Crisis of Confidence to Trigger Marked Slump in Growth in 2012

Economic Outlook for Austria from 2011 to 2013 (December 2011)

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1 Summary

The Austrian economy expanded vigorously in 2011. In its December 2011 economic outlook, the Oesterreichische Nationalbank (OeNB) projects real GDP growth to reach 3.3% in 2011. In 2012, owing to a severe deterioration in external conditions and to a crisis of confidence, real GDP growth is expected to amount to just 0.7%. In line with both the assumed international economic recovery and abatement in the loss of confidence related to the sovereign debt crisis, 2013 will see growth accelerate to 1.6%. Compared with the OeNB economic outlook of June 2011, this means economic prospects look much more unfavorable, with the outlooks for 2012 and 2013 downgraded by 1.6 and 0.9 percentage points, respectively.

In 2011, owing to steeper price increases in the service, food and energy sectors, HICP inflation will reach 3.5%. In 2012 and 2013, inflation, on the back of falling commodity prices, will ease significantly to 2.2% and 1.6%, respectively. In 2011, primarily for cyclical reasons and due to the dissipation of one-off effects, the budget balance will markedly improve from –4.4% to –3.1% of GDP. In 2012 and 2013, it will fluctuate around the 3% target (2012: –2.9%, 2013: –3.2%).

The growth outlook for the world economy has deteriorated significantly

Chart 1

Real GDP Growth (Seasonally and Working-Day Adjusted)

Quarterly change in %

Source: Eurostat, OeNB.

JEL classification: C5, E17
Keywords: forecast, Austria
Editorial deadline: November 25, 2011

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since summer 2011. The intensification of the debt crisis is coinciding with a slowdown in (still buoyant) emerging market growth. The financial markets look skeptical about the progress made in combating the debt problem, which is resulting in a reappraisal of risk and an increase in government bond yields. Although the U.S.A. is not threatened by the dangers of recession, the still very tight situation in the U.S. housing market and high household debt levels are dampening short- to medium-term growth prospects.

Economic activity in the *euro area* slowed down considerably following a healthy first quarter in 2011. Around the turn of 2011/2012, economic output is expected to stagnate, or even decline slightly, before returning to modest growth. This forecast is based on the assumption that the financial and sovereign debt crisis will neither intensify further nor find a quick resolution. Of the countries receiving financial assistance from the EU, only Ireland is currently on track to a modest recovery. Portugal is in the middle of a very tough phase of consolidation while the situation in Greece is deteriorating visibly.

Despite healthy economic fundamentals, *Austria's* economy will be badly hit by the consequences of the debt crisis and the crisis of confidence. As an export-led economy, Austria cannot decouple itself from the deteriorating international economic outlook. Following a very healthy first quarter in 2011, export growth decelerated significantly and is likely to stagnate by year-end. Far more sluggish export growth (+2.9%) is expected in 2012 (2011: +7.3%). In 2013, export growth should bounce back in line with the assumed revival of the international economy.

In the wake of the incipient recovery, the investment cycle slowly picked up in 2010 but lost momentum as early as mid-2011. Excess capacity, which was still extant until mid-2011, suggests that present investment in equipment was aimed at primarily replacing old equipment and directed less at boosting production potential. In 2012, in the wake of the crisis of confidence and the expected economic downturn, companies will postpone their investment plans and reduce their investment in equipment (–0.4%). The investment cycle was therefore unusually short and sluggish. A modest recovery in building construction, which is signaled by a growing number of building permits and recently steep rises in house prices, is not expected until 2012. The civil engineering sector is likely to recover somewhat earlier than the building construction industry. However, clear signs of an upturn are absent, as no additional impetus is coming from the public sector.

In 2011, private consumption suffered from high inflation. Real disposable household income barely rose despite high employment growth. Although the results so far of the fall 2011 round of wage negotiations indicate high growth in collectively agreed wages in 2012, overtime payments and other overpayments, which decline in a downturn, will dampen wage growth. In conjunction with sluggish employment growth and a lack of stimuli from both mixed and investment income, purchasing power will therefore not rise appreciably in 2012 despite a drop in inflation. Projected consumption growth of 1.0% (2011) and 0.7% (2012) can therefore only be financed by a decline in the savings ratio.

The labor market was unexpectedly favorable in 2010 and has been so in 2011 to date. New jobs were created in almost all sectors of the economy. Since mid-2011, however, key leading indicators have been signaling a trend reversal in the Austrian labor market. At 0.4%, employment growth will slacken appreciably in 2012 (2010: 1.5%). The complete liberalization of the Austrian labor market, which came into force in May 2011, generated an increase in labor supply by 20,000 persons according to current data. In 2011, the unemployment rate is expected to fall to 4.2%. In 2012, weak economic activity will mean unemployment will rise

Table 1

OeNB December 2011 Outlook for Austria – Key Results[1]

	2010	2011	2012	2013
Economic activity	*Annual change in % (real)*			
Gross domestic product	+2.3	+3.3	+0.7	+1.6
Private consumption	+2.1	+1.0	+0.7	+1.0
Government consumption	–0.2	+1.2	+0.6	+0.7
Gross fixed capital formation	+0.1	+3.9	+0.1	+2.0
Exports of goods and services	+8.4	+7.3	+2.9	+6.0
Imports of goods and services	+8.0	+7.2	+2.3	+6.1
	% of nominal GDP			
Current account balance	+3.0	+2.4	+2.9	+3.3
Contribution to real GDP growth	*Percentage points of GDP*			
Private consumption	+1.2	+0.5	+0.4	+0.6
Government consumption	+0.0	+0.2	+0.1	+0.1
Gross fixed capital formation	+0.0	+0.8	+0.0	+0.4
Domestic demand (excluding changes in inventories)	+1.1	+1.5	+0.5	+1.1
Net exports	+0.7	+0.5	+0.5	+0.4
Changes in inventories (including statistical discrepancy)	+0.4	+1.3	–0.3	+0.1
Prices	*Annual change in %*			
Harmonised Index of Consumer Prices (HICP)	+1.7	+3.5	+2.2	+1.6
Private consumption expenditure (PCE) deflator	+2.1	+3.0	+2.0	+1.6
GDP deflator	+1.8	+1.8	+2.3	+1.9
Unit labor costs in the total economy	+0.2	+0.5	+2.5	+1.0
Compensation per employee (at current prices)	+1.6	+2.3	+2.8	+2.0
Productivity (whole economy)	+1.4	+1.8	+0.3	+1.0
Compensation per employee (real)	–0.5	–0.7	+0.8	+0.4
Import prices	+4.9	+5.0	+1.1	+1.4
Export prices	+2.9	+3.6	+2.0	+1.7
Terms of trade	–1.8	–1.3	+0.8	+0.4
Income and savings				
Real disposable household income	–0.4	+0.3	+0.4	+1.6
	% of nominal disposable household income			
Saving ratio	8.4	7.6	7.3	7.7
Labor market	*Annual change in %*			
Payroll employment	+0.8	+1.7	+0.4	+0.6
	% of labor supply			
Unemployment rate (Eurostat definition)	4.4	4.2	4.5	4.5
Budget	*% of nominal GDP*			
Budget balance (Maastricht definition)	–4.4	–3.1	–2.9	–3.2
Government debt	71.8	71.7	72.8	73.8

Source: 2010: Eurostat. Statistics Austria; 2011 to 2013: OeNB December 2011 outlook.

[1] *The outlook was drawn up on the basis of seasonally adjusted and working-day adjusted national accounts data. Therefore. the historical values for 2010 may deviate from the nonadjusted data released by Statistics Austria.*

again to 4.5%, a level from which it will not budge in 2013. At these rates, unemployment in Austria is projected to be the lowest in the euro area in 2011, 2012 and 2013.

2 Technical Assumptions

This outlook is the OeNB's contribution to the December 2011 Eurosystem staff macroeconomic projections. The forecast horizon ranges from the fourth quarter of 2011 to the fourth quarter of 2013. All assumptions regarding the development of the global economy as well as the technical assumptions for interest rates, exchange rates and crude oil prices take into account developments up to and including November 18, 2011. The forecast was prepared with the OeNB's quarterly macroeconomic model and on the basis of seasonally and working-day adjusted national accounts data calculated by the Austrian Institute of Economic Research (WIFO), which were fully available up to the second quarter of 2011. Data for the third quarter of 2011 are based on GDP flash estimate, which covers only part of the aggregates in the national accounts, however. The short-term interest rates assumed for the forecast horizon are based on market expectations for the three-month EURIBOR, namely 1.4% in 2011, 1.3% in 2012 and 1.4% in 2013. Long-term interest rates reflect market expectations for government bonds with an agreed maturity of ten years, and have been set at 3.3% (2011), 3.8% (2012) and 4.1% (2013). The exchange rate of the euro vis-à-vis the U.S. dollar is assumed to remain at USD 1.36. The projected trend in crude oil prices is based on futures prices. The oil price assumed for 2011 is USD 111.5 per barrel (Brent), while assumed oil prices for 2012 and 2013 are set at USD 109.4 and USD 104.0, respectively. The prices of commodities excluding energy are also based on futures prices over the forecast horizon.

3 World Economy Hit by Financial and Sovereign Debt Crisis in Europe and the U.S.A. and by Slowing Momentum in Emerging Markets

3.1 Global Economic Recovery Loses Steam

The outlook for the world economy has deteriorated considerably since summer 2011. In addition to the intensifying European sovereign debt crisis, the debate about raising the U.S. debt ceiling helped trigger a loss of confidence. Financial market players do not see the measures implemented in Europe and the U.S.A. as sustainable solutions. Accordingly, many securities dropped sharply in price. Although emerging markets are still growing very rapidly compared with industrialized countries, they have also suffered from slowing economic momentum. In part, this cooling off is attributable to the restrictive monetary and fiscal policies being used to combat high inflation in emerging markets.

The *U.S.* economy grew very slowly in the first half of 2011. The third quarter of 2011, however, saw growth accelerate unexpectedly (+0.5% against the previous quarter). A contributory factor was the automotive industry, which boosted its production following interim product supply constraints induced by the Japanese earthquake. On the demand side, spending on consumer durables, exports and investment were growth drivers. Although the monetary policy of the Federal Reserve System (Fed) is very expansionary – with the federal funds target rate ranging between 0% and 0.25% – further monetary policy stimuli should not be expected. The still very tight situation in the U.S. housing market and high household debt levels are dampening the short- to medium-term growth outlooks. However, a slide into recession is not expected, since investment momentum is robust and residential construction investment is likely to have bottomed out. At 1.8%, U.S. growth in 2012 will be as high as in 2011.

After contracting as early as in the fourth quarter of 2010, the *Japanese* economy was badly hit by the earthquake disaster of March 2011. In the third quarter of 2011, however, direct production outages as a result of the earthquake were overcome, and GDP increased by 1.5% quarter on quarter. Japan's economic policy appears to be expansionary. In view of the earthquake, the Japanese government approved a comprehensive package of support measures. In addition, the Bank of Japan has acted to bolster the economy by purchasing government bonds and intervening in the foreign exchange market. For 2011 as a whole, however, negative growth is expected, with deflation continuing further.

China, notwithstanding moderately slowing growth in 2011, remains on track to extremely dynamic expansion. While the pace of export growth slowed markedly from almost 30% in 2010 to close to 12% in 2011, domestic demand is also playing an increasingly greater role. In addition to high investment momentum, private consumption is also becoming much more important thanks to considerable income growth. High inflation rates in China gave rise to a perceptible tightening in monetary policy. Against a background of easing inflation and the global economic downturn, no further tightening is expected, however.

Latin American countries are faced with slowing economic momentum as export growth declines. This phenomenon is attributable to industrialized countries' weak economic activity on the one hand and to a loss in price competitiveness due to currency appreciation on the other. By contrast, developments in domestic demand have been favorable. Nevertheless, growth in Latin America is expected to decelerate over the forecast horizon.

3.2 Euro Area Crisis Dampens Growth Outlook

Developments in Europe are currently very heterogeneous. EU Member States outside the euro area have higher average economic momentum than those within the euro area. Of the Central and Eastern European countries (CEECs), which have higher potential growth rates owing to their continuing catching-up process, Poland stands out, in particular. Given its robust domestic demand, the country was able to escape the impact of the financial crisis to a greater extent. Of the Scandinavian countries, Sweden best overcame the crisis. The combination of the Swedish krona's depreciation and an expansive monetary and fiscal policy has generated impressive growth following the crisis.

The *euro area* economy deteriorated significantly following a healthy first quarter in 2011. In both the second and third quarters of 2011, euro area economic growth came to no more than a mere 0.2%. In addition to the consolidation measures and loss of confidence related to the intensifying sovereign debt crisis, the cooling global economy and high energy price rises are responsible for this situation.

The situation in *Greece* has deteriorated dramatically in recent times. The savings measures which were agreed within the framework of the second support package and of which some have already been implemented did not cause the fiscal situation to stabilize to the extent expected. Greece is also currently suffering from a huge loss of international competitiveness. This means that, even on the assumption underlying this forecast that Greece does not unilaterally declare itself insolvent, 2012 will be the fifth year in a row when economic output has been on the decline.

In addition to Greece, Ireland and Portugal are currently also receiving financial aid from the EU. Of these three countries, *Ireland* is the only one on track to a modest recovery. Despite dramatic consolidation measures necessitated by the comprehensive bank rescue packages, the recession was overcome thanks to growth in external trade. A critical contributory factor was improved price competitiveness thanks to falling unit labor costs. *Portugal*, by contrast, remains in a very difficult period of adjustment. The savings measures are giving rise to a sharp decline in disposable household income, as large groups of transfer recipients are affected in addition to public sector employees. Further drastic consolidation measures are anticipated for 2012. As a result, the decline in GDP will accelerate appreciably in 2012.

In view of its government debt ratio of 120% of GDP and its sluggish growth, *Italy* is also suffering from a loss of confidence on the part of financial market players. Italian government bond prices have fallen perceptibly in recent months. Currently (as at November 22, 2011), yield spreads between Italian and German government bonds amount to 487 basis points. In conjunction with the sluggish growth

Table 2

Underlying Global Economic Conditions

	2010	2011	2012	2013
Gross domestic product	*Annual change in % (real)*			
World GDP growth outside the euro area	+5.7	+4.1	+3.9	+4.5
U.S.A.	+3.0	+1.8	+1.8	+2.5
Japan	+4.1	–0.3	+1.9	+1.7
Asia excluding Japan	+9.4	+7.3	+6.7	+7.4
Latin America	+6.0	+4.4	+3.5	+4.1
United Kingdom	+1.8	+0.9	+1.0	+2.0
New EU Member States[1]	+1.9	+3.1	+2.2	+3.0
Switzerland	+2.7	+1.9	+0.9	+1.6
Euro area[2]	+1.9	+1.5 to +1.7	–0.4 to +1.0	+0.3 to +2.3
World trade (imports of goods and services)				
World economy	+12.4	+6.9	+5.6	+7.1
Non-euro area countries	+13.6	+7.2	+5.6	+7.6
Real growth of euro area export markets	+11.8	+6.4	+4.8	+6.9
Real growth of Austrian export markets	+11.4	+6.7	+4.4	+6.4
Prices				
Oil price in USD/barrel (Brent)	79.6	111.5	109.4	104.0
Three-month interest rate in %	0.8	1.4	1.2	1.4
Long-term interest rate in %	3.2	3.3	3.8	4.1
USD/EUR exchange rate	1.33	1.40	1.36	1.36
Nominal effective exchange rate (euro area index)	104.63	104.63	103.70	103.70

Source: Eurosystem.

[1] *Member States that joined the EU in 2004 and 2007 and have not yet introduced the euro: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania. Since 2011: excluding Estonia.*

[2] *2011 to 2013: Results of the Eurosystem's December 2011 projections. The ECB publisches the projections as ranges based on historical forecast errors.*

of potential output in 2012, increased financing costs for companies and households will spell a decline in economic output.

While *Spain's* government debt is relatively small compared with that of Greece and Italy, the private sector steadily increased its debt in the wake of the credit-financed housing boom. Furthermore, the required correction of the long accumulated current account deficit dampens growth prospects. Although the Spanish economy will grow in both 2011 and 2012 after stagnating in 2010 (–0.1%), the pace of expansion will remain very subdued.

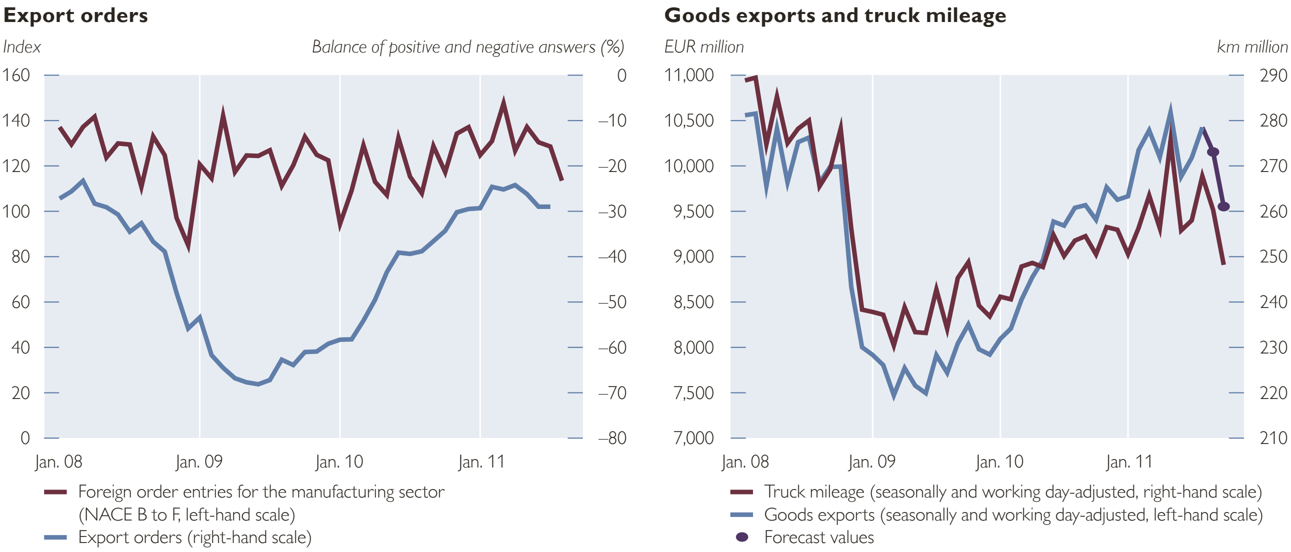
By contrast, *Germany*, the most important economy in the euro area, made an impressive recovery in 2010, which continued well into 2011. In the second quarter of 2011, exceptional factors (weather-induced decline in building investment and the shut-down of power stations after the earthquake disaster in Japan) triggered a significant downturn after a very strong first quarter. Nevertheless the underlying strong momentum was maintained into the third quarter of 2011. As an export-led economy, Germany is directly affected by its slackening export markets. Declining export order volumes indicate a significant dent in export growth by end-2011. As a direct consequence, hitherto very healthy investment activity will also cool, as companies will postpone planned increases in capital investment. The year 2012 will therefore see a significant slowdown in growth for Germany.

4 Austrian Exports Will Stall at End-2011

Austrian exports have still not completely recovered from their sharp slump during the economic and financial crisis of 2009, when the share of exports fell from 59% (2008) to 51% of GDP (2009). In 2010, Austrian companies succeeded in strongly boosting their exports, but, after a very healthy first quarter, export growth has slowed significantly in 2011. The results of the OeNB export indicator of November 2011 show a clear slump in goods exported in October 2011, suggesting a

Chart 2

Significant Slowdown in Exports Begins to Show



Source: OeNB, Statistics Austria.

Table 3

Growth and Price Developments in Austria's Foreign Trade

	2010	2011	2012	2013
	Annual change in %			
Exports				
Competitor prices in Austria's export markets	+5.2	+4.1	+1.3	+1.4
Export deflator	+2.9	+3.6	+2.0	+1.7
Changes in price competitiveness	+2.3	+0.4	–0.6	–0.3
Import demand in Austria's export markets (real)	+11.4	+6.7	+4.4	+6.4
Austrian exports of goods and services (real)	+8.4	+7.3	+2.9	+6.0
Market share	–3.0	+0.6	–1.5	–0.4
Imports				
International competitor prices in the Austrian market	+4.2	+3.9	+1.0	+1.4
Import deflator	+4.9	+5.0	+1.1	+1.4
Austrian imports of goods and services (real)	+8.0	+7.2	+2.3	+6.1
Terms of trade	–1.8	–1.3	+0.8	+0.4
	Percentage points of real GDP			
Contribution of net exports to GDP growth	+0.7	+0.5	+0.5	+0.4

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook, Eurosystem.

decline for the fourth quarter of 2011 as a whole. This picture is also supported by a slide in export orders. In the fourth quarter of 2011, however, total exports will stagnate owing to a rise in services exports.

For 2012 as a whole, owing to expected weaker export demand, export growth will decline sharply to 2.9%, with exports to the euro area growing far more sluggishly than exports to the rest of the world. In 2013, exports will bounce back strongly in line with the assumed global economic recovery. This means the exports-to-GDP ratio in 2013 will return to precrisis levels.

In 2011, owing to robust export growth and healthy investment activity, imports are expected to expand fairly vigorously (+7.2%). In 2012, both these import determinants will lose considerable steam, as a result of which import growth will slow markedly and not pick up until the expected recovery in 2013.

Austria's current account has steadily improved since the mid-1990s. After posting a record surplus of 4.9% of GDP in 2008, the current account balance deteriorated in 2009 owing to the sharp slump in exports. In 2011, the current account surplus will also

Table 4

Austria's Current Account

	2010	2011	2012	2013
	% of nominal GDP			
Balance of trade	3.5	3.3	4.0	4.3
Balance on goods	–1.1	–1.4	–0.8	–0.6
Balance on services	4.6	4.7	4.8	4.9
Balance on income	0.2	–0.1	–0.2	–0.2
Balance on current transfers	–0.7	–0.8	–0.8	–0.8
Current account	3.0	2.4	2.9	3.3

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

shrink on a year-on-year basis due to steep import price increases. For 2012, despite weak export growth, an improvement is expected, as import growth will lag behind export growth owing to the projected decline in investment.

5 Domestic Demand Remains Subdued

5.1 Investment Cycle Ends Prematurely

Austrian companies reduced their investment in equipment by 10% in the 2009 crisis year. At the same time, capacity utilization contracted sharply owing to the decline in demand. Investment activity slowly gathered momentum in the wake of the incipient recovery in 2010. Excess capacity, which was still extant until mid-2011, suggests however that this investment activity was aimed at primarily replacing old equipment and directed less at boosting production potential. Owing to their excellent profit situation, companies were able to finance a large part of this investment internally, which is why corporate lending growth significantly lagged behind precrisis levels. Lower sales expectations are prompting companies to postpone investment that is not absolutely necessary, which means investment in equipment will decline from the fourth quarter of 2011. As a result, the investment cycle was unusually short and sluggish. Recovery is not expected until the second half of 2012. However, equipment investment will decrease in 2012 (–0.4%) and not increase before 2013.

In 2011, building construction, despite growing robustly around mid-2011, will shrink for the third year in a row. Building permits and recently steep rises in housing prices nevertheless point to a slight recovery in building construction in 2012.

The civil engineering sector is likely to recover somewhat earlier than its building construction counterpart. However, clear signs of an upturn are absent, as no stimuli are expected from the public sector. According to their 2012 budget reports, the Austrian Rail-

Table 5

Investment Activity in Austria

	2010	2011	2012	2013
	Annual change in %			
Total gross fixed capital formation (real)	+0.1	+3.9	+0.1	+2.0
of which: Investment in plant and equipment	*+3.3*	*+4.5*	*–0.4*	*+3.3*
Residential construction investment	*–2.2*	*–0.3*	*+1.0*	*+0.5*
Nonresidential construction investment and other investment	*–2.7*	*+0.5*	*+0.2*	*+1.6*
Government investment	*–11.1*	*+2.4*	*+0.0*	*+0.0*
Private investment	*+0.8*	*+4.0*	*+0.1*	*+2.1*
	Contribution to real total gross fixed capital formation growth in percentage points			
Investment in plant and equipment	+1.2	+1.8	–0.2	+1.3
Residential construction investment	–0.5	–0.1	+0.2	+0.1
Nonresidential construction investment and other investment	–1.1	+0.2	+0.1	+0.6
Government investment	–0.6	+0.1	+0.0	+0.0
Private investment	+0.7	+3.8	+0.1	+2.0
	Contribution to real GDP growth in percentage points			
Inventory changes	+0.5	+0.2	–0.5	+0.1

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

ways (ÖBB), the ASFINAG road construction company and the federal real estate company BIG will cut their investments by EUR 400 million to EUR 3.6 billion. Local governments cannot act as pillars of the economy, either, owing to their often extremely tight budgetary situation.

5.2 Consumption Stabilizes at a Low Level

Owing to the still very favorable economic situation throughout the first six months of the year, total employment will rise steeply in 2011 (+1.5%). At 2.3%, wage growth, owing to modest wage settlements (+2.0%), was well below the inflation rate projected for 2011 despite a positive wage drift of 0.3%. This means private consumption will rise by a very modest 1.0%. However, even such modest growth is only attainable because of a recent decline in the savings ratio.

In 2012, high wage settlements (+3.3%) and low inflation will fuel household income. Owing to weak economic momentum, employment will, however, almost stagnate, and lower overpayments (overtime, bonuses, etc.) will dampen wage growth. Overall, real disposable household income will grow as strongly as in 2011. Even the weak consumption growth of 0.7% projected for 2012 is therefore only attainable because of a further decline in the savings ratio.

In 2013, given the anticipated economic recovery and further easing inflation, real household income should also climb somewhat more rapidly. Consumption growth, however, will not accelerate significantly, as households will attempt to adjust their savings ratio upward. The latter rose from less than 8% in 2002 to 11.5% before the outbreak of the crisis, only to fall back to roughly 2002 levels by 2011. Although this trend arises partly from households' desire to smoothen their consumption path, it was also determined by the composition of their household income. Along with investment and mixed income, income categories with a lower-than-average marginal propensity to consume grew disproportionately strongly in the pre-crisis years. Since the outbreak of the

Table 6

Determinants of Nominal Household Income in Austria

	2010	2011	2012	2013
	Annual change in %			
Employees	+0.8	+1.7	+0.4	+0.6
Wages per employee	+1.6	+2.3	+2.8	+2.0
Compensation of employees	+2.3	+4.1	+3.2	+2.7
Property income	–17.3	+3.3	–4.5	+3.4
Mixed income and operating surplus, net	+4.2	+3.9	+2.8	+4.0
	Contribution to disposable household income growth in percentage points			
Compensation of employees	+2.0	+3.4	+2.7	+2.3
Property income	–1.7	+0.3	–0.4	+0.3
Mixed income and operating surplus. net	+0.8	+0.8	+0.6	+0.8
Net transfers minus direct taxes[1]	+0.7	–1.2	–0.5	–0.2
Disposable household income (nominal)	+1.7	+3.2	+2.4	+3.2

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

[1] Negative values indicate an increase in (negative) net transfers minus direct taxes. positive values indicate a decrease.

Table 7

Private Consumption in Austria

	2010	2011	2012	2013
	Annual change in %			
Disposable household income (nominal)	+1.7	+3.2	+2.4	+3.2
Private consumption expenditure (PCE) deflator	+2.1	+3.0	+2.0	+1.6
Disposable household income (real)	–0.4	+0.3	+0.4	+1.6
Private consumption (real)	+2.1	+1.0	+0.7	+1.0
	% of nominal disposable household income			
Saving ratio	8.4	7.6	7.3	7.7

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

crisis, however, household income growth has been primarily fueled by the compensation of employees, the income category with the highest propensity to consume.

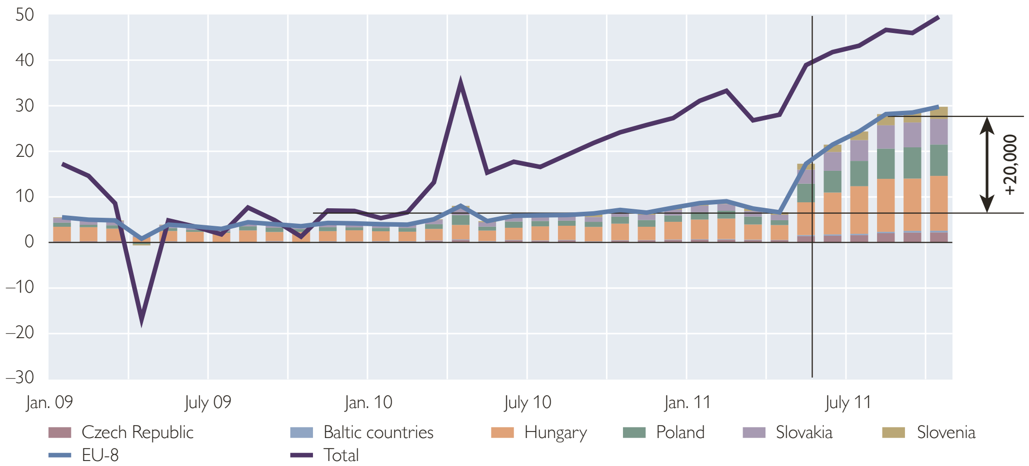
5.3 Robust Employment Growth Reduces the Unemployment Rate Only Slowly

In Austria, employment not only declined by a relatively small amount during the economic recession in 2009, it registered unexpectedly high growth in the ensuing upturn. This trend continued in 2011. New jobs were created in almost all sectors of the economy, with the goods, trade, employee leasing as well as health and social security sectors registering the strongest employment growth. To date (October 2011), employment momentum has remained unbroken. Among other factors, one of the reasons for this situation is likely to be the complete liberalization of the domestic labor market for persons from countries that joined the EU in 2004. About 20,000 additional workers from the new Member States have been registered since May 2011. How many of these new workers were active “unoffi-

Chart 3

Foreign Labor Supply by Country

Annual change in 1,000



Source: AMS (BALI data base).

Table 8

Labor Market Developments in Austria

	2010	2011	2012	2013
	Annual change in %			
Total employment	+0.9	+1.5	+0.4	+0.6
of which: Payroll employment	*+0.8*	*+1.7*	*+0.4*	*+0.6*
Self-employment	*+1.6*	*+0.3*	*+0.5*	*+0.5*
Public sector employment	*–0.2*	*–0.1*	*–0.1*	*–0.1*
Registered unemployment	–8.0	–0.1	+4.5	+2.3
Labor supply	+0.5	+1.5	+0.6	+0.7
	% of labor supply			
Unemployment rate (Eurostat definition)	4.4	4.2	4.5	4.5

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

cially" in the Austrian labor market prior to liberalization and have now been legalized and how many had really newly joined cannot be estimated precisely. Overall, however, the number of persons in payroll employment will rise by more than 60,000 in 2011 (+1.7%).

Since mid-2011, however, key leading indicators have been signaling a trend reversal in the Austrian labor market. For instance, the number of vacancies has been down since the third quarter of 2011 and the number of temporary employees registered as unemployed (in both cases, seasonally adjusted, on a quarterly basis) has been rising since the second quarter of 2011. For 2012 and 2013, therefore, much weaker employment growth of 0.3% and 0.6% is expected respectively, which also tallies with the projected cooling of the economy.

As in the past, labor supply will grow very procyclically over the forecast horizon, with the final opening-up of the labor market reinforcing this pattern in addition. Although almost 60,000 additional workers are expected in 2011, this number will more than halve in 2012 and 2013. From 2012, domestic demography will have a dampening effect on labor supply but will be more than offset by rising participation rates. The key factor for the growing labor supply remains the influx of foreign labor.

Austria continues to rank among those countries with the lowest unemployment rates in the euro area. In 2011, the unemployment rate (Eurostat definition) will stand at 4.2%. As a result of slowing growth, the unemployment rate will, however, climb from 4.1% in the second quarter of 2011 to 4.6% by end-2012, only to drop slightly thereafter. In 2012 and 2013, the rate will remain at 4.5%.

Box 1

Scenarios of Fiscal Development[1]

Scenario 1: Implications of the Debt Brake and the Stability and Growth Pact

In mid-November 2011 the Austrian federal government decided to constitutionally prescribe a debt brake for Austria, which is to take full effect from 2017 onward. According to the related government bill, a ceiling of 0.35% of GDP will be imposed on the structural deficit of Austria's central government (including social security institutions) from 2017, whereas regional and local governments' structural net lending/net borrowing will have to be at least balanced. Any deviations from this target will have to be booked to separate control accounts and corrected as directed by economic conditions. Unlike the nominal deficit targets laid down in the current Austrian Stability Pact, structural deficit targets should in particular counteract any incentives to pursue a procyclical fiscal policy.

According to the OeNB's economic outlook, Austria's structural deficit in 2012 will come to approximately 2.8% of GDP, a value that is still far above the 2017 target value of 0.35% of GDP. To be able to meet this target, the structural deficit would need to be reduced by an annual average of 0.5% of GDP. Further consolidation measures will also be necessary owing to the requirements Austria must fulfill according to the Stability and Growth Pact (annual improvement of the structural balance of at least ½% of GDP[2]) and under the excessive deficit procedure (by 2013 at the latest, the deficit-to-GDP ratio must be reduced to below 3%). Since the OeNB's economic outlook is based on a no-policy-change assumption, no additional measures have been assumed. The table below shows a scenario in which an austerity package of 0.5% of GDP (EUR 1.6 billion) is implemented in 2013.[3]

Effect of Fiscal Consolidation in 2013

	Volume	GDP	Budget balance
	% of GDP	*Annual change in %*	*% of GDP*
OeNB economic outlook		**1.6**	**–3.2**
Total effect	**0.5**	**–0.3**	**0.4**
Expenditure cuts	0.3	–0.2	0.2
Tax increases	0.2	–0.1	0.2
Forecast including fiscal consolidation		**1.3**	**–2.8**

Source: OeNB.

Scenario 2: Real Economy and Budget Effects of Higher Interest Rates

A major factor of uncertainty in the OeNB's present budget forecast is the expected development of Austrian government bond yields. Between early October and end-November 2011, Austrian government bond yields increased strongly and yield differentials against Germany, the Netherlands and Finland widened significantly. This increase has, for a large part, already been included in the forecast assumptions (table 2 in the main text). However, it cannot be excluded that market turmoil will further intensify. The table below shows the effects the public and the private sector would experience if short- and long-term interest rates were to increase steeply (i.e. by 100 basis points against the baseline scenario) in early January 2012.[4]

[1] Compiled by the Economic Analysis Division, lukas.reiss@oenb.at.

[2] This annual adjustment by ½% of GDP is necessary to realize the medium-term objective of achieving a structural balance of zero.

[3] The underlying assumption is that 40% of fiscal consolidation will be achieved by cutting back government transfers and negotiating lower wage settlements in the public sector, 20% by reducing other government consumption, 20% by raising indirect taxes and another 20% by increasing direct taxes.

[4] This scenario only analyzes the effects of higher interest rates in Austria (assuming unchanged interest rates in the rest of the world).

Simulations based on the OeNB's macroeconomic model illustrate the amount of macroeconomic costs associated with such a sudden interest rate increase. They also show that – in particular in the year 2013 – the indirect budgetary effects caused by the worse macroeconomic developments are significantly larger than the direct effects of higher interest payments, which can be explained by the relatively low volume of government bonds maturing in the years 2012 and 2013, among other factors.

Effect of a 100 Basis Point Interest Rate Increase on Austria

	GDP		Budget balance	
	2012	2013	2012	2013
	Annual change in %		*% of GDP*	
OeNB economic outlook	0.7	1.6	–2.9	–3.2
Total effect	–0.4	–0.5	–0.2	–0.4
Real economy effect	–0.4	–0.5	–0.1	–0.3
Increase in government financing costs	×	×	–0.1	–0.1
Forecast assuming higher interest rates	0.3	1.1	–3.1	–3.6

Source: OeNB.

6 Drop in Inflation in 2012 Determined Mainly by Energy

In 2011, average HICP inflation will amount to 3.5%. The steep rise in inflation in 2011 is primarily attributable to price increases in the service sector (particularly, hotel and restaurant services) and, to a lesser extent, to those in the food and energy sectors, with tax increases within the framework of the 2011 consolidation package contributing 0.4 percentage points to HICP inflation. In the food and energy sectors, above all, global commodity price rises were passed onto domestic consumer prices but some services (e.g. hotel and restaurant services) were also affected.

Inflation is expected to go down sharply to around 2.0% by the end of the first quarter of 2012 and should flatten to some extent by end-2012. Average HICP inflation of 2.2% is anticipated for 2012 as a whole.

The drop in inflation from 3.5% (2011) to 2.2% (2012) will be primarily attributable to developments in both the energy and service sectors and, to a lesser extent, to those in the food sector. This phenomenon will be primarily due to falling commodity prices and base effects (rise in service price inflation from fall 2010; 2011 consolidation package), which should now contribute significantly to the decline in HICP inflation. The relatively high collectively agreed wage settlements sealed in the 2011 fall round of wage negotiations should become apparent with core inflation (HICP inflation excluding unprocessed food and energy) rising only slightly in the course of 2012.

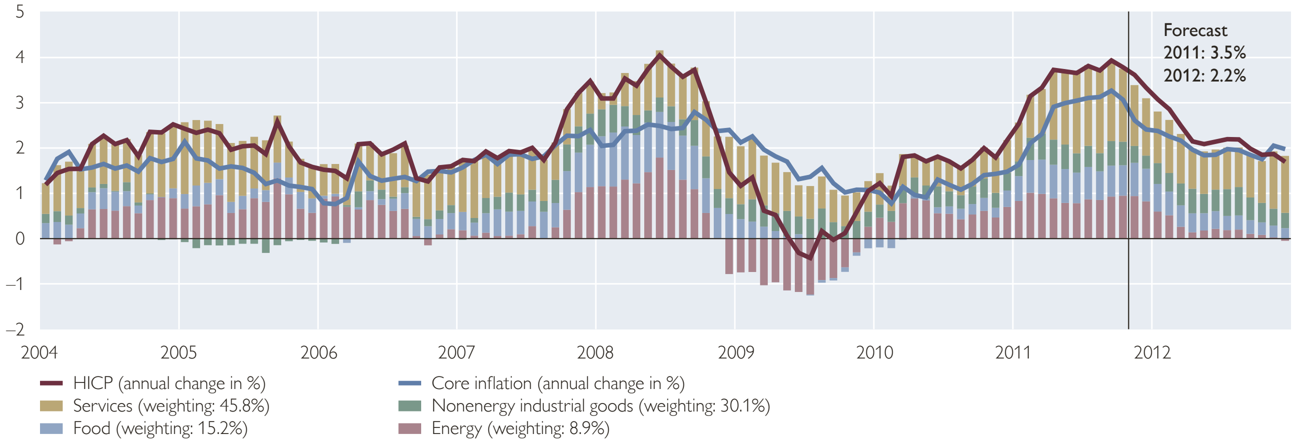
In 2011, changes in administered prices and those influenced by the public sector will contribute about 0.7 percentage points to HICP inflation, with 0.4 percentage points and 0.3 percentage points coming from tax increases and administered measures, respectively. In 2012, the public sector's contribution to HICP inflation will fall to 0.4 percentage points, according to current information available.

In 2011, buoyant economic activity meant both high overpayments and robust profit margin growth. In 2012,

Chart 4

HICP Inflation and Contributions by Subcomponents

Contributions to inflation in percentage points *Last observation: October 2011*



Source: OeNB, Statistik Austria.

these two components will decrease for economic reasons, as a result of which the price pressures stemming from the high wage settlements will be dampened. The wage settlements for 2013 should be lower owing to the weak economy expected in 2012, which means that production prices are not expected to come under pressure in either 2012 or 2013. Together with falling commodity prices, inflation should stand at well below 2%.

7 Forecast Risks Are High, but Not Only on the Downside

The current forecast was prepared in a period marked by an extremely high degree of uncertainty reflected in very high risks to the forecast, most of which are pointing to the downside. The largest

Table 9

Selected Price and Cost Indicators for Austria

	2010	2011	2012	2013
	Annual change in %			
Harmonised Index of Consumer Prices (HICP)	+1.7	+3.5	+2.2	+1.6
HICP energy	+7.6	+11.3	+2.6	+0.2
HICP excluding energy	+1.2	+2.8	+2.0	+1.7
Private consumption expenditure (PCE) deflator	+2.1	+3.0	+2.0	+1.6
Investment deflator	+2.9	+2.6	+1.8	+1.5
Import deflator	+4.9	+5.0	+1.1	+1.4
Export deflator	+2.9	+3.6	+2.0	+1.7
Terms of trade	–1.8	–1.3	+0.8	+0.4
GDP at factor cost deflator	+1.8	+2.0	+1.7	+1.8
Unit labor costs	+0.2	+0.5	+2.5	+1.0
Compensation per employee	+1.6	+2.3	+2.8	+2.0
Labor productivity	+1.4	+1.8	+0.3	+1.0
Collectively agreed wage settlements	+1.6	+2.0	+3.3	+2.2
Profit margins[1]	+1.6	+1.5	–0.8	+0.7

Source: 2010: Eurostat, Statistics Austria; 2011 to 2013: OeNB December 2011 outlook.

[1] *GDP deflator divided by unit labor costs.*

downside risk to growth undoubtedly consists in the further intensification of the financial and sovereign debt crisis. This forecast is based on the implicit assumption that the uncertainty associated with the sovereign debt crisis will gradually abate during the first half of 2012 and that the euro area will slowly resume its course of long-term growth. However, unforeseeable consequences may arise in the case of a disorderly Greek sovereign default. Although the direct impact seems manageable due to Greece's size, the risks of contagion for other countries cannot be easily estimated. The recently observed steep rise in yields for Italian and Spanish government bonds reflects an intensification of the crisis. A recession in the euro area, and therefore also in Austria, would be the most probable scenario in this case.

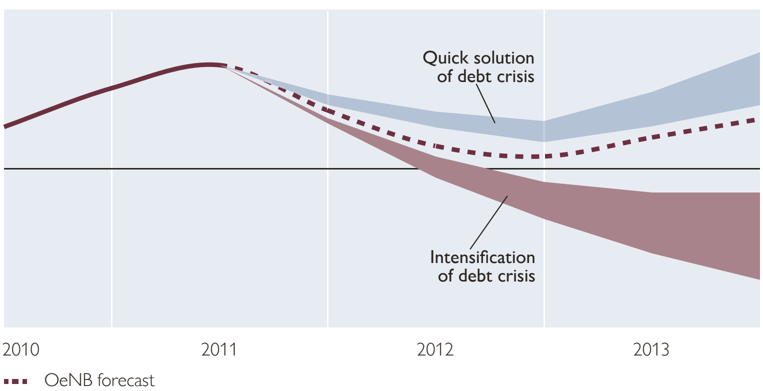
However, upside risks are also present. This forecast is based on both hard facts and sentiment indicators. Although signs of an economic downturn are visible in the real economy – for instance, export growth currently shows clear signs of cooling – the indicators available are not signaling a recession. If European economic policy quickly creates a credible and sustainable solution, growth could be even higher when the related uncertainties are resolved. Chart 5 illustrates the situation where the forecast ranges between two extreme scenarios, with each showing a non-negligible probability of event. This forecast assumes stagnation in the fourth quarter of 2011 and slightly positive growth in the first two quarters of 2012. The emergence of a technical recession (two successive quarters of declining economic output) cannot be ruled out even if the sovereign debt crisis does not escalate.

The inflationary risks look balanced over the forecast horizon. A depreciation of the euro might trigger higher inflation via increasing import prices. Likewise, the risk of faster rising commodity prices cannot be ruled out, but does not seem very likely owing to the sluggish growth of the world economy. In the event of a deeper-than-expected economic slump at both a European and global level, the inflationary risk from commodity prices would even point downward. In this case, a more strongly negative wage drift would be expected owing to the disappearance of overpayments.

Chart 5

Basic Forecast Scenario and Possible Alternative Scenarios

Annual real GDP change in %



Source: OeNB.

8 Weaker Export Market Growth and Loss of Confidence Trigger Downward Revision of Forecast

The international climate has deteriorated considerably since the OeNB's June 2011 economic outlook. Bleaker prospects for the global economy and downward revisions of the other euro area countries included in this forecast have generated a far more downbeat growth assessment of Austrian export markets. This effect is relevant to 2012 primarily. Lower interest rates, nevertheless, are providing positive stimuli for the economy. Changes in exchange rate and oil price assumptions, by con-

Table 10

Change in the External Economic Conditions since the OeNB June 2011 Outlook

	December 2011			June 2011			Difference		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
	Annual change in %								
Growth of Austria's export markets	+6.7	+4.4	+6.4	+7.5	+7.4	+7.2	–0.8	–3.0	–0.8
Competitor prices in Austria's export markets	+4.1	+1.3	+1.4	+3.7	+1.7	+1.6	+0.4	–0.4	–0.2
Competitor prices in Austria's import markets	+3.9	+1.0	+1.4	+3.8	+1.8	+1.6	+0.1	–0.8	–0.2
	USD per barrel (Brent)								
Oil price	111.5	109.4	104.0	111.1	108.0	103.7	+0.4	+1.4	+0.3
	Annual change in %								
Nominal effective exchange rate (exports)	+0.4	–0.1	+0.0	+0.2	–0.1	+0.0	+0.2	+0.0	+0.0
Nominal effective exchange rate (imports)	+0.7	–0.2	+0.0	+0.6	+0.0	+0.0	+0.1	–0.2	+0.0
	%								
Three-month interest rate	1.4	1.2	1.4	1.5	2.3	2.8	–0.1	–1.1	–1.4
Long-term interest rate	3.3	3.8	4.1	3.7	4.0	4.3	–0.4	–0.2	–0.2
	Annual change in %								
U.S. GDP (real)	+1.8	+1.8	+2.5	+2.6	+2.7	+2.8	–0.8	–0.9	–0.3
	USD/EUR								
USD/EUR exchange rate	1.40	1.36	1.36	1.42	1.43	1.43	–0.02	–0.07	–0.07

Source: Eurosystem.

trast, have no significant effect on forecast revisions.

The effects of these changed external assumptions were simulated using the OeNB macroeconomic model. Table 11 lists the reasons for revising the forecast in detail. Apart from the impact of changed external assumptions, they are attributable to the impact of new data and to a residual ("Other"). The influence of new data includes the effects of the revisions of both the historical data already available at the time of the OeNB's June 2011 economic outlook (i.e. data up to the first quarter of 2011) and the forecasting errors of the previous outlook for the periods for which data have now been published for the first time (i.e. data for the second and third quarter of 2011). The item "Other" includes new expert assessments regarding the development of domestic variables such as government consumption or wage settlements, as well as any changes to the model.

The slight upward revision of the outlook for 2011 by 0.1 percentage points is mainly caused by an upward revision of historical data. Since the forecast horizon commences in the fourth quarter of 2011, the more unfavorable international environment for 2011 as a whole is almost irrelevant. For 2012, however, almost half of the downward revision is determined by the external assumptions of the forecast. A major feature of the current situation is the marked loss of confidence on the part of the economic players. Since confidence effects are empirically difficult to record and model, they are not recorded technically and hence find themselves under the item "Other." For 2012 and 2013, this effect is about as strong as the impact of the external assumptions.

Table 11

Breakdown of Forecast Revisions

	GDP			HICP		
	2011	2012	2013	2011	2012	2013
	Annual change in %					
December 2011 outlook	+3.3	+0.7	+1.6	+3.5	+2.2	+1.6
June 2011 outlook	+3.2	+2.3	+2.4	+3.2	+2.1	+1.9
Difference	+0.1	–1.6	–0.8	+0.3	+0.1	–0.3
Due to:	*Percentage points*					
External assumptions	–0.1	–0.8	–0.4	+0.0	+0.0	–0.2
New data	+0.3	–0.1	+0.0	+0.1	+0.0	+0.0
of which: Revision of historical data until Q1 11	*+0.4*	*+0.0*	*+0.0*	*+0.0*	*x*	*x*
Projection errors for Q2 11 and Q3 11	*–0.1*	*–0.1*	*+0.0*	*+0.1*	*x*	*x*
Other[1]	–0.1	–0.7	–0.4	+0.2	+0.1	–0.1

Source: OeNB December 2011 and June 2011 outlooks.

[1] Different assumptions about trends in domestic variables such as wages, government consumption, effects of tax measures, other changes in assessment and model changes.

In 2011, inflation will rise more steeply than forecast in June. Only a small share (0.04 percentage points) of this increase is explicable by the new external assumptions. Most of it, however, stems from stronger domestic adjustments. Despite the downward growth revision, the inflation outlook for 2012 remains almost unchanged owing to high wage settlements. In 2013, the bleaker macroeconomic environment should have an impact on inflation.

Box 2

OeNB-BOFIT Outlook for Selected CESEE Countries: Growth Moderates Due to Worsening External Demand[1,2]

The recent projections indicate a slowdown in economic growth for selected Central, Eastern and Southeastern European (CESEE) economies as a result of the deteriorating external environment. Mainly for technical reasons, the baseline is based on a rather optimistic outlook for euro area GDP growth and points to moderate economic growth in the CESEE-7 region of 2.8% in 2011 and 2.5% in 2012 – a downward revision of the March 2011 projections. Therefore, we also calculated a more pessimistic alternative scenario. This scenario, for which we assume a potentially worse growth performance of euro area GDP in 2012 (1 percentage point lower), would push the 2012 GDP growth[3] rate of the CESEE-7[4] region down to 1.9%.

The contribution of external demand will decline over the projection horizon. Domestic demand will strengthen in all countries, but will remain negative in Hungary. Poland, the larg-

[1] Compiled by the OeNB's Foreign Research Division, julia.woerz@oenb.at.

[2] The OeNB and the Bank of Finland Institute for Economies in Transition (BOFIT) compile semiannual forecasts of economic developments in selected Central, Eastern and Southeastern European (CESEE) countries. These forecasts are based on a broad range of available information, including country-specific time-series models for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania (for technical details on the models used, see Crespo Cuaresma, J., M. Feldkircher, T. Slačík and J. Wörz. 2009. Simple but Effective: The OeNB's Forecasting Model for Selected CESEE Countries. In: OeNB. Focus on European Economic Integration Q4/09. 84–95). The projections for Russia, which were prepared by BOFIT, are based on a SVAR model. Cutoff date for all projections was September 29, 2011.

[3] The external assumptions are taken from the September 2011 macroeconomic projection exercise, prepared by the ECB. Annual real GDP growth of the euro area is thus assumed to range between 1.4% and 1.8% in 2011 and between 0.4% and 2.2% in 2012.

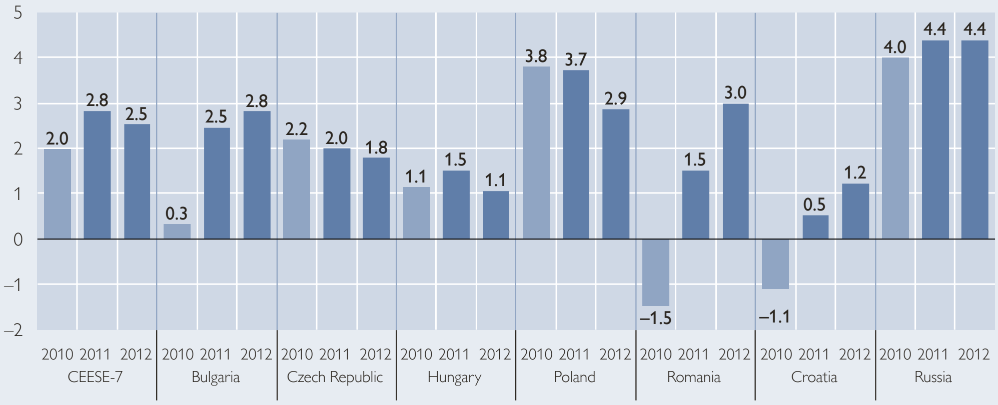
[4] Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania.

est economy in the region, continues to be an exception in terms of both growth rates and growth drivers. Russian economic growth in the first half of 2011 was weaker than forecast. Consequently, our GDP forecast was revised downward to 4.4% for 2011 and 2012. With a moderate economic recovery in the second half of the year, Croatian GDP is forecast to expand by a modest 0.4% in 2011 and to pick up slightly to 1.2% in 2012 on the back of strengthening domestic demand.

The risks to the current projections are clearly on the downside. A further and possibly substantial deterioration of external demand in the form of rising economic and financial tensions in the euro area has not been factored into the projections. Negative consequences for the CESEE-7 region could arise via trade and supply-chain links if economic growth in the euro area weakens or even stagnates. Additional possible contagion through the financial sector and the banking system imply further downside risks. Moreover, uncertainty prevails over the appropriate response to existing and possibly newly arising fiscal consolidation needs in the region. For Russia, the forecast risks are likewise on the downside, comprising lower oil prices, new bouts of risk aversion and related impairments of capital flows, uncertainties with respect to consumer confidence, a new food inflation wave, and heightened import growth in case of stronger real ruble appreciation.

CESEE-7: GDP Projections for the Period from 2010 to 2012

Annual growth rate in %, real



Source: OeNB-BOFIT September 2011 Projections, Eurostat.

How Would CESEE-7 Growth React to a More Pronounced Dip in Euro Area Growth? A Sensitivity Analysis

The current projections are based on rather optimistic external assumptions, which do not incorporate the consequences of the most recent developments in the euro area. Therefore, we illustrate here the sensitivity of our growth forecast for the CESEE-7 countries to a potentially worse growth performance in the euro area. More specifically, euro area GDP growth in 2012 is assumed to be 1 percentage point lower than the baseline.

Lower euro area GDP growth implies lower CESEE-7 GDP growth in the same year for various reasons. First of all, because the euro area represents the major trading partner for all countries in the region, slower euro area growth automatically reduces the CESEE-7 region's external demand for goods and services. Second, funding constraints for euro area banks active in the CESEE-7, consequent deleveraging in the region, increased uncertainty and negative wealth effects could also arise in the region with a negative impact on private consumption. Not all of these effects will necessarily materialize, and their growth impact would certainly vary from country to country, but the point is that there is an array of channels that may transmit lower growth in the euro area to the CESEE-7 countries.

In our models, the major influence of this change on CESEE-7 growth comes through the drop in external demand as compared to the baseline. Exchange rate developments are also *directly affected in the model, apart from indirect effects on all growth components feeding through the system. Our sensitivity analysis has to be interpreted as a conservative estimate of the effects, as financial transmission channels are not taken into account.*[5]

In this scenario, GDP growth in the CESEE-7 region would be 0.6 percentage points lower in 2012 relative to the baseline under these weaker external growth assumptions. Individual countries would be affected differently: The GDP outlook for Poland, by far the largest economy in the region, would fall by 0.7 percentage points to only 2.2% year on year. Likewise, growth projections for Bulgaria would have to be revised downward by 0.8 percentage points. In Hungary, projected growth for 2012 would be more than halved to 0.5% year on year, down from 1.1%. Projected GDP in the Czech Republic would also 0.5 percentage points lower. By contrast, the impact on Romania would be smaller. The projected growth rate would only drop by 0.2 percentage points to 2.8%.

CESEE-7: GDP Projections for 2012 – Impact of Moderate Euro Area GDP Growth

	GDP growth 2012	
	According to projection (baseline)	In case of lower euro area GDP growth
	Annual growth in %	
CESEE-7	**2,5**	**1,9**
Bulgaria	2,8	2,0
Czech Republic	1,8	1,3
Hungary	1,1	0,5
Poland	2,9	2,2
Romania	3,0	2,8

Source: OeNB.

CESEE-7: External Demand to Fade as Growth Driver

The first quarter of 2011 brought about an acceleration of growth in the CESEE-7 region (+0.8% quarter on quarter in seasonally adjusted terms, up from 0.5% in the last quarter of 2010), while growth in the second quarter 2011 again moderated to 0.6% quarter on quarter. Uncertainties about economic developments in the CESEE-7 countries have risen in recent months. For 2011 as a whole, the CESEE-7 region is expected to expand by 2.8% and thus more moderately than projected in our March forecast. Growth in Poland, the largest economy in the region, will not expand further against 2010, but will remain the region's growth engine. This implies an acceleration of growth dynamics for all CESEE-7 countries apart from the Czech Republic and Poland. In the Czech Republic, the fiscal austerity package will restrict further growth, while in Poland investment growth will moderate after strong pre-election public investments. The deteriorating external environment and developments in the euro area imply that economic growth in the CESEE-7 region will remain well below its precrisis level and that catching-up will resume at a slow pace.

Based on the assumptions on euro area growth as put forward by the ECB in its September 2011 macroeconomic projection exercise, economic growth in 2012 will moderate to 2.5% in the CESEE-7 region. As described above, a more realistic assumption concerning economic growth in the euro area in 2012 would reduce CESEE-7 growth projections by 0.6 percentage points, to 1.9% per annum. The growth moderation will be led by the Central European countries, while the Southeastern European economies – Bulgaria and Romania – will continue to show a domestic demand-driven expansion that relies heavily on private consumption. In Hungary, domestic demand will be further hampered by the strength of the Swiss franc given the high ratio of private foreign currency loans. The contribution of net exports is falling in all countries except for Poland. At the same time, the growth contribution of domestic demand is rising in all countries apart from Poland, where it remains at a comparatively high level. In Hungary, domestic demand and, in particular, private consumption will remain subdued to the extent that their overall contribution to growth will remain slightly negative. For the region as a whole, several factors will weigh on economic activity in 2012 in addition to the weakening external environment, namely tight and uncertain financing conditions, hesitant investment activity and uncertainties about capital inflows.

[5] *In order to calculate the effect of the euro area dip on the CESEE-7 region as a whole, GDP growth in Latvia and Lithuania for 2012 was scaled down by the average growth reduction for the CESEE-5 aggregate.*

Russia: Growth Is Relatively Brisk, but Leveling Off

The speed of Russia's economic recovery went down to 3.7% year on year in the first half of 2011. Regarding the second half of 2011, growth is forecast to pick up from a slow second quarter, supported by easing inflation. The full-year 2011 GDP growth forecast of 4.4% is also supported by investment, which should gain momentum since the output gap is closing. Rebuilding inventories is likely to continue in 2011.

However, GDP growth is projected to slow down soon, assuming oil prices will level off, i.e. stop rising, during the forecast period. The annual GDP growth rate will remain at 4.4% in 2012, given the current year's partly low GDP level (another base effect), the partial winding-back of social security contributions in 2012 and government spending increases in the run-up to the presidential elections.

Private consumption is forecast to remain the crucial driver of growth and to increase briskly. Wages in the private sector are anticipated to rise swiftly as unemployment declines gradually from a relatively low level. Consumer loans are expected to rise further. Public consumption is anticipated to increase in 2012, since the authorities plan to augment total general government spending by around 6% in real terms in the run-up to the elections. Fixed investments are foreseen to recover in 2012, as pre-slump capacity utilization rates will be attained. Restocking is expected to subside in 2012.

Croatia: Protracted Recovery of Domestic Demand

With a moderate economic recovery in the second half of the year, the Croatian economy is forecast to grow by 0.4% in 2011 as a whole. The growth pattern seen in 2009 and 2010 will also prevail in 2011, implying a negative contribution of domestic demand and a positive contribution of net exports (albeit less pronounced than in previous years). Private and public consumption are expected to strengthen somewhat in the second half of the year in the wake of the upcoming parliamentary elections in December 2011. At the same time, restocking is expected to compensate slightly for weak investment activity. A fairly good summer tourism season is expected to underpin exports in the third quarter of 2011, but given the base effect-related slump in exports in the first quarter of 2011, export growth will turn out to be negative for 2011 as a whole. However, given the faster contraction of imports, the contribution of net exports to growth will remain positive.

GDP growth is expected to accelerate to 1.2% in 2012, driven mainly by a pickup in domestic demand. Consumption will remain weak, though. In particular, increasing fiscal consolidation needs following the 2011 election year will negatively affect public consumption. At the same time, private consumption is estimated to pick up slightly as the first signs of improving labor market conditions become apparent and the support measures of the government to support borrowers who have taken out loans in Swiss francs will help ease households' financial situation. After having contracted considerably for three consecutive years, gross fixed capital formation is forecast to recover in 2012, mainly driven by gradually increasing FDI inflows ahead of Croatia's EU entry in 2013. In a less supportive global environment, exports are expected to grow only marginally in 2012. At the same time, the investment-driven recovery of domestic demand will also contribute to a pickup in import growth, so that the positive contribution of net exports to GDP growth is likely to decrease further.

Annex: Detailed Result Tables

Table 12

Demand Components (Real Prices)

Chained volume data (reference year = 2005)

	2010	2011	2012	2013	2010	2011	2012	2013
	EUR million				Annual change in %			
Private consumption	142,223	143,621	144,695	146,203	+2.1	+1.0	+0.7	+1.0
Government consumption	49,436	50,036	50,339	50,710	–0.2	+1.2	+0.6	+0.7
Gross fixed capital formation	51,589	53,606	53,677	54,763	+0.1	+3.9	+0.1	+2.0
of which: Investment in plant and equipment	*20,367*	*21,290*	*21,204*	*21,896*	*+3.3*	*+4.5*	*–0.4*	*+3.3*
Residential construction investment	*10,288*	*10,258*	*10,365*	*10,419*	*–2.2*	*–0.3*	*+1.0*	*+0.5*
Investment in other construction	*20,838*	*20,949*	*21,000*	*21,339*	*–2.7*	*+0.5*	*+0.2*	*+1.6*
Changes in inventories (including statistical discrepancy)	2,046	5,412	4,539	4,761	×	×	×	×
Domestic demand	245,295	252,674	253,250	256,437	+1.7	+3.0	+0.2	+1.3
Exports of goods and services	145,758	156,405	160,960	170,633	+8.4	+7.3	+2.9	+6.0
Imports of goods and services	128,078	137,321	140,446	148,963	+8.0	+7.2	+2.3	+6.1
Net exports	17,680	19,084	20,514	21,670	×	×	×	×
Gross domestic product	262,975	271,759	273,764	278,107	+2.3	+3.3	+0.7	+1.6

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

Table 13

Demand Components (Current Prices)

	2010	2011	2012	2013	2010	2011	2012	2013
	EUR million				Annual change in %			
Private consumption	155,936	162,156	166,669	171,179	+4.2	+4.0	+2.8	+2.7
Government consumption	55,518	57,333	59,249	61,040	+1.9	+3.3	+3.3	+3.0
Gross fixed capital formation	58,521	62,379	63,554	65,804	+3.1	+6.6	+1.9	+3.5
Changes in inventories (including statistical discrepancy)	3,270	6,718	5,210	5,844	×	×	×	×
Domestic demand	273,245	288,586	294,682	303,868	+4.6	+5.6	+2.1	+3.1
Exports of goods and services	154,720	171,991	180,459	194,646	+11.6	+11.2	+4.9	+7.9
Imports of goods and services	141,978	159,708	165,203	177,618	+13.2	+12.5	+3.4	+7.5
Net exports	12,742	12,283	15,256	17,028	×	×	×	×
Gross domestic product	285,988	300,869	309,938	320,896	+4.2	+5.2	+3.0	+3.5

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

Table 14

Deflators of Demand Components

	2010	2011	2012	2013	2010	2011	2012	2013
	2005 = 100				*Annual change in %*			
Private consumption	109.6	112.9	115.2	117.1	+2.1	+3.0	+2.0	+1.6
Government consumption	112.3	114.6	117.7	120.4	+2.1	+2.0	+2.7	+2.3
Gross fixed capital formation	113.4	116.4	118.4	120.2	+2.9	+2.6	+1.8	+1.5
Domestic demand (excluding changes in inventories)	111.0	114.0	116.4	118.4	+2.3	+2.7	+2.1	+1.7
Exports of goods and services	106.1	110.0	112.1	114.1	+2.9	+3.6	+2.0	+1.7
Imports of goods and services	110.8	116.3	117.6	119.2	+4.9	+5.0	+1.1	+1.4
Terms of trade	95.8	94.5	95.3	95.7	–1.8	–1.3	+0.8	+0.4
Gross domestic product	108.7	110.7	113.2	115.4	+1.8	+1.8	+2.3	+1.9

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

Table 15

Labor Market

	2010	2011	2012	2013	2010	2011	2012	2013
	Thousands				*Annual change in %*			
Total employment	4,118.6	4,181.5	4,197.8	4,223.2	+0.9	+1.5	+0.4	+0.6
of which: Private sector employment	*3,587.1*	*3,650.8*	*3,667.8*	*3,693.9*	*+1.1*	*+1.8*	*+0.5*	*+0.7*
Payroll employment (national accounts definition)	3,527.7	3,588.8	3,601.9	3,624.2	+0.8	+1.7	+0.4	+0.6
	% of labor supply							
Unemployment rate (Eurostat definition)	4.4	4.2	4.5	4.5	×	×	×	×
	EUR per real output unit x 100							
Unit labor costs (whole economy)[1]	63.5	63.8	65.4	66.0	+0.2	+0.5	+2.5	+1.0
	EUR thousand per employee							
Labor productivity (whole economy)[2]	63.8	65.0	65.2	65.9	+1.4	+1.8	+0.3	+1.0
	EUR thousand							
Real compensation per employee[3]	37.0	36.7	37.0	37.1	–0.5	–0.7	+0.8	+0.4
	At current prices in EUR thousand							
Gross compensation per employee	40.5	41.5	42.6	43.5	+1.6	+2.3	+2.8	+2.0
	At current prices in EUR million							
Total gross compensation of employees	142,987	148,788	153,535	157,621	+2.3	+4.1	+3.2	+2.7

Source: 2010: Eurostat; 2011 to 2013: OeNB December 2011 outlook.

[1] Gross wages divided by real GDP.
[2] Real GDP divided by total employment.
[3] Gross wages per employee divided by the private consumption expenditure (PCE) deflator.

Table 16

Current Account

	2010	2011	2012	2013	2010	2011	2012	2013
	EUR million				*% of nominal GDP*			
Balance of trade	9,928.0	9,921.9	12,257.1	13,900.5	3.5	3.3	4.0	4.3
Balance on goods	–3,189.0	–4,119.2	–2,625.8	–1,819.6	–1.1	–1.4	–0.8	–0.6
Balance on services	13,117.0	14,041.1	14,882.9	15,720.0	4.6	4.7	4.8	4.9
Balance on income	538.0	–178.5	–736.1	–746.8	0.2	–0.1	–0.2	–0.2
Balance on transfers	–2,009.0	–2,387.0	–2,405.8	–2,430.4	–0.7	–0.8	–0.8	–0.8
Current account	8,457.0	7,356.3	9,115.2	10,723.2	3.0	2.4	2.9	3.3

Source: 2010, Eurostat; 2011 to 2013: OeNB December 2011 outlook.

Table 17

Quarterly Outlook Results

	2011	2012	2013	2011				2012				2013			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Prices, wages and costs	*Annual change in %*														
HICP	+3.5	+2.2	+1.6	+3.0	+3.7	+3.8	+3.6	+2.8	+2.1	+2.1	+1.8	+1.7	+1.7	+1.6	+1.5
HICP (excluding energy)	+2.8	+2.0	+1.7	+2.2	+3.1	+3.1	+2.7	+2.3	+1.9	+1.9	+1.9	+1.9	+1.8	+1.7	+1.6
Private consumption expenditure (PCE) deflator	+3.0	+2.0	+1.6	+3.1	+2.9	+3.1	+2.8	+2.4	+1.9	+2.0	+1.7	+1.7	+1.7	+1.6	+1.6
Gross fixed capital formation deflator	+2.6	+1.8	+1.5	+3.1	+2.8	+2.2	+2.3	+2.2	+1.6	+1.7	+1.6	+1.5	+1.5	+1.5	+1.4
GDP deflator	+1.8	+2.3	+1.9	+1.4	+1.5	+1.9	+2.4	+2.8	+2.6	+2.0	+1.7	+1.6	+1.8	+2.1	+2.2
Unit labor costs	+0.5	+2.5	+1.0	–1.1	+0.0	+1.3	+1.7	+3.2	+2.8	+2.4	+1.6	+0.4	+0.7	+1.2	+1.8
Nominal wages per employee	+2.3	+2.8	+2.0	+2.2	+2.3	+2.4	+2.2	+3.0	+2.8	+2.8	+2.7	+1.7	+1.9	+2.1	+2.4
Productivity	+1.8	+0.3	+1.0	+3.3	+2.3	+1.1	+0.5	–0.2	+0.0	+0.4	+1.1	+1.3	+1.2	+0.8	+0.6
Real wages per employee	–0.7	+0.8	+0.4	–0.8	–0.7	–0.7	–0.6	+0.5	+0.9	+0.8	+0.9	+0.1	+0.2	+0.5	+0.8
Import deflator	+5.0	+1.1	+1.4	+6.6	+5.5	+4.1	+3.8	+1.4	+0.4	+1.3	+1.4	+1.3	+1.3	+1.4	+1.4
Export deflator	+3.6	+2.0	+1.7	+4.2	+3.8	+3.6	+3.0	+2.6	+2.1	+1.6	+1.5	+1.6	+1.7	+1.8	+1.9
Terms of trade	–1.3	+0.8	+0.4	–2.3	–1.6	–0.5	–0.7	+1.2	+1.7	+0.3	+0.1	+0.3	+0.4	+0.4	+0.4
Economic activity	*Annual and/or quarterly changes in % (real)*														
GDP	+3.3	+0.7	+1.6	+1.1	+0.4	+0.3	+0.0	+0.1	+0.1	+0.3	+0.4	+0.4	+0.4	+0.5	+0.5
Private consumption	+1.0	+0.7	+1.0	–0.2	+0.3	+0.7	+0.3	+0.0	+0.0	+0.1	+0.2	+0.3	+0.3	+0.4	+0.4
Government consumption	+1.2	+0.6	+0.7	+1.3	+0.8	–1.0	–0.2	+0.5	+0.4	+0.4	+0.2	+0.1	+0.1	+0.1	+0.2
Gross fixed capital formation	+3.9	+0.1	+2.0	–1.1	+2.7	+0.9	+0.0	–0.8	–0.5	+0.0	+0.5	+0.8	+0.6	+0.7	+0.7
Exports	+7.3	+2.9	+6.0	+4.1	–0.2	+1.0	+0.0	+0.7	+1.0	+1.3	+1.4	+1.4	+1.6	+1.7	+1.7
Imports	+7.2	+2.3	+6.1	+4.7	–0.1	+0.6	–0.7	+0.2	+1.4	+1.6	+1.6	+1.3	+1.4	+1.5	+1.6
	Contribution to real GDP growth in percentage points														
Domestic demand	+1.5	+0.5	+1.1	–0.1	+0.8	+0.4	+0.1	–0.1	+0.0	+0.1	+0.2	+0.3	+0.3	+0.3	+0.3
Net exports	+0.5	+0.5	+0.4	+0.0	–0.1	+0.3	+0.3	+0.3	–0.1	–0.1	+0.0	+0.2	+0.2	+0.2	+0.2
Changes in inventories	+1.3	–0.3	+0.1	+1.2	–0.3	–0.3	–0.5	–0.1	+0.3	+0.3	+0.1	–0.1	–0.1	–0.1	+0.0
Labor market	*% of labor supply*														
Unemployment rate (Eurostat definition)	4.2	4.5	4.5	4.4	4.1	3.8	4.4	4.3	4.5	4.5	4.6	4.6	4.6	4.5	4.4
	Annual and/or quarterly changes in %														
Total employment	+1.5	+0.4	+0.6	+0.4	+0.4	+0.3	+0.2	+0.1	–0.1	–0.1	+0.0	+0.2	+0.3	+0.4	+0.4
of which: Private sector employment	*+1.8*	*+0.5*	*+0.7*	*+0.4*	*+0.5*	*+0.3*	*+0.3*	*+0.1*	*–0.1*	*–0.2*	*+0.0*	*+0.2*	*+0.3*	*+0.4*	*+0.5*
Payroll employment	+1.7	+0.4	+0.6	+0.5	+0.4	+0.4	+0.2	+0.1	–0.1	–0.2	+0.0	+0.2	+0.3	+0.4	+0.4
Additional variables	*Annual and/or quarterly changes in % (real)*														
Real disposable household income	+0.3	+0.4	+1.6	–1.5	–0.6	+1.0	–0.6	+0.3	+0.0	+0.1	+0.3	+0.3	+0.5	+0.7	+0.9
	% of real GDP														
Output gap	0.5	–0.3	–0.4	0.7	0.7	0.6	0.2	–0.1	–0.4	–0.4	–0.4	–0.4	–0.4	–0.4	–0.3

Source: OeNB December 2011 outlook (based on seasonally and working-day adjusted data).

Table 18

Comparison of Current Economic Forecasts for Austria

Indikator	OeNB			WIFO		IAS		OECD			IMF		European Commission		
	December 2011			September 2011		September 2011		November 2011			September 2011		November 2011		
	2011	2012	2013	2011	2012	2011	2012	2011	2012	2013	2011	2012	2011	2012	2013
Key results	*Annual change in %*														
GDP (real)	+3.3	+0.7	+1.6	+2.9	+0.8	+3.0	+1.3	+3.2	+0.6	+1.8	+3.3	+1.6	+2.9	+0.9	+1.9
Private consumption (real)	+1.0	+0.7	+1.0	+0.9	+0.8	+1.0	+0.8	+1.2	+0.9	+1.2	×	×	+0.6	+1.0	+1.4
Government consumption (real)	+1.2	+0.6	+0.7	+0.5	+0.5	+0.5	+0.5	+1.3	+0.7	+0.6	×	×	+1.0	+1.0	+1.2
Gross fixed capital formation (real)[1]	+3.9	+0.1	+2.0	+4.0	+1.1	+7.7	+1.1	+3.6	+1.2	+2.2	×	×	+4.7	+0.7	+3.0
Exports (real)	+7.3	+2.9	+6.0	+6.9	+3.6	+7.9	+3.5	+7.0	+3.1	+6.1	+8.2	+4.4	+6.8	+3.8	+6.4
Imports (real)	+7.2	+2.3	+6.1	+6.1	+3.8	+7.4	+3.0	+7.0	+3.1	+5.5	+6.7	+3.9	+6.4	+3.7	+6.4
GDP per employee	+1.8	+0.3	+1.0	+1.1	+0.4	+1.0	+0.8	×	×	×	×	×	+2.8	+1.9	+1.8
GDP deflator	+1.8	+2.3	+1.9	+2.0	+2.1	+2.1	+2.0	+1.8	+1.8	+1.7	×	×	+2.2	+2.1	+2.0
CPI	×	×	×	+3.1	+2.1	+3.2	+2.1	×	×	×	+3.2	+2.2	×	×	×
HICP	+3.5	+2.2	+1.6	+3.5	+2.3	×	×	+3.5	+1.9	+1.7	×	×	+3.4	+2.2	+2.1
Unit labor costs	+0.5	+2.5	+1.0	+1.6	+2.1	×	×	×	×	×	×	×	+1.2	+1.2	+0.7
Payroll employment	+1.5	+0.4	+0.6	+1.8	+1.4	+1.9	+0.5	×	×	×	×	×	+1.4	+0.2	+0.8
	% of labor supply														
Unemployment rate (Eurostat definition)	4.2	4.5	4.5	4.2	4.4	4.1	4.3	4.2	4.4	4.4	4.1	4.1	4.2	4.5	4.2
	% of nominal GDP														
Current account	2.4	2.9	3.3	2.8	2.8	×	×	3.0	3.4	3.8	2.8	2.7	2.7	2.8	2.9
Budget balance (Maastricht definition)	–3.1	–2.9	–3.2	–3.1	–3.1	–3.1	–2.8	–3.4	–3.2	–3.1	–3.5	–3.2	–3.4	–3.1	–2.9
External assumptions															
Oil price in USD/barrel (Brent)	111.5	109.4	104.0	110.0	100.0	112.0	115.0	111.0	110.0	110.0	103.2	100.0	111.0	104.0	100.0
Short-term interest rate in %	1.4	1.2	1.4	1.4	1.5	1.4	1.1	1.4	1.0	0.6	1.3	1.2	1.4	1.2	1.5
USD/EUR exchange rate	1.40	1.36	1.36	1.40	1.40	1.40	1.39	1.39	1.36	1.36	1.41	1.41	1.40	1.37	1.37
	Annual change in %														
Euro area GDP (real)	+1.5 to +1.7	–0.4 to +1.0	+0.3 to +2.3	+1.6	+0.5	+1.6	+1.0	+1.6	+0.2	+1.4	+1.6	+1.1	+1.5	+0.5	+1.3
U.S. GDP (real)	+1.8	+1.8	+2.5	+1.8	+1.0	+1.6	+2.0	+1.7	+2.0	+2.5	+1.5	+1.8	+1.6	+1.5	+1.3
World GDP (real)	+3.7	+3.6	+4.1	+3.8	+3.1	×	×	×	×	×	+4.0	+4.0	+3.7	+3.5	+3.6
World trade	+6.9	+5.6	+7.1	+6.0	+5.0	+7.0	+5.7	+6.7	+4.8	+7.1	+7.5	+5.8	+7.2	+5.3	+6.4

Source: OeNB, WIFO, IAS, OECD, IMF, European Commission.

[1] *For IAS: Gross investment.*