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CYCLICAL RECOVERY EXPECTED TO PROCEED SMOOTHLY

ECONOMIC OUTLOOK FOR 2002 AND 2003

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Austrian Institute of Economic Research

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CYCLICAL RECOVERY EXPECTED TO PROCEED SMOOTHLY

ECONOMIC OUTLOOK FOR 2002 AND 2003

The business cycle recovery in the USA will give early incentives to activity in Europe during the first half of 2001, leading to a marked revival of demand and output growth. Such expectations are confirmed by survey results and statistical data collected over the past few months. The WIFO projection for economic growth from last December may therefore remain unchanged.

Domestic business activity is set to pick up smoothly in the course of this year. From quarter to quarter, real GDP should rise by a seasonally adjusted ½ to ¾ percent, yielding an annual growth rate of more than 2½ percent towards the end of the year. Due to the low starting level (negative statistical overhang from last year), the average growth rate in 2002 will only be 1.2 percent, while in 2003 the projected 2.8 percent would be clearly above the medium-term trend.

Underlying this forecast is a cyclical recovery in the USA and in Europe, which is being announced by key leading indicators, such as business sentiment in the major countries or the low interest rates. The major factor of uncertainty is currently the political unrest in the Middle East which may keep oil prices high or drive up still further.

The forecast for inflation has to be adjusted slightly upwards, as oil prices are exceeding earlier expectations. Consumer prices may rise by 1.7 percent this year, still 1 percentage point less than in 2001.

No turnaround is as yet visible on the labour market. Data for the annual average 2002 will be weaker than for last year. The rate of unemployment (as traditionally defined) will go up from 6.1 to 6.7 percent. Nevertheless, by 2003 employment should pick up significantly, allowing the jobless rate to fall.

Public finances have returned to balance in 2001, for the first time since 1974. The closing of the deficit has been achieved on the back of a sharp rise in the tax burden. In 2002 and 2003, budget deficits should remain close to zero. In the current year, the cyclical weakness is complicating the task of balancing the budget; in 2003, while economic conditions should be more favourable, some revenues will be lost as a number of temporary measures wear off. Thus, if budget balance is to be maintained, the scope for a tax reform is extremely limited.

U.S. recession swiftly overcome through counter-cyclical policy action

The U.S. economy slipped into recession in the second quarter 2001. Monetary and fiscal policies reacted decisively, such that the downturn was relatively quickly overcome, in spite of the shock caused by the terrorist attacks. Activity around the turn of the year was stronger than expected, and leading indicators are signalling further growth ahead.

In the USA, the business cycle has passed the lower turning point, and signs are mounting that a recovery is under way. De-stocking appears to have ended, and the index of purchasing managers, a key leading indicator, is rising steeply. There is a good deal of evidence to suggest that the recession in the USA which according to the National Bureau for Economic Research (NBER) started in March 2001, has run its course.

In the wake of the terrorist attacks, the Federal Reserve cut short-term interest rates aggressively, down to a low 1¾ percent. Real short-term rates converged towards zero, yielding a stimulatory effect in a similar way as during the 1991-92 recession. Thus, economic activity was surprisingly robust in the fourth quarter 2001, immediately after the attacks, with real GDP rising by 1.7 percent (seasonally adjusted annualised rate). Higher public spending (on defence) and private purchases boosted by low interest rates and special rebates were the main supporting forces.

Due to the unexpectedly robust activity around the turn of the year, the forecast for U.S. economic growth in 2002 may be revised upwards. GDP is likely to rise by 1¾ percent this year and by 3¼ percent in 2003. Judging by past experience, the low interest rates will stimulate construction activity, and the improvement in business confidence should give rise to a pick-up of investment. The further trend in private consumption is less certain, given the low household saving ratio and the rather volatile consumer sentiment.

For Japan, the projection requires a downward correction, as demand and output are set to decline further this year. Nevertheless, first signs of revival have become apparent in the manufacturing sector, following the depreciation of the yen. In South America, the severe crisis in Argentina has not spread to the whole continent, as has been the case in South-East Asia during the 1998 crisis.

European economy pulled by the upturn in the USA

Much as during the downturn, sentiment indicators in Europe and the USA are moving highly synchronised also in the nascent recovery, reflecting the globalisation of economic activity. International transmission channels are not confined to foreign trade, but also include investment activity, stock market trends and interest rates.

The European economy was lagging clearly behind the USA over the last cyclical expansion, but its subsequent downturn has also been less sharp. GDP in the EU rose by 1.7 percent in 2001 and is expected to advance at a similar 1.5 percent pace in 2002, before accelerating to almost 3 percent in 2003.

Over the second half of 2001, economic activity in the EU was broadly flat on a seasonally adjusted basis, the year-on-year increase was a modest 1 percent. Nearly all leading indicators show that a cyclical turnaround is now under way also in Europe. Business sentiment has improved over the last few months, underpinned by the pick-up in the USA, lower interest rates and the run-down of inventories. In the first instance, oil prices also had a stabilising influence on the cycle, before turning into a factor of uncertainty in recent weeks.

The "euroframe" indicator developed by a group of European economic research institutes suggests economic activity in the euro area may expand by 1.4 percent in the first and 1.8 percent in the second quarter, which rather appears to be the upper end of the likely range. In a critical phase of the cycle, negative shocks such as a jump in oil prices may still undermine a fragile recovery.

In 2001, differences in economic performance between EU countries have been marked. Spain, France and the U.K. registered growth of 2 to 2¾ percent, but Germany only a modest ½ percent, as GDP remained flat already in the second quarter 2001, edging down in seasonally adjusted terms over the remainder of the year.

While German exports rose relatively strongly in 2001, domestic demand was trailing the EU average, notwithstanding a lowering of the tax burden taking effect. Construction investment and firms' spending on machinery and equipment both dropped sharply. Since the beginning of the year, industrial confidence has started reviving, with the ifo business climate index heading up over the last months. On annual average 2002, German GDP is projected to rise by ¾ percent, accelerating to a rate of 2½ percent in 2003.

Sluggishness in key Western markets is adversely affecting also the countries in East Central Europe. The Polish economy is close to stagnation, whereas in Hungary growth is holding up much better. With the recovery in the EU gaining momentum, GDP growth in the candidate countries should attain 3 percent in 2003.

Vienna, 16 April 2002.

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Projections - April 2002

Main results

Percentage changes from previous year

		1998	1999	2000	2001	2002	2003
GDP							
Volume		+ 3.5	+ 2.8	+ 3.0	+ 1.0	+ 1.2	+ 2.8
Value		+ 4.1	+ 3.5	+ 4.2	+ 2.9	+ 2.4	+ 4.0
Manufacturing[1], volume		+ 4.4	+ 3.4	+ 7.3	+ 1.5	+ 1.5	+ 5.0
Private consumption expenditure, volume		+ 2.8	+ 2.7	+ 2.5	+ 1.3	+ 1.6	+ 2.3
Gross fixed investment, volume		+ 3.4	+ 1.5	+ 5.1	– 1.5	+ 0.3	+ 4.1
Machinery and equipment[2]		+ 6.4	+ 4.3	+ 11.1	– 0.8	+ 1.8	+ 7.0
Construction		+ 1.3	– 0.7	+ 0.3	– 2.2	– 1.0	+ 1.5
Exports of goods[3]							
Volume		+ 8.1	+ 7.7	+ 13.1	+ 5.4	+ 4.0	+ 8.5
Value		+ 8.4	+ 7.0	+ 15.6	+ 6.8	+ 4.5	+ 10.1
Imports of goods[3]							
Volume		+ 7.1	+ 6.9	+ 10.9	+ 2.9	+ 3.0	+ 7.6
Value		+ 6.6	+ 6.7	+ 14.7	+ 5.0	+ 3.5	+ 9.8
Current balance	€ bn	– 4.68	– 6.33	– 5.71	– 4.80	– 4.28	– 5.04
As a percentage of GDP	%	– 2.5	– 3.2	– 2.8	– 2.3	– 2.0	– 2.2
Long-term interest rate[4]	%	4.7	4.7	5.6	5.1	5.5	5.7
Consumer prices		+ 0.9	+ 0.6	+ 2.3	+ 2.7	+ 1.7	+ 1.4
Unemployment rate							
Percent of total labour force[5]	%	4.5	3.9	3.7	3.6	3.9	3.8
Percent of dependent labour force[6]	%	7.2	6.7	5.8	6.1	6.7	6.5
Dependent employment[7]		+ 1.0	+ 1.2	+ 1.0	+ 0.4	– 0.2	+ 0.8
General government financial balance							
As a percentage of GDP	%	– 2.5	– 2.4	– 1.7	– 0.1	– 0.4	± 0.0

[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.- [6] According to Labour Market Service.- [7] Excluding parental leave and military service.

Key policy indicators

	1998	1999	2000	2001	2002	2003
Fiscal policy						
	As a percentage of GDP					
Central government net balance	– 3.1	– 2.5	– 1.4	– 0.7	– 1.0	– 0.7
General government financial balance	– 2.5	– 2.4	– 1.7	– 0.1	– 0.4	± 0.0
General government primary balance	+ 1.4	+ 1.3	+ 2.0	+ 3.4	+ 3.0	+ 3.3
Public deficit/surplus according to Maastricht definition	– 2.4	– 2.3	– 1.5	+ 0.1		
Monetary policy						
	In percent					
3-month interest rate	3.6	3.0	4.4	4.3	3.5	4.2
Long-term interest rate[1]	4.7	4.7	5.6	5.1	5.5	5.7
	Percentage changes from previous year					
Effective exchange rate						
Nominal	2.8	1.5	-2.5	1.0	0.5	0.1
Real	0.3	-1.1	-3.6	0.1	0.0	-0.6

[1] 10-year central government bonds (benchmark).

World economy

Percentage changes from previous year

		1998	1999	2000	2001	2002	2003
Real GDP							
Total OECD		+ 2.7	+ 3.1	+ 3.8	+ 1.1	+ 1.5	+ 3.1
USA		+ 4.3	+ 4.1	+ 4.1	+ 1.2	+ 1.8	+ 3.3
Japan		– 1.1	+ 0.7	+ 2.4	– 0.5	– 1.0	+ 1.0
EU		+ 2.9	+ 2.6	+ 3.3	+ 1.7	+ 1.5	+ 2.9
Euro area		+ 2.9	+ 2.7	+ 3.4	+ 1.6	+ 1.4	+ 2.9
Germany		+ 2.0	+ 1.8	+ 3.0	+ 0.6	+ 0.8	+ 2.5
Central Eastern Europe[1]		+ 3.6	+ 3.2	+ 3.9	+ 2.5	+ 2.0	+ 3.0
World trade, volume		+ 5.6	+ 6.2	+ 12.9	+ 0.3	+ 3.0	+ 8.8
OECD exports		+ 5.5	+ 5.4	+ 12.0	– 0.3	+ 1.5	+ 8.0
Intra-OECD trade		+ 8.3	+ 7.8	+ 11.6	– 1.0	+ 1.0	+ 6.8
Market growth[2]		+ 11.3	+ 7.3	+ 13.0	+ 3.0	+ 3.0	+ 7.0
Primary commodity prices, in US$							
HWWA Index, total, 1990=100		– 22.0	+ 12.0	+ 31.0	– 11.0	– 1.0	+ 5.0
Excluding energy		– 13.0	– 8.0	+ 1.0	– 7.0	– 3.0	+ 3.0
Crude oil prices							
Average import price (cif) for OECD countries	US$/barrel	12.6	17.3	28.0	24.5	24.5	26.0
Exchange rate							
US$ per ECU/Euro		1.121	1.067	0.924	0.896	0.90	0.90

[1] Poland, Slovak Republic, Slovenia, Czech Republic, and Hungary.
[2] Real import growth of trading partners weighted by Austrian export shares.

Private consumption, income and prices

	1998	1999	2000	2001	2002	2003
	Percentage changes from previous year, volume					
Private consumption expenditure	+ 2.8	+ 2.7	+ 2.5	+ 1.3	+ 1.6	+ 2.3
Durables	+ 5.8	+ 9.4	+ 3.9	– 2.6	+ 1.5	+ 3.5
Non-durables and services	+ 2.3	+ 1.8	+ 2.3	+ 1.9	+ 1.6	+ 2.1
Household disposable income	+ 3.6	+ 2.2	+ 1.8	– 0.1	+ 1.6	+ 2.4
Household saving ratio						
As a percentage of disposable income	8.0	7.7	6.7	6.0	6.2	6.7
	Percentage changes from previous year					
Direct lending to domestic non-banks[1]	+ 3.7	+ 5.2	+ 6.7	+ 3.5	+ 3.8	+ 5.0
	In percent					
Inflation rate						
National	0.9	0.6	2.3	2.7	1.7	1.4
Harmonised	0.8	0.5	2.0	2.3	1.6	1.4
Core inflation[2]	1.2	0.6	1.0	2.3	2.0	1.6

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

Productivity

Percentage changes from previous year

	1998	1999	2000	2001	2002	2003
Total economy						
Real GDP	+ 3.5	+ 2.8	+ 3.0	+ 1.0	+ 1.2	+ 2.8
Employment[1]	+ 0.7	+ 1.2	+ 0.5	+ 0.2	– 0.2	+ 0.7
Full-time equivalent	+ 0.8	+ 1.0	+ 1.3	+ 0.1	– 0.3	+ 0.6
Productivity (GDP per employment)	+ 2.8	+ 1.5	+ 2.5	+ 0.8	+ 1.4	+ 2.1
Full-time equivalent	+ 2.7	+ 1.8	+ 1.6	+ 0.9	+ 1.5	+ 2.2
Manufacturing						
Production[2]	+ 4.5	+ 3.4	+ 7.2	+ 1.5	+ 1.5	+ 5.0
Employees[3]	+ 0.1	– 0.7	+ 0.0	+ 0.2	– 2.3	– 0.2
Productivity per hour	+ 4.3	+ 4.8	+ 7.3	+ 1.9	+ 3.9	+ 5.1
Working hours per day per employee[4]	+ 0.1	– 0.6	– 0.1	– 0.6	± 0.0	+ 0.1

[1] Dependent and self-employed according to National Accounts.-
[2] Value added.-
[3] According to Federation of Austrian Social Security Institution.-
[4] According to 'Konjunkturerhebung' of Statistics Austria.

Earnings and international competitiveness

Percentage changes from previous year

	1998	1999	2000	2001	2002	2003
Gross earnings per employee[1]	+ 3.0	+ 2.0	+ 2.5	+ 2.8	+ 2.5	+ 2.5
Full-time equivalent	+ 3.2	+ 2.4	+ 2.3	+ 3.0	+ 2.7	+ 2.8
Gross real earnings per employee[1]	+ 2.5	+ 1.2	+ 1.0	+ 0.4	+ 0.8	+ 1.1
Net real earnings per employee	+ 2.3	+ 4.3	+ 1.7	– 0.2	+ 0.3	+ 0.6
Net wages and salaries	+ 3.3	+ 3.7	+ 4.3	+ 2.5	+ 2.4	+ 3.0
Unit labor costs						
Total economy	– 0.2	+ 0.4	– 0.1	+ 2.0	+ 1.2	+ 0.0
Manufacturing	– 1.7	– 1.5	– 5.1	+ 0.9	– 0.7	– 1.8
Relative unit labor costs[2]						
Vis-à-vis trading partners	– 0.9	– 2.5	– 5.8	– 0.7	– 1.8	– 2.1
Vis-à-vis Germany	+ 0.4	– 1.1	– 2.4	– 0.1	– 1.2	– 1.8
Effective exchange rate - manufactures						
Nominal	+ 2.5	+ 0.6	– 2.7	+ 0.9	+ 0.3	± 0.0
Real	+ 0.5	– 1.3	– 3.5	+ 0.3	± 0.0	– 0.6

[1] Employees according to National Accounts definition.-
[2] Manufacturing, in a common currency; minus sign indicates improvement of competitiveness.

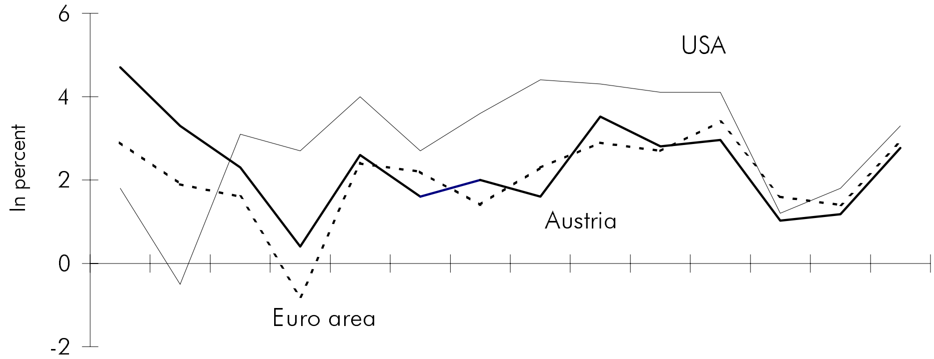
Labour market

Changes from previous year (in 1,000)

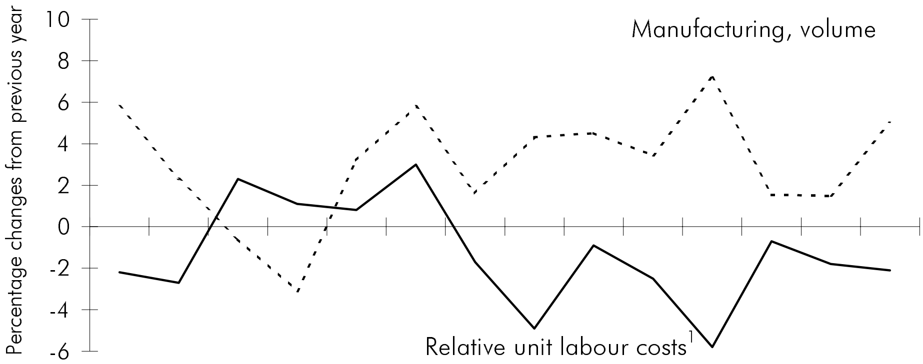
		1998	1999	2000	2001	2002	2003
Demand for labour							
Civilian employment		+ 22.1	+ 32.2	+ 27.7	+ 15.9	+ 7.1	+ 26.3
Excluding parental leave and military service		+ 30.8	+ 38.2	+ 30.8	+ 15.1	– 2.9	+ 26.3
Dependent employment[1]		+ 21.1	+ 31.2	+ 25.8	+ 14.4	+ 5.0	+ 24.0
Excluding parental leave and military service		+ 29.8	+ 37.2	+ 28.9	+ 13.6	– 5.0	+ 24.0
Percentage changes from previous year		+ 1.0	+ 1.2	+ 1.0	+ 0.4	– 0.2	+ 0.8
Parental leave and military service[1]		– 8.7	– 6.0	– 3.1	+ 0.8	+ 10.0	± 0.0
Foreign workers		– 0.2	+ 7.8	+ 13.4	+ 9.5	+ 4.0	+ 14.0
Self-employed[2]		+ 1.0	+ 1.0	+ 1.9	+ 1.5	+ 2.1	+ 2.3
Labour supply							
Economically active population	(15-64)	+ 11.0	+ 19.8	+ 25.2	+ 26.1	+ 22.9	+ 19.1
	(15-59)	+ 10.9	– 2.6	– 17.5	– 15.6	– 5.5	+ 3.1
Total labour force		+ 26.5	+ 16.2	+ 0.3	+ 25.5	+ 30.6	+ 18.3
Excluding parental leave and military service		+ 35.2	+ 22.2	+ 3.4	+ 24.7	+ 20.6	+ 18.3
Foreign		+ 0.7	+ 6.6	+ 12.0	+ 14.3	+ 9.5	+ 10.0
Migration of nationals		+ 3.9	+ 3.0	+ 1.0	± 0.0	± 0.0	± 0.0
Indigenous		+ 21.9	+ 6.6	– 12.7	+ 11.2	+ 21.1	+ 8.3
Excluding parental leave and military service		+ 30.6	+ 12.6	– 9.6	+ 10.4	+ 11.1	+ 8.3
Surplus of labour							
Registered unemployed[3]		+ 4.4	– 16.1	– 27.4	+ 9.6	+ 23.5	– 8.0
In 1,000		237.8	221.7	194.3	203.9	227.4	219.4
Unemployment rate							
Percent of total labour force[4]	%	4.5	3.9	3.7	3.6	3.9	3.8
Percent of total labour force[3]	%	6.5	6.0	5.3	5.5	6.1	5.8
Percent of dependent labour force[3]	%	7.2	6.7	5.8	6.1	6.7	6.5
Participation rate[5]	%	67.6	67.6	67.3	67.5	67.8	67.9
Excluding parental leave and military service[6]		70.7	71.2	71.5	72.2	72.7	73.0
Employment rate[7]	%	63.2	63.6	63.8	63.8	63.7	63.9
Excluding parental leave and military service[6]		66.1	66.9	67.7	68.2	68.2	68.7

[1] According to Federation of Austrian Social Security Institutions.- [2] According to WIFO.- [3] According to Labour Market Service.- [4] According to Eurostat.- [5] Total labour force as percent of active population (15-64).-
[6] As percent of population aged 15 to 59.- [7] Employment as percent of active population (15-64).

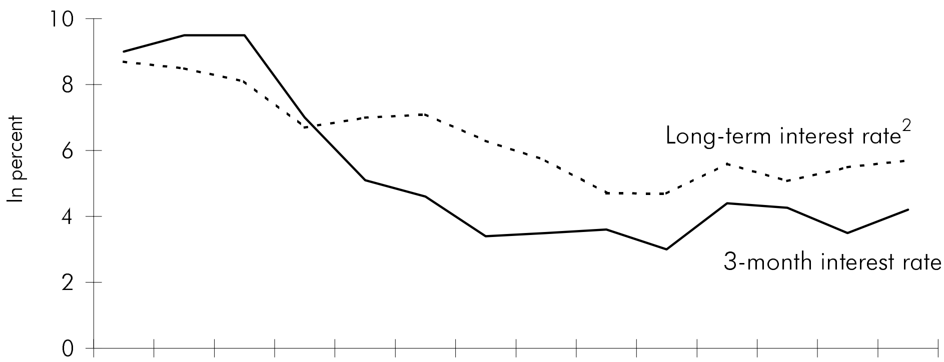
Growth of real GDP



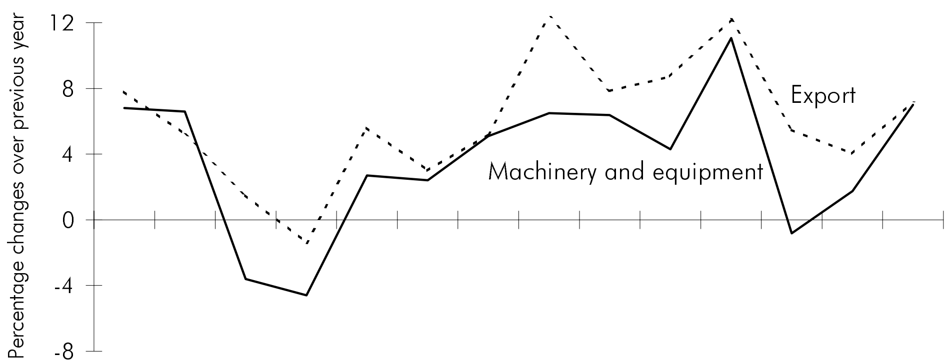
Competitiveness and manufacturing output



Short-term and long-term interest rates



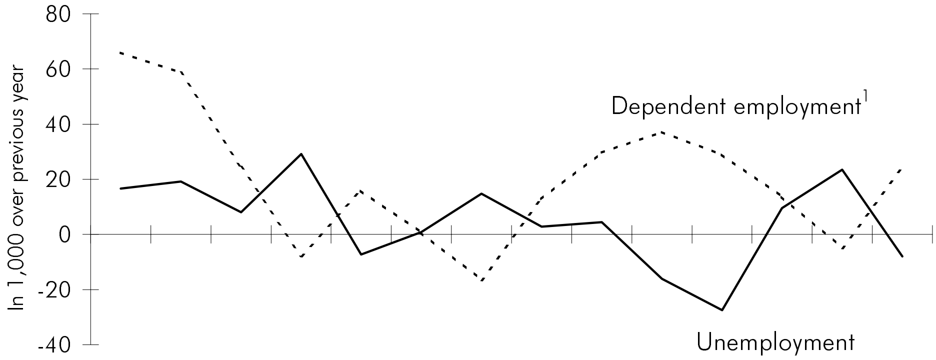
Exports and gross fixed investment (constant prices)



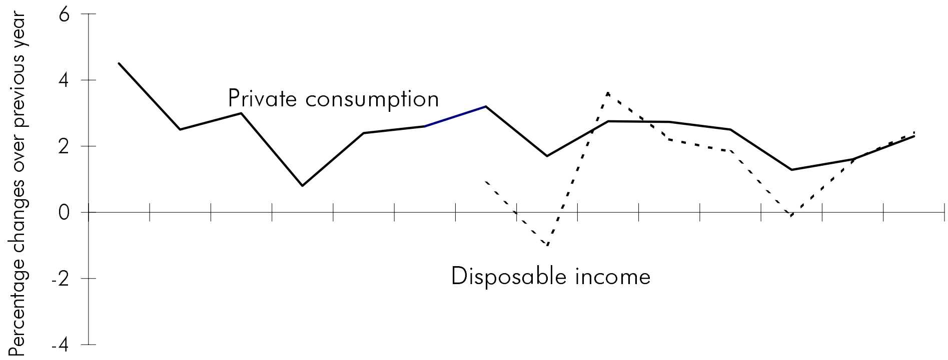
[1] Manufacturing; in a common currency vis-à-vis trading partners.–

[2] 10-year central government bonds (benchmark).

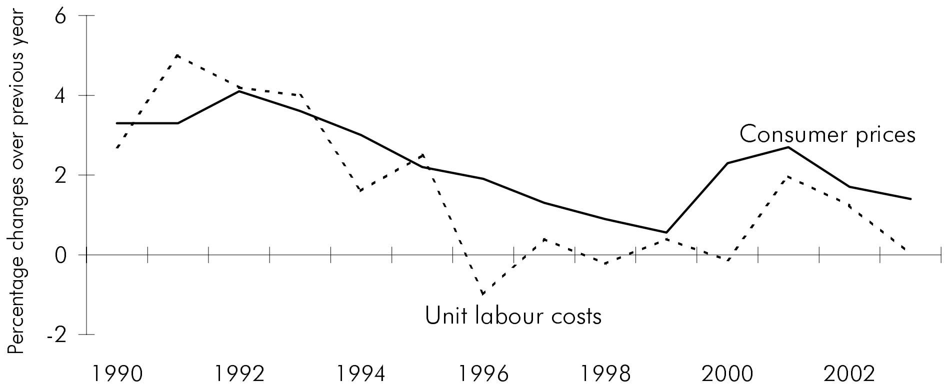
Employment and unemployment



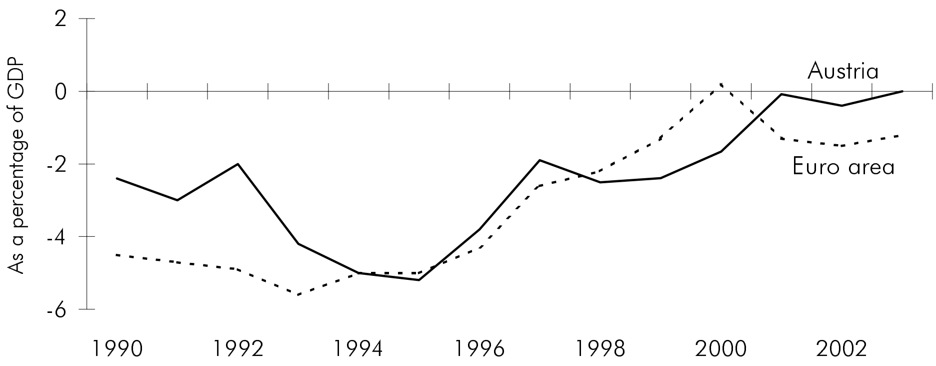
Consumption and income of private households (constant prices)



Inflation and unit labour costs



General government financial balance



[1] Excluding parental leave and military service.

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