyclical activity of last year is extending into 2007. After an increase of 3.2 percent in 2006, real GDP is expected to grow by 3.0 percent this year. While exports are slightly losing momentum, investment is gaining strength. Private household consumption is also picking up, though trailing the overall rate of economic growth. The positive trend on the labour market continues, with a further considerable gain in the number of new jobs and a continued fall in unemployment. In 2008, economic growth is set to moderate to a rate of 2.4 percent.**

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The regular WIFO business survey among domestic companies shows still no sign of slackening of the current lively economic activity. The strong momentum of demand and output will boost Austrian real GDP again by 3 percent this year. Only by 2008, the deceleration in the USA and the strength of the euro will dampen the pace of growth in the EU and in Austria.

Manufacturing and construction are the sectors currently posting the strongest expansion, with construction activity having also been sustained by the mild weather in the first quarter. Likewise, business services, to which also belong the cyclically sensitive personnel service agencies, benefit from booming activity to an above-average degree.

With the slackening of business activity in the USA, export demand is set to ebb in the course of the year, although strength within the euro area will dampen the negative repercussions on Austria's foreign trade. Exports of goods are projected to increase by 8¼ percent in volume this year, abating to a gain of 7 percent in 2008.

Both the semi-annual WIFO investment survey and the quarterly business survey among capital goods manufacturers indicate an extraordinary strength of investment demand. WIFO expects purchases of machinery and equipment to go up by 8 percent in 2007 and by 4½ percent in 2008. Construction investment, instead, will decelerate from +4½ percent last year to +3½ percent in 2007 and further to +2½ percent in 2008.

At a projected rate of 2¼ percent, consumption of private households will pick up from last year, although the upswing remains relatively modest when compared with previous cyclical episodes. A genuine business cycle upturn will only be attained when consumer demand starts to rebound strongly. Labour incomes are boosted mainly by the rising number of jobs, while the increase in hourly wages remains subdued. The moderate wage development accounts for the absence of cost pressure, while the resulting sluggishness of private consumption holds down prices from the demand side. Against this background, inflation will hardly accelerate.

The labour market is reacting unusually strongly to the lively activity. The number of persons in dependent active employment is set to increase by 56,000 or 1.8 percent, while unemployment will fall by 23,000, pushing the jobless rate down to 6.1 percent

of the dependent labour force (4.2 percent according to Eurostat definition). Both trends are expected to continue at a somewhat slower pace in 2008, with employment rising by 25,000 or 0.8 percent and unemployment declining by 5,000 to a rate of 5.9 percent (4.1 percent, respectively).

Table 1: Main results

		2003	2004	2005	2006	2007	2008	
		Percentage changes from previous year						
<b>GDP</b>								
Volume		+ 1.1	+ 2.4	+ 2.0	+ 3.2	+ 3.0	+ 2.4	
Value		+ 2.4	+ 4.2	+ 3.9	+ 4.6	+ 4.8	+ 4.2	
<b>Manufacturing<sup>1</sup>, volume</b>								
		+ 0.1	+ 2.4	+ 2.4	+ 7.2	+ 6.0	+ 3.3	
<b>Wholesale and retail trade, volume</b>								
		+ 0.5	+ 1.3	+ 0.3	+ 1.3	+ 2.2	+ 2.0	
<b>Private consumption expenditure, volume</b>								
		+ 1.3	+ 1.9	+ 1.7	+ 1.8	+ 2.2	+ 2.0	
<b>Gross fixed investment, volume</b>								
Machinery and equipment <sup>2</sup>		+ 5.9	+ 0.6	+ 0.3	+ 4.7	+ 5.5	+ 3.4	
Construction		+ 6.8	- 0.7	+ 0.1	+ 4.9	+ 8.0	+ 4.5	
		+ 5.1	+ 1.6	+ 0.4	+ 4.6	+ 3.5	+ 2.5	
<b>Exports of goods<sup>3</sup></b>								
Volume		+ 2.6	+12.9	+ 2.2	+10.2	+ 8.3	+ 7.0	
Value		+ 1.9	+13.9	+ 5.4	+12.7	+ 9.4	+ 7.5	
<b>Imports of goods<sup>3</sup></b>								
Volume		+ 6.5	+11.4	+ 2.3	+ 7.2	+ 8.5	+ 6.5	
Value		+ 5.0	+12.5	+ 5.9	+10.8	+ 9.9	+ 7.4	
<b>Current balance</b>		billion €	- 0.48	+ 1.08	+ 3.24	+ 5.62	+ 6.01	+ 6.45
As a percentage of GDP			- 0.2	+ 0.5	+ 1.3	+ 2.2	+ 2.2	+ 2.3
<b>Long-term interest rate<sup>4</sup></b>		in percent	4.2	4.2	3.4	3.8	4.0	4.2
<b>Consumer prices</b>								
			+ 1.3	+ 2.1	+ 2.3	+ 1.5	+ 1.7	+ 1.8
<b>Unemployment rate</b>								
Eurostat definition <sup>5</sup>	in percent	4.3	4.8	5.2	4.7	4.2	4.1	
National definition <sup>6</sup>	in percent	7.0	7.1	7.3	6.8	6.1	5.9	
<b>Persons in active dependent employment<sup>7</sup></b>								
			+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.8	+ 0.8
<b>General government financial balance according to Maastricht definition</b>								
As a percentage of GDP			- 1.6	- 1.2	- 1.5	- 1.1	- 1.0	- 1.0

Source: WIFO Economic Outlook. – <sup>1</sup> Value added, including mining and quarrying. – <sup>2</sup> Including other products. – <sup>3</sup> According to Statistics Austria. – <sup>4</sup> 10-year central government bonds (benchmark). – <sup>5</sup> According to Eurostat Labour Force Survey. – <sup>6</sup> According to Public Employment Service Austria, as a percentage of total labour force excluding self employed. – <sup>7</sup> Excluding parental leave, military service, and unemployed persons in training.

Thanks to the strong growth of demand and output, the general government deficit narrowed markedly in 2006, to a ratio of 1.1 percent of GDP. In the current year, too, tax revenues will post strong gains, lowering the deficit ratio to 1 percent. The present projections were made before information on the Federal budget drafts for 2007 and 2008 became available. Thus, notably the assumption of the deficit remaining unchanged at 1 percent of GDP in 2008 is surrounded by a considerable margin of uncertainty.

In 2007, the world economy will expand by close to 5 percent, broadly keeping the momentum of the last three years. Only in 2008, growth is likely to moderate somewhat to a rate of 4½ percent.

In the USA, signs are for a marked cyclical slowdown. After a strong increase of GDP in the first quarter 2006 (by 1.4 percent in volume quarter-on-quarter, on a seasonally-adjusted basis), total output edged up by only ½ percent each in the following three-month periods. The deceleration was caused by a sharp fall in housing investment, which gained further momentum in the course of the year. In the fourth quarter 2006, investment in machinery and equipment also declined. Although private

## Marked slowdown of US growth

consumption is still supporting activity, the fall in real estate prices and the deceleration of economic activity will weigh on household spending with a lag. The only stimulus will then come from exports, which benefit from the weaker dollar. In the fourth quarter, exports rose by a seasonally-adjusted 1.1 percent in volume from the previous period.

As in the past, the US Central Bank is likely to react to the cyclical slowdown by cutting the (currently high) key interest rates. While this should cushion the downturn, the dollar may further depreciate, notably against the euro as the ECB contributes additionally towards narrowing the USA – euro area interest rate differential by raising its reference rate. An exchange rate of \$ 1.33 per euro in 2007 and of \$ 1.40 per euro for 2008 is underlying the WIFO projections.

*In 2007, the world economy is set to grow at a similar pace as last year, with lively activity in Europe offsetting a slowdown in the USA. Activity in China is also expected to slacken.*

Table 2: World economy

	2003	2004	2005	2006	2007	2008	
	Percentage changes from previous year						
<i>Real GDP</i>							
World total	+ 4.1	+ 5.3	+ 4.9	+ 5.0	+ 4.8	+ 4.6	
Total OECD	+ 2.0	+ 3.2	+ 2.6	+ 3.2	+ 2.7	+ 2.4	
USA	+ 2.5	+ 3.9	+ 3.2	+ 3.3	+ 2.0	+ 2.3	
Japan	+ 1.4	+ 2.7	+ 1.9	+ 2.2	+ 1.9	+ 1.6	
EU 27	+ 1.3	+ 2.4	+ 1.7	+ 2.9	+ 2.9	+ 2.4	
EU 15	+ 1.1	+ 2.3	+ 1.5	+ 2.7	+ 2.7	+ 2.2	
Euro area	+ 0.8	+ 2.0	+ 1.4	+ 2.6	+ 2.7	+ 2.2	
Germany	- 0.2	+ 1.2	+ 0.9	+ 2.7	+ 2.5	+ 2.0	
New member states <sup>1</sup>	+ 4.0	+ 5.4	+ 4.6	+ 6.2	+ 5.5	+ 5.2	
China	+10.0	+10.1	+10.4	+10.7	+ 9.5	+ 9.5	
<i>World trade, volume</i>	+ 5.1	+10.3	+ 7.2	+ 9.3	+ 7.0	+ 6.5	
<i>Market growth<sup>2</sup></i>	+ 5.4	+ 9.1	+ 7.4	+10.3	+ 7.7	+ 6.7	
<i>Primary commodity prices</i>							
HWVA index, total	- 4	+18	+29	+19	- 4	- 4	
Excluding energy	- 6	+18	+ 6	+22	- 1	- 4	
<i>Crude oil prices</i>							
Average import price (cif) for OECD countries	\$ per barrel	28.4	36.3	50.6	61.1	61.0	62.0
<i>Exchange rate</i>							
\$ per euro		1.131	1.243	1.245	1.256	1.33	1.40

Source: WIFO Economic Outlook. – <sup>1</sup> Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia. – <sup>2</sup> Real import growth of trading partners weighted by Austrian export shares.

The slowdown in the USA will dampen imports of consumer goods, which will be reflected in slower growth of world trade and also weigh on the Chinese economy. The latter is expected to expand by 9.5 percent both in 2007 and 2008, somewhat less than the rate of 10.7 percent recorded in 2006. In Japan also, demand and output will probably lose momentum, although a relapse into stagnation appears unlikely.

Latest developments on international oil markets fail to show a clear trend. The WIFO assumption is for an average OECD import price of \$ 61 and \$ 62 for 2007 and 2008, respectively, which is in line with a gentle upward long-term trend deemed plausible.

On 1 January, Bulgaria and Romania joined the EU. The group of new EU member states in East-central Europe has thereby been increased by two dynamically-expanding economies. For this area as a whole, WIFO projects GDP to grow by 5½ percent in volume in 2007 and 5¼ percent in 2008, after +6.2 percent in 2006. Apart from the ongoing catching-up process, the region is also benefiting from the cyclical upswing in the euro area.

**Cyclical high and catching-up process driving growth in East-central Europe**

In some countries, however, swift economic development is accompanied by growing imbalances. Thus in Poland, the largest of these economies, the current account deficit is widening more rapidly than warranted by the catching-up process. The major part of the deficit is financed via short-term capital whose volatility may potentially give rise to severe currency turbulence, with negative repercussions for the entire region. Such a risk scenario, the possible consequences of which are difficult to anticipate, has not been retained for the present projections.

Business surveys suggest that cyclical conditions in the euro area will remain favourable, at least until the middle of the year. Despite a gradual deceleration in the course of the second semester, GDP growth for the year as a whole will again attain 2¾ percent. While overseas exports provided the major stimulus last year, domestic investment should become the driving force in 2007.

Private consumption is also expected to strengthen in 2007, although the momentum remains relatively moderate for a cyclical high going into its second year. Household demand is benefiting from rising employment and low inflation. However, the increase in hourly wages typical for the present stage of the cycle is largely absent, mainly due to unemployment still being high in several countries and to heightened competitive pressure on international markets.

Wage moderation and the hesitant rebound of consumer demand keep inflation low – again in relation to the duration and strength of the upswing. In January and February 2007, the Harmonised Consumer Price Index for the euro area rose by only 1.8 percent year-on-year, remaining below the ceiling of 2 percent that the ECB considers compatible with price stability. The oil price hike has not triggered any second-round price effects, nor has lively activity given rise to higher inflationary pressure so far. In February, the ECB has nevertheless raised the key interest rate by ¼ percentage point, and underlying the projections is the assumption of a further increase by the same amount during the second half of the year.

The strong growth momentum is also reflected on the labour market. Employment in the euro area advanced by 1.4 percent in 2006 and unemployment receded. The favourable trend is set to continue this year.

Business conditions in the euro area should remain favourable also in 2008, although GDP growth is expected to moderate to 2¼ percent. The main reasons are lagged effects from the slowdown in the USA, the appreciation of the euro against major trading partner currencies and the persistent sluggishness of private consumption.

In 2006, the German economy enjoyed a strong cyclical revival. After having been caught in quasi-stagnation for years, GDP growth jumped to 2.7 percent. Pre-emptive purchases ahead of the VAT increase in early 2007 provided additional stimulus, with new car registrations rising by some 18 percent and retail sales rebounding markedly. As a counter-effect, new car registrations dropped by 13 percent year-on-year in the first two months of 2007 and retail sales by 6.8 percent in volume in January.

Nevertheless, business surveys confirm the continued robust activity in manufacturing and construction. Opinions on the current economic situation (excluding the retail sector biased by the one-off factors) virtually keep their extraordinarily high level.

With the positive development continuing, the situation on the German labour market is improving, thereby enhancing the prospects for a pick-up in consumer demand. Thus, the index of consumer confidence has been on a clear upward trend over the last few months. A rebound of this component of aggregate demand is a crucial requirement for the durability of the cyclical upswing, not only in Germany but in the euro area as a whole. So far, however, the signs for such a rebound are still lacking in Germany, although the latest economic data are difficult to interpret on account of the impact of the VAT increase. Moreover, hourly wages have not yet started to drift upwards, as would be typical at the present stage of the cycle.

*Growth in the new EU countries of East-central Europe will remain distinctly stronger over the forecast period than in the euro area. High current account deficits in some of these countries constitute a risk.*

### **Performance of the euro area staying strong, moderating only in 2008**

*In the euro area, growth remains robust this year. Internal demand is strengthening, thereby offsetting the slower growth of exports induced by the deceleration of external economic activity. The labour market situation keeps improving while inflation remains remarkably low.*

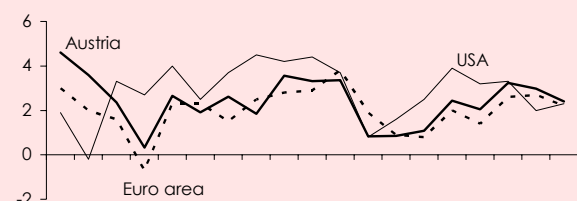
### **German economy is the EU growth engine also in 2007**

*Having been the laggard among the EU countries for several years, Germany has since last year regained its role as the engine of EU growth. While the one-off effect of the VAT increase will temporarily dampen activity in 2007, the underlying trend remains upward bound.*

Figure 1: Indicators of economic performance

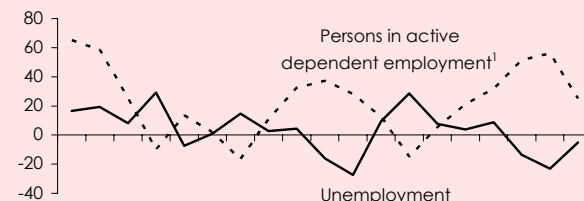
## Growth of real GDP

Percent



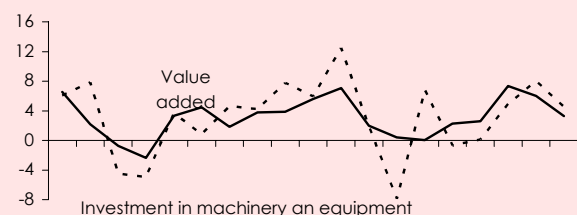
## Employment and unemployment

1,000 from previous year



## Manufacturing and investment

Percentage changes from previous year, volume



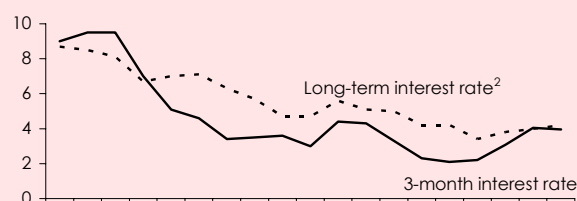
## Consumption and income

Percentage changes from previous year, volume



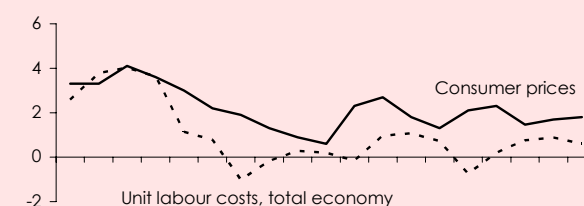
## Short-term and long-term interest rates

Percent



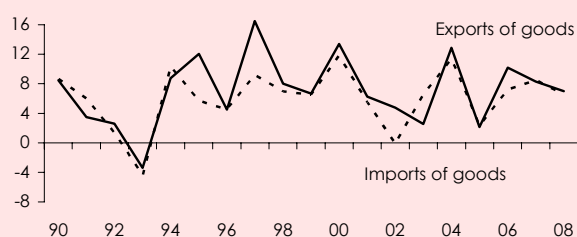
## Inflation and unit labour costs

Percentage changes from previous year



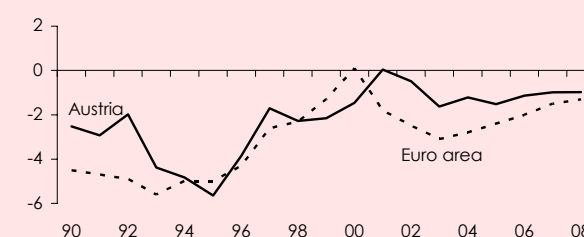
## Trade

Percentage changes from previous year, volume



## General government financial balance

As a percentage of GDP



Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> 10-year central government bonds (benchmark).

In line with the profile expected for the euro area, activity in Germany should slow somewhat in the course of 2007. Reasons are the cyclical weakening in the USA, the strength of the euro and the only modest increase in private consumption. GDP growth will nevertheless attain a rate of 2½ percent this year, abating to 2 percent in 2008.

The remarkably strong expansion of the Austrian economy since last year will continue in the coming months. It has received additional momentum in the first quarter when construction activity benefited from mild weather conditions. Although the

**Growth in Austria still robust in 2007**

relatively high temperatures were not favourable for winter sports, the tourism sector achieved the same excellent results as last year.

The WIFO survey among domestic manufacturers gives so far no hints for an imminent cyclical weakening. Particularly the investment goods manufacturers judge their current order levels as highly positive and are also optimistic about future developments. Although overseas demand is likely to slacken during the remainder of the year, lively activity in the euro area will make for further dynamism in foreign trade.

Table 3: Productivity

	2003	2004	2005	2006	2007	2008
	Percentage changes from previous year					
<i>Total economy</i>						
Real GDP	+ 1.1	+ 2.4	+ 2.0	+ 3.2	+ 3.0	+ 2.4
Employment <sup>1</sup>	- 0.0	- 0.0	+ 0.5	+ 1.4	+ 1.3	+ 0.4
Productivity (GDP per employment)	+ 1.1	+ 2.5	+ 1.6	+ 1.8	+ 1.7	+ 2.0
<i>Manufacturing</i>						
Production <sup>2</sup>	+ 0.1	+ 2.3	+ 2.6	+ 7.4	+ 6.0	+ 3.3
Employees <sup>3</sup>	- 1.7	- 0.6	- 0.8	+ 0.2	+ 0.7	- 0.1
Productivity per hour	+ 1.4	+ 2.0	+ 4.0	+ 6.6	+ 5.2	+ 3.4
Working hours per day per employee <sup>4</sup>	+ 0.3	+ 0.8	- 0.6	+ 0.5	+ 0.1	± 0.0

Source: WIFO Economic Outlook. – <sup>1</sup> Dependent and self-employed according to National Accounts definition. – <sup>2</sup> Value added, volume. – <sup>3</sup> According to Federation of Austrian Social Security Institutions. – <sup>4</sup> According to "Konjunkturerhebung" of Statistics Austria.

In 2006, goods exports rose by over 10 percent in real terms. The cyclical revival boosted demand for Austrian goods notably in Germany, Italy and the new EU member states in central and eastern Europe. Deliveries to the OPEC countries, to the USA, Canada and Japan were also buoyant. Exports to Germany profited from the front-loading of demand ahead of the VAT increase. Exports of engines rose at double-digit rates as from September 2006, car exports followed in the fourth quarter, exceeding the year-earlier level by around 20 percent, respectively, in November and December.

Merchandise exports are projected to increase by 8¼ percent in volume this year and 7 percent in 2008, which implies further gains in market shares, as recorded during the last years. With domestic demand picking up, imports of goods (+8½ percent) will even outpace export growth. In 2008, the relation should be reversed, when imports rise by 6½ percent<sup>1</sup>.

The investment planned by the corporate sector is mainly for the purpose of capacity increase. Demand for machinery and equipment will go up by an inflation-adjusted 8 percent this year, extending to motor vehicles as well as to machinery and electronic equipment. Next year, capital spending will move at a slower pace, rising by a projected 4½ percent in volume.

Already this year, investment in new structures is growing less rapidly than last year. Although mild weather in the first quarter 2007 boosted construction output, business surveys already point to a slowdown in the near future. Civil engineering in particular reported a fall in order levels in the latest round of the WIFO business survey. Also in the building sector, orders have been pointing down for some months, albeit from an extraordinarily high level. After an increase by 4.6 percent last year, construction investment remains vigorous this year, with a projected gain of 3½ percent, before slowing down to +2½ percent in 2008.

Following an expansion by 3.2 percent in 2006, Austrian GDP growth is expected at 3 percent this year. The projection for 2008 is for a deceleration to a rate of 2.4 percent.

## Investment becoming the driver of growth

Booming economic activity requires the expansion of productive capacities, leading to a strong increase in investment in 2007. Demand for construction will slacken, however, from 2006.

<sup>1</sup> In both years, goods imports include deliveries of military aircrafts (€ 500 million and € 900 million, respectively).

Private consumption is also benefiting to a rising extent from the favourable business conditions. An increase of 1.8 percent at constant prices last year will be followed by +2.2 percent this year, an altogether disappointing performance for the second year of a cyclical boom. Neither retail sales nor new car registrations suggest a stronger momentum of consumption so far. One reason may be seen in the sluggish growth of real disposable income of private households, rising by only 2.2 percent this year despite low inflation and strong employment gains. Growing demand for labour has so far not led to an increase in hourly wages. Like in the whole euro area, heightened competitive pressure on ever more closely integrated markets are likely to be a major factor.

### Consumer demand strengthening only tentatively

*Private disposable income is boosted by growing employment, but gains in hourly wages remain unusually low in the current benign cyclical conditions.*

Table 4: Private consumption, income and prices

	2003	2004	2005	2006	2007	2008
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 1.3	+ 1.9	+ 1.7	+ 1.8	+ 2.2	+ 2.0
Durables	+ 3.1	+ 5.1	+ 2.2	+ 1.7	+ 3.2	+ 2.3
Non-durables and services	+ 1.1	+ 1.5	+ 1.6	+ 1.8	+ 2.1	+ 2.0
Household disposable income	+ 2.1	+ 2.0	+ 2.1	+ 2.1	+ 2.2	+ 1.6
	As a percentage of disposable income					
Household saving ratio	8.6	8.8	9.1	9.4	9.4	9.1
	Percentage changes from previous year					
Direct lending to domestic non-banks <sup>1</sup>	+ 1.6	+ 5.0	+ 4.7	+4.5	+ 5.4	+ 5.0
	Percentage changes from previous year					
Inflation rate						
National	1.3	2.1	2.3	1.5	1.7	1.8
Harmonised	1.3	2.0	2.1	1.7	1.9	2.0
Core inflation <sup>2</sup>	1.3	1.6	1.5	1.3	1.8	1.9

Source: WIFO Economic Outlook. – <sup>1</sup> End of period. – <sup>2</sup> Excluding unprocessed food (meat, fish, fruits, vegetables) and energy items.

Household surveys confirm the strengthening of consumer confidence in Austria. In January and February, not only the partial index for the assessment of the general economic climate rose, but also the forward-looking indicators sampling the respondents' own financial situation and plans for major purchases in the months to come. An increase in private consumption beyond the WIFO projection may be financed by a lower saving ratio. With the cyclical high continuing, it also becomes more likely that the robust demand for labour will be reflected in higher wage increases.

Neither abroad nor in Austria did the jump in energy prices lead to a wage-price spiral. Indeed, inflation remained subdued. In 2006, crude oil on a euro basis cost some 20 percent more on average than the year before. Nevertheless, the consumer price index edged up by only 1.5 percent over the same period.

Despite the cyclical upturn continuing, price increases will remain modest overall this year. Despite the increase in the mineral oil tax as from the middle of the year, annual headline inflation will not exceed 1.7 percent. In the first two months of 2007, the consumer price index increased by only 1.6 percent and 1.7 percent year-on-year, respectively, although the partial index for "housing, water and energy" went up considerably due to substantial price increases for electricity and gas.

Heightened competitive pressure on many markets leaves little scope for price hikes. Thus, in the expenditure categories including goods produced in highly competitive markets, like "clothing and shoes", "transport" and "telecommunication", prices were either falling or rising below average.

The only small increase in hourly wages is holding back inflation in two ways: first through the below-average rise of a cost component, second via sluggish growth of household income and the resulting weakness of consumer demand. The result is an increase in consumer prices by only 1.7 percent on average for 2007. The trend is to continue into 2008, when the projected rate of inflation of 1.8 percent will again fall

### Inflation below 2 percent, despite lively activity and fuel tax increase

*The strong upward drift in oil prices over the last few years has so far not triggered second-round effects. Nor has the cyclical high led to higher inflation in Austria.*

short of the 2 percent benchmark. In both years, the increase in the mineral oil tax adds 0.1 percentage point to the inflation rate<sup>2</sup>.

Table 5: Earnings and international competitiveness

	2003	2004	2005	2006	2007	2008
	Percentage changes from previous year					
Gross earnings per employee <sup>1</sup>	+ 1.9	+ 1.9	+ 1.7	+ 2.6	+ 2.6	+ 2.5
Gross real earnings per employee <sup>1</sup>	+ 0.3	- 0.0	+ 0.0	+ 1.1	+ 0.9	+ 0.7
Net real earnings per employee <sup>1</sup>	+ 0.0	+ 0.1	+ 1.1	+ 0.5	+ 0.4	+ 0.2
<b>Total economy</b>						
Unit labour costs	+ 0.7	- 0.8	+ 0.2	+ 0.8	+ 0.9	+ 0.6
<b>Manufacturing</b>						
Unit labour costs	+ 0.8	- 0.8	- 0.6	- 3.9	- 2.3	- 0.6
Relative unit labour costs <sup>2</sup>						
Vis-à-vis trading partners	+ 3.6	+ 1.8	+ 0.9	- 2.3	- 1.6	- 1.0
Vis-à-vis Germany	+ 2.1	+ 2.2	+ 3.9	+ 0.1	- 0.2	- 0.1
<b>Effective exchange rate, manufactures</b>						
Nominal	+ 4.3	+ 1.5	- 0.6	+ 0.2	+ 0.7	+ 0.4
Real	+ 3.4	+ 1.0	- 0.9	- 0.5	+ 0.3	+ 0.2

Source: WIFO Economic Outlook. – <sup>1</sup> Employees according to National Accounts definition. – <sup>2</sup> In a common currency; minus sign indicates improvement of competitiveness.

Already last year, the labour market showed a clear improvement, as labour demand picked up as from the middle of the year. Employment growth accelerated and unemployment declined. In early 2007, the positive cyclical effect was reinforced by the unusually mild weather. This benefited particularly the construction sector, where in February employment rose by 10.2 percent (January +8.7 percent) above the year-earlier level, according to the statistics from the social insurance agency. For the whole year 2007, the increase in the number of persons in dependent active employment is projected at 56,000 or 1.8 percent; in 2008, it will moderate to +25,000 or 0.8 percent.

Labour supply continued to grow, but not at the same pace as employment. Therefore, the number of registered unemployed will once again fall markedly this year, by 23,000, having decreased by 13,500 in 2006, to a total 240,000. In 2008, the jobless figure will edge down further, albeit by only 5,000.

The unemployment rate (in the national definition) will fall from 6.8 percent last year to 6.1 percent in 2007 and 5.9 percent in 2008. According to the Eurostat calculation method, the downward trend is confirmed, but at a lower level, with the jobless rate abating from 4.7 percent to 4.2 percent and 4.1 percent, respectively.

The losses of corporate tax revenue expected to occur with a lag after the tax cuts of 2005 have so far not materialised. The high profits accruing with the cyclical upswing could compensate for such losses. Also yields from other taxes surprise on the upside. As a consequence, the general government deficit narrowed to 1.1 percent of GDP already last year.

In the current year, tax revenues remain buoyant, boosted further by the increase in the mineral oil tax. The present projections already include the measures of the "administrative reform II", but none of the other plans of the Federal government.

For 2008, the deficit-to-GDP ratio is expected to remain broadly unchanged from this year. However, this outlook is still subject to major uncertainty, since the draft Federal budget for 2007 and 2008 was still undisclosed by the cut-off date of the present forecast.

### Strong rise in employment, coupled with fall in unemployment

*The labour market is responding remarkably strongly to the favourable business conditions. Employment growth and decline in unemployment will both continue in 2008.*

### Strongly growing tax revenues reducing the budget deficit

<sup>2</sup> This projection is consistent with an increase in the mineral oil tax by either 0.03 € per litre (diesel) and 0.01 € per litre (petrol), or by 0.05 € and 0.03 €, respectively.



Table 6: Labour market

	2003	2004	2005	2006	2007	2008
	Changes from previous year, in 1,000					
<i>Demand for labour</i>						
Persons in active employment <sup>1</sup>	+ 8.5	+25.1	+37.2	+57.0	+61.0	+29.5
Employees <sup>2</sup>	+ 5.5	+21.1	+31.9	+51.5	+56.0	+25.0
<i>Percentage changes from previous year</i>	+ 0.2	+ 0.7	+ 1.0	+ 1.7	+ 1.8	+ 0.8
Nationals	- 10.4	+ 9.2	+20.0	+35.0	+37.2	+14.3
Foreign workers	+ 15.9	+11.9	+11.9	+16.5	+18.8	+10.7
Self-employed <sup>3</sup>	+ 3.0	+ 4.0	+ 5.3	+ 5.5	+ 5.0	+ 4.5
<i>Labour supply</i>						
Population of working age						
15 to 64 years	+ 37.7	+34.4	+15.6	+21.2	+20.3	+25.8
15 to 59 years	+ 21.2	+35.6	+48.5	+52.2	+24.9	+16.1
Labour force <sup>4</sup>	+ 16.1	+28.9	+45.9	+43.5	+38.0	+24.5
<i>Surplus of labour</i>						
Registered unemployed <sup>5</sup>	+ 7.7	+ 3.8	+ 8.8	-13.5	-23.0	- 5.0
In 1,000	240.1	243.9	252.7	239.2	216.2	211.2
	Percent					
<i>Unemployment rate</i>						
Eurostat definition <sup>6</sup>	4.3	4.8	5.2	4.7	4.2	4.1
As a percentage of total labour force <sup>5</sup>	6.3	6.4	6.5	6.1	5.5	5.3
National definition <sup>5,7</sup>	7.0	7.1	7.3	6.8	6.1	5.9
<i>Employment rate</i>						
Persons in active employment <sup>1,8</sup>	62.2	62.3	62.8	63.5	64.4	64.6
Total employment <sup>6,8,9</sup>	-	67.8	68.6	70.2	70.7	70.8

Source: WIFO Economic Outlook. – <sup>1</sup> Excluding parental leave, military service, and unemployed persons in training. – <sup>2</sup> According to Federation of Austrian Social Security Institutions. – <sup>3</sup> According to WIFO. – <sup>4</sup> Economically active employment plus unemployment. – <sup>5</sup> According to Public Employment Service Austria. – <sup>6</sup> According to Eurostat Labour Force Survey. – <sup>7</sup> As a percentage of total labour force, without self-employed. – <sup>8</sup> As a percentage of population of working age (15 to 64 years). – <sup>9</sup> Changed survey method.

On the back of lively economic growth, tax revenues will rebound strongly. The tax reform of 2005 has not yet led to any noticeable revenue losses, due to excellent corporate profits. The deficit as a ratio of GDP remains broadly constant over the forecast period.

Table 7: Key policy indicators

	2003	2004	2005	2006	2007	2008
	As a percentage of GDP					
<i>Fiscal policy</i>						
General government financial balance						
According to Maastricht definition	-1.6	-1.2	-1.5	-1.1	-1.0	-1.0
According to National Accounts	-1.8	-1.3	-1.6	-1.2	-1.1	-1.1
General government primary balance	+1.3	+1.6	+1.3	+1.6	+1.7	+1.7
	Percent					
<i>Monetary policy</i>						
3-month interest rate	2.3	2.1	2.2	3.1	4.1	4.0
Long-term interest rate <sup>1</sup>	4.2	4.2	3.4	3.8	4.0	4.2
	Percentage changes from previous year					
<i>Effective exchange rate</i>						
Nominal	+4.3	+1.5	-0.7	+0.2	+0.7	+0.4
Real	+3.3	+1.0	-1.0	-0.5	+0.3	+0.2

Source: WIFO Economic Outlook. – <sup>1</sup> 10-year central government bonds (benchmark).