

Austria's Economy Moves beyond the Crisis

Powerful Economic Growth Provides a Tailwind to Reduce Budget Deficits

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

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1 Summary: Austrian Economy Grows at an Above-Average Pace

In the June 2011 economic outlook, the Oesterreichische Nationalbank (OeNB) expects the Austrian economy to grow by 3.2% in 2011. Growth will remain above the long-term average in 2012 and 2013 as well (2012: 2.3%; 2013: 2.4%). Compared with the OeNB December 2010 outlook, short-term growth expectations have thus improved considerably. The prospects for growth in 2011 have been revised upward by more than 1 percentage point. The recovery is being driven mainly by exports, but unlike in 2010, domestic demand is contributing substantially to growth as well. The unemployment

rate will drop from 4.3% in 2011 to 4.1% in 2013. HICP inflation is set to quicken to 3.2% in 2011 above all because of higher commodity prices and increased taxes and levies. But over the forecast horizon, HICP inflation is expected to ease to 2.1% in 2012 and to 1.9% in 2013. The budget deficit is projected to decrease to 3.0% of GDP already in 2011, given favorable economic developments and good fiscal consolidation performance. With economic growth conditions remaining auspicious, the deficit ratio is anticipated to shrink further in 2012 and 2013.

The emerging economies, especially emerging Asia and South America, were the *main engine of global economic growth* in 2010. But the worldwide

Chart 1

Real GDP Growth (Seasonally and Working-Day Adjusted)

Quarterly and annual changes in %



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upswing was also accompanied by a considerable rise in energy and food prices in recent months, heating up inflation. Many countries and regions are counteracting the danger of their economies overheating by tightening monetary policy.

The global economy will continue to revive over the forecast horizon, but the development within the *euro area* in the fourth year after the outbreak of the international financial and economic crisis is highly heterogeneous. Countries whose production structure is dominated by an internationally competitive export sector were more strongly affected by the crisis and the slump in world trade, but recovered faster than average in 2010. Conversely, countries suffering from competitive weaknesses or structural budget problems were faced with a loss of international investors' confidence and therefore with surging risk premiums and refinancing costs for their government debt. In Spain, Greece and Ireland, GDP contracted further in 2010.

The recovery of the world economy, above all of the German economy, provides the key impulses for Austrian economic performance. In 2011 as a whole, *Austrian exports* will surge (10.4%) nearly as strongly as in 2010. In 2012 and 2013, the expected slowdown of the international development will cause Austrian export growth to slacken. However, at roughly 7%, exports will continue to expand at an above-average rate and will remain a pillar of economic growth.

Powered by the recovery of export demand, *gross fixed capital formation* picked up again from the second quarter of 2010. For the most part, investment focused on plant and equipment, whereas investment in building construction and civil engineering was still contracting as late as in the fourth

quarter of 2010. Overall, construction investment is anticipated to keep declining in 2011 but to recover over the remainder of the forecast horizon. Gross fixed capital investment as a whole is projected to grow by 3.7% in 2011, by 3.1% in 2012 and by 3.4% in 2013.

Like in 2010, households will partly finance *private consumption* by reducing their savings in 2011. Over the remainder of the forecast horizon, the financial burden imposed by the budget consolidation package will largely unwind and the rate of inflation will ease significantly. These developments will moderately boost real consumer spending (+1.2% each in 2012 and 2013); at the same time, the saving ratio will recover to nearly the level measured before the crisis.

In 2011 as a whole, the *number of employed persons* is likely to rise by 60,000 (or 1.7%) year on year. Above-average employment growth of 1.2% a year is expected in 2012 and 2013. The *unemployment rate* (Eurostat definition) declined to 4.4% in 2010 on the back of a marked increase in employment. Austria is thus among the countries with the lowest unemployment rate in the euro area. Given rising labor supply, the rate of unemployment is likely to decline only marginally to 4.3% in 2011, will stay unchanged in 2012, and will decline to 4.1% in 2013.

Higher commodity prices and the increase in taxes and fees will cause inflation to quicken to 3.2% on average in 2011. Whereas energy price-induced inflation should diminish markedly toward the end of 2011, the overall rate of inflation will be influenced to a greater degree by the expected higher wage settlements for 2012 over the rest of the forecasting horizon. Accordingly, HICP inflation will amount to 2.1% in 2012 and will sink to 1.9% in 2013.

Table 1

OeNB June 2011 Outlook for Austria – Key Results¹

	2010	2011	2012	2013
Economic activity				
<i>Annual change in % (real)</i>				
Gross domestic product	+2.2	+3.2	+2.3	+2.4
Private consumption	+1.1	+0.9	+1.2	+1.2
Government consumption	-0.1	+0.8	+0.8	+1.0
Gross fixed capital formation	-1.1	+3.7	+3.1	+3.4
Exports of goods and services	+10.4	+10.0	+6.8	+7.2
Imports of goods and services	+8.3	+8.9	+6.0	+6.6
<i>% of nominal GDP</i>				
Current account balance	+2.7	+4.0	+4.8	+5.0
Contribution to real GDP growth				
<i>Percentage points of GDP</i>				
Private consumption	+0.6	+0.5	+0.6	+0.6
Government consumption	+0.0	+0.1	+0.1	+0.2
Gross fixed capital formation	-0.2	+0.7	+0.6	+0.7
Domestic demand (excluding changes in inventories)	+0.4	+1.4	+1.4	+1.5
Net exports	+1.5	+1.2	+0.9	+0.9
Changes in inventories (including statistical discrepancy)	+0.3	+0.7	+0.0	+0.0
Prices				
<i>Annual change in %</i>				
Harmonised Index of Consumer Prices (HICP)	+1.7	+3.2	+2.1	+1.9
Private consumption expenditure (PCE) deflator	+1.5	+2.7	+1.9	+1.8
GDP deflator	+1.6	+2.1	+1.9	+1.9
Unit labor costs in the total economy	+0.1	+1.1	+1.8	+1.3
Compensation per employee (at current prices)	+1.3	+2.6	+2.9	+2.5
Productivity (whole economy)	+1.2	+1.5	+1.1	+1.2
Compensation per employee (real)	-0.2	-0.1	+0.9	+0.7
Import prices	+3.9	+3.5	+2.2	+1.8
Export prices	+2.2	+2.9	+2.1	+1.9
Terms of trade	-1.6	-0.6	-0.1	+0.1
Income and savings				
<i>% of nominal disposable household income</i>				
Real disposable household income	-0.7	+0.5	+2.1	+2.5
<i>% of nominal disposable household income</i>				
Saving ratio	9.2	8.6	9.4	10.3
Labor market				
<i>Annual change in %</i>				
Payroll employment	+0.8	+1.7	+1.2	+1.2
<i>% of labor supply</i>				
Unemployment rate (Eurostat definition)	4.4	4.3	4.3	4.1
Budget				
<i>% of nominal GDP</i>				
Budget balance (Maastricht definition)	-4.6	-3.0	-2.6	-2.3
Government debt	72.3	71.9	71.8	71.3

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

2 Technical Assumptions

This forecast is the OeNB's contribution to the June 2011 Eurosystem staff macroeconomic projections. The forecasting horizon ranges from the first quarter of 2011 to the fourth quarter of 2013. All assumptions about the devel-

opment 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 May 19, 2011. The forecast was prepared with the OeNB's macroeconomic quarterly model and of

seasonally and working day-adjusted national accounts data calculated by the Austrian Institute for Economic Research (WIFO), which were fully available up to the fourth quarter of 2010. The data for the first quarter of 2011 are based on GDP flash estimates, which cover only part of the aggregates in the national accounts, however. The short-term interest rates used for the forecasting horizon are based on market expectations for the three-month EURIBOR, namely 1.5% in 2011, 2.3% in 2012, and 2.8% in 2013. Long-term interest rates reflect market expectations for ten-year government bonds, and have been set at 3.7% (2011), 4.0% (2012) and 4.3% (2013). The exchange rate of the euro vis-à-vis the U.S. dollar is assumed to remain at USD 1.43. The projected trend in crude oil prices is based on futures prices. The oil price assumed for 2011 is USD 111.1 per barrel of Brent, while those for 2012 and 2013 are set at USD 108.0 and USD 103.7, respectively. The prices of commodities excluding energy are also based on futures prices over the forecast horizon.

3 Global Upswing Driven by Emerging Countries – Development Remains Heterogeneous across Europe

Sustained by the large Asian and South American emerging economies, *world economic growth* in 2010 came to 4.9%, nearly as high as in the boom year 2007 (5.4%). World growth remained fast-paced at the beginning of 2011, though no longer at the rates measured at end-2009 and in early 2010. While staying robust, global economic activity will recede slightly to about 4 ¼% from 2011 to 2013. World trade growth, too, is anticipated to slow somewhat to about 8% over the forecast horizon compared to 12% in 2010.

In recent months, the international upturn has been accompanied by skyrocketing commodity prices in the energy and food industries. Much as in 2007, this surge spurred inflation. In many regions across the world, policy-makers are counteracting accelerating inflation by increasingly tightening monetary policy.

At the beginning of 2011, the growth prospects for the world's largest economy clouded over: The U.S. economy expanded only moderately in the first quarter of 2011 (0.4% quarter on quarter). The silver lining, though, is the composition of growth, which points toward a positive development in the further course of the year. GDP growth was fueled by consumer spending and investment in plant and equipment. By contrast, public spending as well as commercial and residential construction spending acted as a brake on growth. In view of the planned austerity measures, public spending is not expected to provide any impulses for economic growth over the entire forecast horizon, but the dip in construction spending is seen as temporary, being caused by poor weather conditions. Starting from a very low level, construction spending is therefore expected to provide significant positive impulses for growth in 2012 and 2013. For 2011 as well as 2012 and 2013, GDP is anticipated to advance by between 2½% and 3%.

The emerging countries, above all those in Asia and South America, were the engines of international growth in 2010. In addition to China and India, Taiwan, Singapore, Argentina and Turkey registered over 9% annual GDP growth. South Korea, Indonesia, Thailand, Hong Kong, Malaysia and Brazil posted between 6% and 7% growth, whereas the oil-producing countries of the Middle East, Russia and the Central,

Eastern and Southeastern European (CESEE) countries grew by just 2% to 4%. Compared to the recovery year 2010, in which these economies had embarked on a strong catching-up process after the crisis in 2009, growth is anticipated to decline marginally in this very heterogeneous group of countries over the forecast horizon but to remain very high in an international comparison. The countries with the largest populations, China and India, continue to set the pace of world economic growth. In the wake of these two countries, Asia will remain the region powering international growth.

As a result of the Tohoku Pacific Ocean earthquake and the devastation by the tsunami waves that the earthquake triggered, *Japan's economy* suffered a slump in the first half of 2011. The post-tsunami reconstruction work is set to put the economy back on a positive growth path in the second half of 2011 and in 2012 mainly on account of government consumption and public investment. Full-year GDP is likely to fall slightly in 2011, however. The revival of net exports should additionally boost growth over the remainder of the horizon (2% to 3% in 2012 and 2013).

In the fourth year following the onset of the world financial and economic crisis, economic activity in Europe, in particular in the euro area, presents a very heterogeneous picture. Whereas in 2009, the external shock had entailed a fall in output in all European countries except Poland, the crisis revealed serious structural differences between individual Member States as well as significant macroeconomic imbalances that led to discrepancies between countries so that the crisis manifested itself in differing ways. Countries whose manufacturing structure is strongly oriented on an internationally competitive export sector – especially Germany,

Finland, Slovakia, Luxembourg and Austria – were hit harder by the 2009 crisis than others, but also recovered faster in 2010. By contrast, other countries were hit by a country-specific shock in addition to the external shock: A real estate bubble burst in Spain; the banking system required a massive bank bailout in Ireland; risk premiums on, and refinancing costs for, government debt shot up in Greece and in Portugal as a result of fundamental structural budget problems. GDP continued to contract in Spain, Greece and Ireland in 2010. In Greece, Ireland and Portugal, the government debt crisis required joint intervention by the EU, IMF and ECB. The situation prior to the outbreak of the financial and economic crisis as well as the factors that further exacerbated the turmoil point to structural weaknesses and ineffective economic governance. In more detail, the financial sector lacked adequate regulation and supervision; economic structures were not competitive; macroeconomic imbalances had not been addressed; and government debts and deficits had increased substantially. Reforms and problem-solving in these countries are indispensable. In the short term, they will dampen growth, but in the medium term the measures should improve the growth potential.

Even though some of its member countries were grappling with problems, the euro area as a whole closed the first quarter of 2011 with above-average quarter-on-quarter growth of 0.8%. The animated growth drew mostly on the highly dynamic development of the German economy, but France, Belgium and Slovakia also contributed. Growth in Italy and Spain was comparatively subdued, and Portugal's economy even contracted. Overall, the euro area will remain on a moderate growth path and is expected to mount

Table 2

Underlying Global Economic Conditions

	2010	2011	2012	2013
<i>Annual change in % (real)</i>				
Gross domestic product				
World GDP growth outside the euro area	+5.5	+4.5	+4.7	+4.7
U.S.A.	+2.9	+2.6	+2.7	+2.8
Japan	+4.0	-0.4	+2.8	+1.9
Asia excluding Japan	+9.4	+7.9	+7.5	+7.5
Latin America	+6.0	+4.5	+3.9	+4.1
United Kingdom	+1.3	+1.4	+1.9	+2.2
New EU Member States ¹	+2.0	+3.1	+3.8	+3.9
Switzerland	+2.6	+2.4	+1.8	+1.7
Euro area ²	+1.7	+1.5 to +2.3	+0.6 to +2.8	x
World trade (imports of goods and services)				
World economy	+12.0	+8.0	+7.8	+7.6
Non-euro area countries	+13.2	+8.9	+8.6	+8.1
Real growth of euro area export markets	+11.6	+8.3	+7.9	+7.5
Real growth of Austrian export markets	+11.5	+7.5	+7.4	+7.2
Prices				
Oil price in USD/barrel (Brent)	79.6	111.1	108.0	103.7
Three-month interest rate in %	0.8	1.5	2.3	2.8
Long-term interest rate in %	3.2	3.7	4.0	4.3
USD/EUR exchange rate	1.33	1.42	1.43	1.43
Nominal effective exchange rate (euro area index)	104.63	105.52	105.98	105.98

Source: Eurosystem.

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

² 2011 to 2013: Results of the Eurosystem's June 2011 projections. The ECB presents the result in ranges based upon average differences between actual outcomes and previous projections.

by 1.5% to 2.3% in 2011 and by 0.6% to 2.8% in 2012.

Closing the first quarter of 2011 with growth of 1.5%, Germany outperformed even high expectations: GDP resumed the level it had posted before the crisis in the first quarter of 2008. Germany benefited not just from favorable international developments, but also from a stepped-up construction activity. These two factors do not suffice to explain the robust performance, though, as the economy expanded across the board. Both private consumption and investment in plant and equipment represent powerful motors for growth, and net exports continue to contribute at an above-average rate. Even if the rise in GDP should lose momentum in the next quarters, the German economy is likely to advance

by more than 3% in 2011, for the first time posting over 3% growth in two successive years since German unification. French GDP also posted healthy growth in the first quarter of 2011, but the forecasts for the French economy are more moderate. Domestic demand is on the mend, and is supported especially by a dynamic development of investment, but net exports represent a drag on growth. Italy, the euro area's third-largest economy after Germany and France, achieved a mere 0.1% quarterly growth in the first half of 2011. Italy's economy is hampered by persistent structural problems, and high debt has reduced the government's room for maneuver. Spain, the fourth-largest economy in the euro area, also acts as a damper on overall euro area growth. Before the crisis, Spain had

been one of the top performers on the periphery of the euro area in terms of GDP growth and had supported the overall euro area growth rate. But over the forecasting horizon, a slump in the construction sector, the government's fiscal consolidation measures, plus troubles in the labor market will keep a rein on domestic spending; its negative contribution to growth will lead to below-average growth in the long-term comparison.

The CESEE countries also underwent highly disparate developments. Each country was affected differently by the crisis, depending on the importance of its export sector and the size of its foreign currency borrowing share, current account deficit and government debt. Hungary, Romania and Latvia had to resort to help from the IMF and the EU. Growth in those EU Member States that had acceded in 2004 and 2007 but that have not yet introduced the euro is expected to pick up gradually from roughly 3% in 2011 to nearly 4% in 2013.

4 Austria: Robust Growth Coupled with Rising Inflation Provides Momentum to Cut Deficit

With growth running at 3.2%, Austria is one of the growth engines of the euro area. According to recent forecasts by the OECD and the European Commission, only Germany, Finland, Slovakia, Luxembourg and Estonia will post at least similarly high growth. This development already started in 2010, as the Austrian economy has been expanding at an above-average rate for one year. As a result, seasonally adjusted real GDP growth came to 4.0% in the first quarter of 2011 on the same quarter of the previous year.

However, Austria is also posting comparatively high rates of price increase in 2011. Apart from Austria, annual inflation rates of over 3% are anticipated for Spain, Belgium, Greece, Finland, Portugal, Slovakia, Luxembourg, Cyprus and Estonia. For several months, inflation has been quickening substantially, a development traceable

Box 1

Bright Economic Prospects Give Effort to Cut Deficit an Impetus¹

In 2010, Austria's general government deficit widened to 4.6% of GDP, and government debt rose to 72.3% of GDP. Changes in the accounting recommendations resulting from the implementation of Eurostat's updated Manual on Government Deficit and Debt (MGDD) entailed a marked deterioration of both the budget result for 2010 and of the fiscal indicators for the preceding years. Under the new MGDD, liabilities of extrabudgetary units that are ultimately assumed by the government must be recorded as deficit- and debt-increasing as soon as debt is incurred. Application of these recommendations to the extrabudgetary debt of provincial hospitals and the financing agreement between the federal government and the Austrian Federal Railways result not only in a revision of historical data, but also in a permanent increase in government spending by roughly 1/2% of GDP.

For 2011, the OeNB expects a significant improvement of some 1 1/2% of GDP in the general government balance in its economic outlook. The following reasons corroborate this assumption:

- On the expenditure side, the one-off effect of deficit-increasing capital transfers of 0.6% of GDP to KA Finanz AG and Hypo Alpe Adria in 2010 has ended.*
- Furthermore, low wage settlements for the public sector, a comparatively small increase in pensions and the reduction of social transfers to families contribute to the expectation that primary expenditure growth will be low compared to trend GDP growth.*

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– At the same time, tax increases and the exceptionally good macroeconomic developments sharply boost government revenue.

In 2012 and 2013, the general government balance is anticipated to improve somewhat further. A fairly strong rise in social transfers (in cash and in kind) and interest expenditure will be more than offset by continued sound revenue growth.

The most recent planned values of the Ministry of Finance for the general government budget balance are more pessimistic for 2011 and 2012 in particular than the values of the OeNB's economic outlook. The main reasons are the OeNB's comparably more optimistic projections for the development of social security contributions to the budget and interest payments from the budget. Thanks to relatively high growth over the entire forecast horizon, this deficit development will lead to a stabilization of the debt ratio at an elevated level despite positive stock-flow adjustments (resulting from bilateral loans to states at the euro area periphery).

not just to the rise in commodity and food prices. When the general government deficit has been rolled back to 3% of GDP, the budget will develop fairly well in a euro area comparison on the back of a booming economy. OECD and European Commission forecasts show only Germany, Finland, Luxembourg, Estonia and Malta posting a deficit of a magnitude roughly as low as that of Austria.

With GDP having augmented at above-average rates in the past quarters, in the first quarter of 2011 Austria's economy regained the real GDP level it had stood at prior to the outbreak of the financial and economic crisis.

Having remained in positive territory throughout the recession, consumer spending acted as a stabilizer during the crisis. By contrast, exports and investment shrank markedly. At end-2011, exports will have recovered to the precrisis level whereas investment will stay below the precrisis level until the end of the forecast horizon. The crisis had only a comparatively small impact on the domestic labor market, among other things because a multitude of labor market policy measures were taken. Employment has been developing at an above-average pace for months, reaching the precrisis level in the fourth quarter of 2010.

Box 2

Long-Term Output Losses – But No Job Losses¹

The OeNB's economic outlook sees the Austrian economy developing soundly and overcoming the slump triggered by the crisis faster than many other countries. Yet this does not mean that the crisis will not have a long-term negative impact. Against this backdrop, we compared a data set comprising actual data for GDP, employment, unemployment and exports up to the first quarter of 2011 and forecast data for the same indicators for the period up to the end of 2013 with a data set of hypothetical developments for the same periods without the crisis. To determine the hypothetical developments, we used two different precrisis trends:² first, developments from the first quarter of 1990 to the fourth quarter of 2005 (i.e. excluding the two boom years 2006 and 2007 preceding the crisis) and second, developments from the first quarter of 1990 to the fourth quarter of 2007 (i.e. including the boom years). The precrisis

¹ Compiled by the Economic Analysis Division with contributions by Gerhard Fenz (gerhard.fenz@oenb.at) and Martin Schneider (martin.schneider@oenb.at).

² The trends were generated with the HP filter ($\Lambda = 1600$).

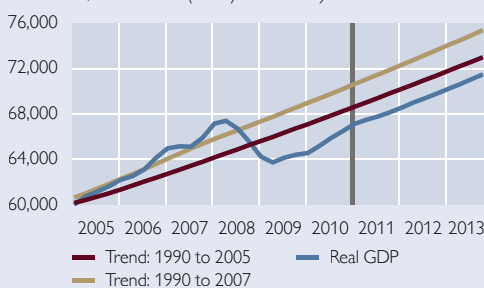
trends are extrapolated with the average growth rates of each variable up to the fourth quarter of 2013 and compared with the forecast developments.

The chart below shows the level of real GDP and real exports as well as employment and unemployment figures along with the respective trend developments. GDP growth returned to its precrisis level in the first quarter of 2011, and employment had already surpassed its precrisis level in the fourth quarter of 2010. According to the OeNB's economic outlook, export growth will outperform its precrisis level in the fourth quarter of 2011, and jobless numbers will fall below their precrisis level in the third quarter of 2013. Employment already surpassed its precrisis level in the fourth quarter of 2010, whereas the number of jobless persons will sink below its precrisis level in the third quarter of 2013.

Forecast and Precrisis Trends

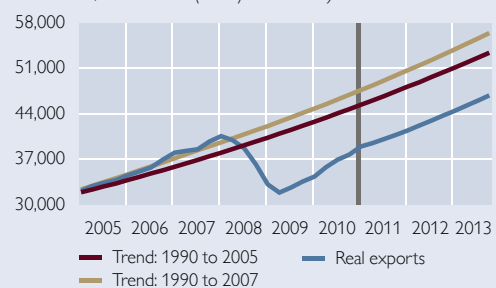
GDP

EUR million, in real terms (base year = 2005)



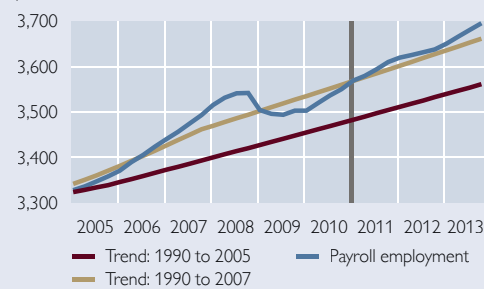
Exports

EUR million, in real terms (base year = 2005)



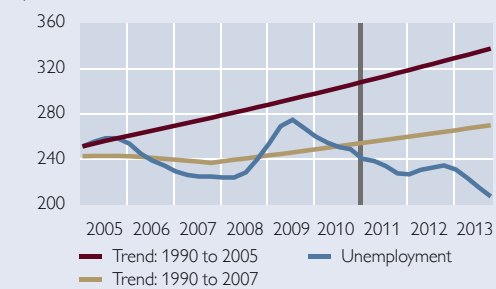
Employment

1,000



Unemployment

1,000



Source: OeNB, Eurostat.

The results reflect the sharp drop in economic performance: Both GDP and exports are shown to remain below their precrisis trends until the end of 2013. The output losses in the wake of the crisis may be calculated as the average annual deviation of GDP from the extrapolated precrisis trend. Compared to the trend for 1990 to 2005, the annual real output loss for 2009 to 2013 comes to 2.6% of trend GDP of the respective year, and compared to the trend for 1990 to 2007, the output loss even surges to 5.4%.

The impact of the crisis on the labor market differs sharply from the impact on GDP. Both employment and the number of unemployed persons developed better than the trend extrapolations suggested. Extrapolating the trend for 1990 to 2005, unemployment is noticeably below the precrisis level; employment is substantially higher. Apparently, the two boom years prior to the crisis provided for an employment buffer that the crisis did not eliminate, partly because of appropriate economic policy measures. Employment runs slightly above, unemployment considerably below the trend at the end of the forecast horizon even on the basis of the trend for 1990 to 2007.

5 Export Industry Benefits from Global Momentum

Austria's export industry was among the sectors which suffered most from the economic and financial crisis. Accordingly, exports declined sharply in 2009, only to post a remarkable recovery in 2010: After slumping by 20% in 2009, goods trade expanded by some 16% in the following year. This swift growth continued into 2011. In the current outlook, the OeNB's export indicator expects nominal goods exports to soar by 5.3% in April and 5.4% in May 2011 quarter on quarter. Austria benefits from high demand from Germany, Switzerland and the U.S.A., whose economies are propelled by the fast growth of the Asian and South American emerging countries. At a later point of the forecast horizon, the quickening recovery in the CESEE countries is set to boost demand for Austrian goods. Despite the upturn, Austria again recorded a deficit on goods trade, which came to about EUR 4 billion in 2010.

Thus, the positive development of Austrian exports is attributable to ser-

vices. In addition to the traditionally successful service sector (tourism), above all business services (excluding transport) contributed a surplus of EUR 6.3 billion to the notable overall result. The crisis hit service trade far less severely than goods trade, so that services acted as a stabilizing factor.

With exports mounting considerably in the first quarter of 2011, export growth in full-year 2011 is anticipated to remain nearly as strong as in 2010. Over the remainder of the forecast horizon, though, the forecast slackening of the international recovery will take its toll on foreign trade as well. A modest slowdown in export growth to about 7% a year is therefore anticipated for 2012 and 2013.

Austria's current account has improved steadily since the mid-1990s. 2008 saw a record surplus of 4.9% of GDP. Although the balance on current account deteriorated as a consequence of plummeting demand for exports during the crisis, it nevertheless remained in positive territory and will more or less resume its precrisis level by 2012.

Table 3

Growth and Price Developments in Austria's Foreign Trade

	2010	2011	2012	2013
<i>Annual change in %</i>				
Exports				
Competitor prices in Austria's export markets	+5.4	+3.7	+1.7	+1.6
Export deflator	+2.2	+2.9	+2.1	+1.9
Changes in price competitiveness	+3.3	+0.8	-0.4	-0.2
Import demand in Austria's export markets (real)	+11.5	+7.5	+7.4	+7.2
Austrian exports of goods and services (real)	+10.4	+10.0	+6.8	+7.2
Market share	-1.2	+2.6	-0.6	+0.1
Imports				
International competitor prices in the Austrian market	+4.5	+3.8	+1.8	+1.6
Import deflator	+3.9	+3.5	+2.2	+1.8
Austrian imports of goods and services (real)	+8.3	+8.9	+6.0	+6.6
Terms of trade	-1.6	-0.6	-0.1	+0.1
<i>Percentage points of real GDP</i>				
Contribution of net exports to GDP growth	+1.5	+1.2	+0.9	+0.9

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

Table 4

Austria's Current Account

	2010	2011	2012	2013
	% of nominal GDP			
Balance of trade	3.6	4.9	5.7	5.9
Balance on goods	-1.1	-0.6	-0.2	0.2
Balance on services	4.7	5.5	5.8	5.7
Balance on income	-0.1	-0.4	-0.4	-0.4
Balance on current transfers	-0.7	-0.6	-0.5	-0.5
Current account	2.7	4.0	4.8	5.0

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

6 Investment Drives Domestic Demand

6.1 Divergent Developments in Investment Activity

The crisis had a negative impact on confidence, caused exports to slump and therefore resulted in a build-up of capacity utilization, which in turn dampened investment activity. On the back of dynamic export demand, gross fixed capital formation rebounded from the second quarter of 2010.

This recovery of gross fixed capital formation drew mainly on strengthening

investment in plant and equipment. Both incoming orders and above-average industrial capacity utilization rates by historical standards (86.3%, long-term average since 1990: 85.4%) point to further impulses for investment activity. Also, over the forecast horizon, more and more capacity-boosting investment is expected. Once the rebound following the crisis has ended, the pace of investment in plant and equipment will ease up again later on during the forecast horizon. Residential construction and civil engineering in-

Table 5

Investment Activity in Austria

	2010	2011	2012	2013
	Annual change in %			
Total gross fixed capital formation (real)	-1.1	+3.7	+3.1	+3.4
<i>of which: Investment in plant and equipment</i>	-0.4	+6.3	+5.0	+3.6
Residential construction investment	-2.7	-0.9	+1.1	+1.8
Nonresidential construction investment and other investment	-2.9	-0.8	+3.0	+4.0
Government investment	+1.7	-0.5	+0.0	+0.0
Private investment	-1.2	+4.0	+3.3	+3.6
	Contribution to real total gross fixed capital formation growth in percentage points			
Investment in plant and equipment	-0.2	+2.6	+2.1	+1.5
Residential construction investment	-0.5	-0.2	+0.2	+0.3
Nonresidential construction investment and other investment	-1.2	-0.3	+1.1	+1.5
Government investment	+0.1	+0.0	+0.0	+0.0
Private investment	-1.2	+3.7	+3.1	+3.4
	Contribution to real GDP growth in percentage points			
Inventory changes	+0.6	+0.9	+0.0	+0.0

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

vestment was still shrinking in the fourth quarter of 2010. No clear signs of a revival in this sector have become noticeable yet; overall construction output (NACE F) still continued to decrease slightly in the first quarter of 2011. So far, no trend reversal has become apparent in civil engineering, and the development of building construction will remain moderate, even though the number of residential building permits was somewhat higher in 2009 and 2010 than prior to the emergence of the crisis. Thus, construction activity is anticipated to decline further in 2011. Over the remainder of the forecast horizon, rising real estate prices and the ongoing upswing are expected to fuel a recovery of investment in both building construction and in civil engineering.

Government investment increased by 1.7% in 2010. The public sector's consolidation measures will cause investment to decline in 2011 (−0.5%) and then to stagnate. Gross fixed capital formation overall is forecast to augment by 3.7% in 2011, by 3.1% in 2012 and by 3.4% in 2013.

6.2 Consumption Growth to Stay Moderate

With the economy picking up, all components of household income (compensation of employees, investment income, mixed income of the self-employed, and operating surpluses) will post nominal increases in 2011 for the first time since the crisis. Compensation of employees will advance decisively in 2011 on account of above-average employment growth (1.7%) and positive wage drift in spite of a moderate increase in negotiated standard wages (2.2%). In 2012 and 2013, employment will grow significantly by 1.2% in each year driven by demand. Negotiated standard wages are set to go

up by 2.7% in 2012, which is a reaction to high inflation in 2011, and by a more moderate 2.3% in 2013. Overall, compensation of employees is thus calculated to increase by 4.7% in 2011, by 4.1% in 2012 and by 3.8% in 2013. Mixed income of the self-employed and operating surpluses are also set to post animated growth. In 2011 as well as the two subsequent years, investment income will benefit from rising interest income and the distribution of profits.

Over the entire forecast horizon, nominal household income will be burdened measurably by consolidation measures, i.e. higher petroleum and tobacco taxes, taxes on airline tickets and cuts in social transfers. The growth contribution of net transfers after direct taxes will therefore be negative in the years 2011 through 2013. Overall, nominal household income will expand by 3.3% in 2011 (2012: 4.1%; 2013: 4.4%). With inflation in 2011 running comparatively high, household real disposable income will edge up by a mere 0.5%; real wages (per employee) will in fact drop. During the remaining forecast horizon, inflation is expected to ease substantially. This will boost real household income by 2.1% in 2012 and by 2.5% in 2013.

The saving ratio will contract in 2011 because real per capita wages are on the decline. But in 2012 and 2013, the saving ratio is set to rise again and to approach the 10.3% level it had stood at before the crisis unfolded, for one thing because consumer spending is below average in light of the revival of investment income and mixed income of the self-employed, and for another because uncertainty about the long-term sustainability of the state pension system and the reforms that will have to be implemented is on the rise again. Real consumer spending by households is anticipated to edge up by 0.9% in

Table 6

Determinants of Nominal Household Income in Austria

	2010	2011	2012	2013
<i>Annual change in %</i>				
Employees	+0.8	+1.7	+1.2	+1.2
Wages per employee	+1.3	+2.6	+2.9	+2.5
Compensation of employees	+2.1	+4.3	+4.1	+3.8
Property income	-20.9	+10.9	+11.3	+13.2
Mixed income and operating surplus, net	+0.4	+1.9	+3.7	+4.4
<i>Contribution to disposable household income growth in percentage points</i>				
Compensation of employees	+1.7	+3.7	+3.5	+3.3
Property income	-2.0	+0.8	+0.9	+1.1
Mixed income and operating surplus, net	+0.1	+0.4	+0.7	+0.8
Net transfers minus direct taxes ¹	+0.7	-1.5	-1.0	-0.9
Disposable household income (nominal)	+0.8	+3.3	+4.1	+4.4

Source: 2010: Eurostat; 2011 to 2013: OeNB June 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
<i>Annual change in %</i>				
Disposable household income (nominal)	+0.8	+3.3	+4.1	+4.4
Private consumption expenditure (PCE) deflator	+1.5	+2.7	+1.9	+1.8
Disposable household income (real)	-0.7	+0.5	+2.1	+2.5
Private consumption (real)	+1.1	+0.9	+1.2	+1.2
<i>% of nominal disposable household income</i>				
Saving ratio	9.2	8.6	9.4	10.3

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

2011 and by 1.2% in 2012 as well as 2013.

6.3 Robust Employment Growth Dampens Unemployment only Slowly

The recovery of the Austrian labor market in 2010 was unexpectedly rapid and powerful by historical and international standards. The number of employed persons mounted by around 28,000 (0.8%) all in all. So far, employment growth has been reflected by a sharp increase in leased employment contracts (business support services), in health and social services and, in line

with the marked rise in output, in manufacturing. This trend continued into the beginning of 2011. Unlike in 2010, though, construction employment posted slight gains. In the first quarter of 2011, employment advanced by 1.9% (seasonally adjusted). In 2011 as a whole, the number of employed persons is likely to rise by 60,000 (or 1.7% year on year). As GDP growth is set to be above potential in 2012 and 2013, employment will expand at an above-average pace of 1.2% a year as well.

Throughout the cycle so far, employment supply has been highly cyclical; it nearly stagnated in 2009 (+5,000 per-

Table 8

Labor Market Developments in Austria

	2010	2011	2012	2013
<i>Annual change in %</i>				
Total employment	+1.0	+1.7	+1.2	+1.2
of which: Payroll employment	+0.8	+1.7	+1.2	+1.2
Self-employment	+2.1	+1.9	+1.6	+1.2
Public sector employment	+0.1	-0.1	-0.1	-0.1
Registered unemployment	-4.8	-6.5	-1.1	-5.5
Labor supply	+0.8	+1.2	+1.1	+0.9
<i>% of labor supply</i>				
Unemployment rate (Eurostat definition)	4.4	4.3	4.3	4.1

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

sons; 2008: still roughly +75,000 persons). In 2010, labor supply reacted to the improved economic outlook by widening by nearly 34,000 persons. Over the remainder of the forecast horizon, however, robust economic activity will not be the only factor driving up labor supply. The complete liberalization in May 2011 of the Austrian labor market to persons from the countries that joined the EU in 2004 will add to labor supply growth. Given these countries' proximity to the Austrian border, Austria is liable to experience not just labor supply migration but also more commuter traffic. Over the entire forecast horizon, labor supply could surge by roughly 75,000 commuters or migrants. Considering that a number of professions already benefit from nearly full labor mobility and that the statistical coverage is fraught with uncertainty, this estimate represents an upper limit.

Austria boasted an unemployment rate of 4.4% (Eurostat definition) in 2010, one of the lowest unemployment rates in the euro area. As labor supply is expanding, though, the unemployment rate is expected to ease only marginally to 4.3% in 2011 and to drop further to 4.1% in 2013 despite animated employment growth. Unemployment figures

will dip to below the precrisis level again in 2013.

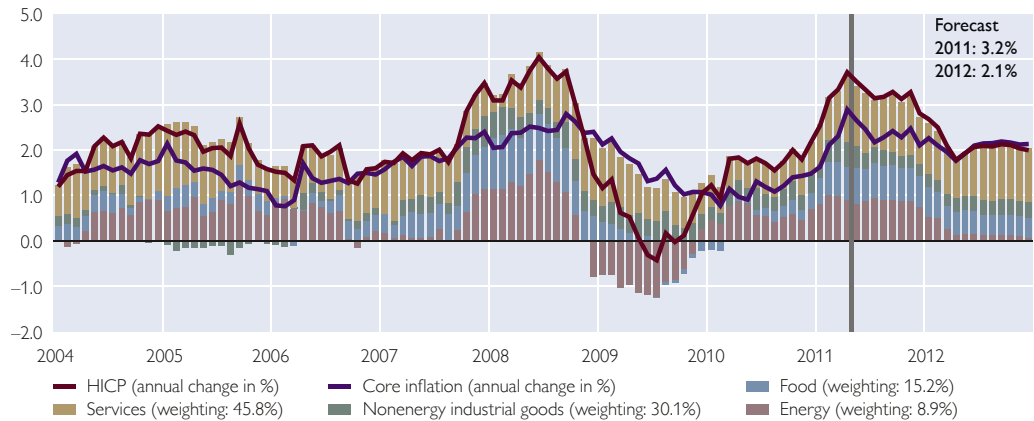
7 Inflation in 2011 to Top 3%

In the first four months of 2011, HICP inflation jumped from 2.5% in January to 3.7% in April, pushing the Austrian rate to above the euro area average (2.8%) and to above the German (2.7%) as well as Italian (2.9%) inflation rates. From January through March 2011, inflation was driven by the rise in externally determined energy and food prices as well as the price of industrial goods excluding energy. A strong surge in service prices speeded up HICP and core inflation further in April 2011. The higher energy and food prices reflect an external price surge on the one hand, but higher petroleum taxes also added to more expensive energy prices. With regard to food prices, Austria has a very high share of discount food stores in a European comparison, which results in international food prices with their low price margins being passed on more directly and more rapidly to the final consumer than in other countries. Service prices rose more sharply in Austria than in Germany in April 2011, especially because special factors – the cut in VAT for accommodation services and the abolition of

HICP Inflation and Contributions by Subcomponents

Contributions to growth in percentage points

Last observation: April



Source: OeNB, Statistics Austria.

tuition fees in one German state – dampened German service price inflation.

The pace of inflation is expected to slow in May 2011. By the end of 2011, the base effects are likely to have dissipated; thus, energy price-induced inflationary pressure should have run its course. However, the anticipated higher wage settlements for 2012 will result in a greater contribution of ser-

vice prices to HICP inflation. Consequently, HICP inflation will remain at around 2% in 2012 and will not fall below the 2% mark until 2013.

During the forecast horizon, the improved economic outlook will trigger slightly positive wage drift. The opening of the Austrian labor market will barely have an impact on wage drift, as experts assume that the additional labor will be

Table 9

Selected Price and Cost Indicators for Austria

	2010	2011	2012	2013
<i>Annual change in %</i>				
Harmonised Index of Consumer Prices (HICP)	+1.7	+3.2	+2.1	+1.9
HICP energy	+7.6	+11.3	+2.5	+2.3
HICP excluding energy	+1.2	+2.4	+2.1	+1.9
Private consumption expenditure (PCE) deflator	+1.5	+2.7	+1.9	+1.8
Investment deflator	+3.0	+2.0	+1.9	+1.9
Import deflator	+3.9	+3.5	+2.2	+1.8
Export deflator	+2.2	+2.9	+2.1	+1.9
Terms of trade	-1.6	-0.6	-0.1	+0.1
GDP at factor cost deflator	+1.7	+2.0	+2.2	+2.1
Unit labor costs	+0.1	+1.1	+1.8	+1.3
Compensation per employee	+1.3	+2.6	+2.9	+2.5
Labor productivity	+1.2	+1.5	+1.1	+1.2
Collectively agreed wage settlements	+1.6	+2.2	+2.7	+2.3
Profit margins ¹	+1.7	+0.9	+0.4	+0.7

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

¹ GDP deflator divided by unit labor costs.

employed above all in sectors that strictly adhere to negotiated standard wages.

8 Forecast Risks Largely Balance Out

On the domestic side, the risks with respect to economic growth are slightly on the upside. Should the saving ratio decline, the funds freed up may flow into stepped-up consumer spending; higher than projected wage agreements would additionally put more disposable funds into consumers' pockets. In the same vein, it cannot be ruled out that employment and unemployment figures develop better than projected. Against the background of rising real estate prices, construction might also recover faster than expected. The external risks to growth are balanced: Above all, economic developments in Germany and in the CESEE countries could be better than assumed in the forecast. Downside risks could emanate from the negative impact of consolidation problems on confidence and the renewed tension in the financial markets these might elicit.

A further rise in commodity prices represents a risk to economic activity and, in particular, an upward risk for inflation. A further depreciation of the euro, stronger second-round effects and higher output growth in the medium term would also fuel inflation.

9 Forecast Revised after Economic Activity Outperforms Expectations at the Beginning of 2011

The underlying assumptions on the growth of global trade have been revised upward since the OeNB's December 2010 economic outlook. For 2011 (2012), we have raised our growth expectations for Austria's export markets by

0.8 (1.0) percentage points. Crude oil futures prices went up noticeably by USD 22.5 for 2011 and USD 17.3 for 2012. The exchange rate of the euro against the U.S. dollar has moved only little. The nominal effective exchange rate is somewhat lower than projected in December 2010. Both long-term and short-term interest rates are slightly higher than pegged in the December forecast.

The effects of these new external assumptions were simulated using the OeNB macroeconomic model. Table 11 lists the reasons for revising the outlook in detail. Apart from the impact of changed external assumptions, they are attributable to the impact of new data and a residual. The influence of new data includes the effects of the revisions of both the historical data already available at the time of the previous economic outlook (i.e. data up to the third quarter of 2010) and the forecasting errors of the previous outlook for the periods now published for the first time (i.e. data for the fourth quarter of 2010 and for the first 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 reason why higher economic growth is assumed for 2011 is, first and foremost, the fact that growth in the first quarter of 2011 was stronger than expected in the December 2010 forecast. The fiscal consolidation measures were already factored into the December forecast (2011: -0.3 percentage points of GDP growth; 2012: -0.2 percentage points) and are thus not suited to explaining the forecast revision. The upward revision of the inflation forecast for 2011 is primarily due to higher assumed energy and food prices.

Table 10

Change in the External Economic Conditions since the OeNB December 2010 Outlook

	June 2011			December 2010		Difference	
	2011	2012	2013	2011	2012	2011	2012
<i>Annual change in %</i>							
Growth of Austria's export markets	+7.5	+7.4	+7.2	+6.7	+6.4	+0.8	+1.0
Competitor prices in Austria's export markets	+3.7	+1.7	+1.6	+1.9	+1.7	+1.8	+0.0
Competitor prices in Austria's import markets	+3.8	+1.8	+1.6	+2.1	+1.7	+1.7	+0.1
<i>USD per barrel (Brent)</i>							
Oil price	111.1	108.0	103.7	88.6	90.7	+22.5	+17.3
<i>Annual change in %</i>							
Nominal effective exchange rate (exports)	+0.2	-0.1	+0.0	-0.1	+0.0	+0.3	-0.1
Nominal effective exchange rate (imports)	+0.6	+0.0	+0.0	+0.1	+0.0	+0.5	+0.0
%							
Three-month interest rate	1.5	2.3	2.8	1.4	1.7	+0.1	+0.6
Long-term interest rate	3.7	4.0	4.3	3.4	3.7	+0.3	+0.3
<i>Annual change in %</i>							
U.S. GDP (real)	+2.6	+2.7	+2.8	+2.4	+2.7	+0.2	+0.0
<i>USD/EUR</i>							
USD/EUR exchange rate	1.42	1.43	1.43	1.39	1.39	+0.03	+0.04

Source: Eurosystem.

Table 11

Breakdown of Forecast Revisions

	GDP		HICP	
	2011	2012	2011	2012
<i>Annual change in %</i>				
June 2011 outlook	+3.2	+2.3	+3.2	+2.1
December 2010 outlook	+2.1	+2.3	+2.2	+1.8
Difference	+1.1	+0.0	+1.0	+0.3
<i>Percentage points</i>				
Due to:				
External assumptions	+0.0	+0.2	+0.7	+0.2
New data	+1.0	+0.0	+0.0	x
of which: Revision of historical data until Q3 10	+0.0	+0.0	+0.1	x
Projection errors for Q4 10 and Q1 11	+1.0	+0.0	+0.2	x
Other ¹	+0.1	-0.2	+1.0	+0.1

Source: OeNB June 2011 and December 2010 outlooks.

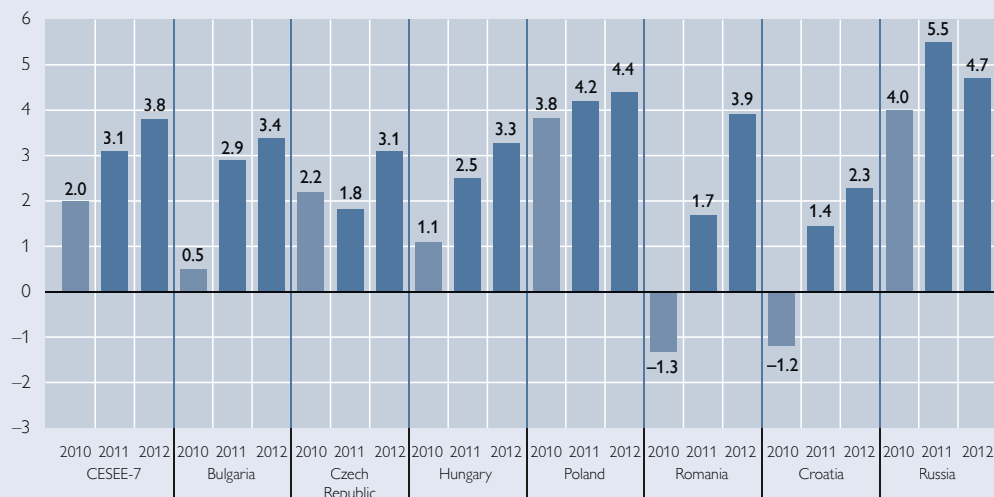
¹ Different assumptions about trends in domestic variables such as wages, government consumption, effects of tax measures, other changes in assessment and model changes.

OeNB-BOFIT Outlook for Selected CESEE Countries: Domestic Demand Strengthens and External Demand Moderates as Growth Engine^{1, 2}

Growth in the CESEE-7 region³ remained uneven across countries in 2010, but has become more balanced from 2011 onward. Backed by recovering domestic demand and continued (albeit declining) support from external demand, GDP growth is expected to reach 3.1% in 2011 and to increase only moderately to 3.8% in 2012. This overall upward revision of our September projections for the region concerns all countries equally, with the exception of the Czech Republic, for which we revise our forecast downward by 0.6 percentage points. Traditional growth drivers are re-emerging in the CESEE-7. Domestic demand, backed by a strong rebound in investment and a moderate revival of private consumption, will contribute positively to GDP growth again from 2011, while the contribution of net exports is shrinking continually and will turn negative in many countries in 2012. In tandem, capacity utilization is rising sharply. At the same time, restocking has mostly come to an end. The projected acceleration of growth to almost 4% in 2012 should bring back a considerable growth differential to Western Europe (of about 2 percentage points), thus ensuring that the convergence process (which slowed down substantially over the past two years) will pick up again. Nevertheless, growth rates will remain below their pre-crisis levels, which can be attributed to the elevated need for fiscal consolidation in a number of countries, continuously tight credit conditions, a weak construction sector and a moderation of demand in the region's major trading partners, mainly the euro area.

CESEE-7: GDP Growth Projections for 2011 to 2012

Year-on-year growth in %, in real terms



Source: OeNB-BOFIT March 2011 forecast, Eurostat, IMF.

¹ Compiled by the 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 CESEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania, Russia and Croatia). They 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, see Crespo Cuaresma, Feldkircher, Slačik and Würz. 2009. Simple but Effective: The OeNB's Forecasting Model for Selected CESEE Countries. Focus on European Economic Integration Q4/09. 84–95). The projections for Russia were prepared by the Bank of Finland Institute for Economies in Transition and are based on an SVAR model. The cutoff date for all projections in this box is March 24, 2011.

³ Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania. Latvia and Lithuania are not covered by our own projections in this note, but are included in the CESEE-7 aggregate based on the most recent IMF projections.

Following a temporary pick-up during the winter, GDP growth in Russia is expected to slow down gradually during the forecast period, slipping from 5.5% in 2011 to 4.7% in 2012. One of the reasons for this decline is that imports are projected to continue expanding rapidly, at about 16% in 2011 and around 10% in 2012. Croatia's GDP growth, in turn, will recover rather moderately by 1.4% in 2011 and accelerate somewhat to 2.3% in 2012 thanks to a further strengthening of domestic demand.

CESEE-7: Cautious Revival of Domestic Demand Hampered by Consolidation Needs

Although growth rates converged somewhat in the second half of 2010, growth was still uneven in the region in 2010 and came to 2% on average. While growth was supported by the sharp expansion in economic activity in Poland and the Czech Republic, it was dampened by weak but positive growth in Hungary and Bulgaria and a persisting real contraction in Romania. In the course of 2010, unemployment rates stabilized in the CESEE-7 region and even declined in some countries, and the downward trend in employment levels came to a halt. Economic sentiment turned cautiously positive in most countries.

For 2011, we expect a further increase of the region's average growth rate to 3.1% and a more even development across countries. With a growth rate of 4.2%, Poland will continue to outperform the other CESEE-7 countries. Growth will accelerate in all CESEE-7 countries except the Czech Republic, where a substantial austerity program is being implemented (even though it was formally repealed by the country's constitutional court and will have to be reapproved by parliament before the end of 2011).

Restocking is coming to an end and investment will pick up as a result of already high capacity utilization levels and renewed demand for investment in the wake of the crisis. Private consumption will also turn positive again in all CESEE-7 countries, while we expect no impetus from public consumption due to harsh budget constraints. Nevertheless, domestic demand is reviving in the region, and we expect it to strengthen further over the forecast horizon. Domestic demand will thus resume its traditional role and contribute positively to economic growth in all CESEE-7 countries except the Czech Republic. Here, the contribution will be slightly negative in 2011.

External demand will cease to be the most important growth driver, as exports are losing momentum. On the one hand, this projection rests on the assumption that euro area import dynamics will moderate; on the other hand, it is associated with the swift and strong rebound in exports in early 2010 and a strong growth impulse from Germany in early 2010, which started to fade out already in the second half of 2010. The trend of currency appreciation further weighs on international price competitiveness, thus compounding these effects. Despite the sharp rise in investment and the revival of private consumption, import growth rates will moderate since it is closely related with export growth. As a result, net exports will continue to contribute positively to growth in the Central European countries, and in the Czech Republic in particular. However, their positive contribution is diminishing in all countries under review and will turn negative in Bulgaria and Romania already in 2011.

The picture will remain largely unchanged in 2012. Domestic demand and investment will gain further momentum, but both will remain well below their 2005–2008 average. This is related to continuing tight credit conditions and sluggish FDI inflows as a result of lower investor trust and strong competition, especially from Asia. Import growth will accelerate to more than 8% across the CESEE-7 region. Net exports will make a negative contribution in all countries apart from Hungary and the Czech Republic.

All countries with the exception of Romania will recover to their pre-crisis GDP levels in 2012. As Poland, the largest economy in the region, did not experience any output loss in 2009, the CESEE-7 region as a whole will reach its pre-crisis output level already by the end of 2011. With growth rates coming close to 4% again, the process of catching-up with Western Europe will pick up pace again after having slowed down substantially for more than two years.

These forecasts are subject to risks that are mainly related to developments in the euro area. Euro area growth may turn out stronger than assumed here, thus posing a sizeable upside risk stemming from external demand. Some downside risks could emerge from fiscal consolidation needs that are stronger than those already addressed by policymakers in the region. Some uncertainty continues to prevail with respect to changes in investor confidence (i.e. the development of global risk aversion, in particular vis-à-vis emerging economies). We still assume that investor confidence will continue to improve gradually over the projection horizon. Investor confidence could, however, strengthen more quickly or it could weaken again, e.g. as a result of contagion from worsening investment conditions in some Western European countries or as a result of a global loss of trust because of current developments in Japan.

Russia: Brisk, but Moderating Growth

Russia's recovery temporarily slowed down in the fall of 2010, which was especially attributable to a stronger rebound of imports and to production losses caused by extreme weather conditions in the summer. Economic growth picked up this winter, supported by the sharp rise of oil, metal and gas prices in recent months. Due to this positive terms-of-trade shock and to the relatively low base level in 2010 (including the unexpected growth dip in the third quarter), annual GDP growth is projected to increase by more than 5% in 2011. GDP expansion is then projected to ease to less than 5% in 2012, assuming that the oil price remains unchanged at around USD 100 per barrel over the forecast period.

The revival of private consumption was rather lackluster in 2010 (3%), while real household income increased by around 4%. Looking ahead, consumption will grow more briskly and will likely become the main growth driver. This will help the agricultural sector rebound from a drastic drop in 2010. Wages are foreseen to rise rather swiftly, but not as fast as in the years before the recession. Consumption is also supported by an expected decline in the household savings rate, which had risen considerably during the crisis, as well as by the continuing growth of household bank lending, which gradually revived in 2010. Yet the increase in households' purchasing power is constrained by inflation, which – spearheaded by the rise in food price and favored by the expansion of M2 – accelerated to almost 10% and induced a tightening of monetary policy. Public consumption, after marginal growth in 2009–2010, is anticipated to increase slowly over the forecast period. This development is backed by the oil price, which is higher than assumed in the three-year budget for 2011–2013 and will thus generate additional budget revenues and allow for some additional expenditure, also in the context of the forthcoming elections.

As noted in the previous outlook (September 2010), fixed investment is recovering with a delay (+6.1% in 2010 following a plunge in 2009). A full-fledged revival is expected for 2011 and 2012, as during the latter part of 2011, utilization of production capacity can be expected to rise to the level observed during the pre-slump boom. Remarkably, inventory restocking was the main growth driver in 2010. In our forecast, this inventory cycle is assumed to be almost completed.

Russia's export volume picked up quickly in 2010 from a recessionary dip and exceptional disruptions of gas delivery in early 2009. However, from 2011, exports are expected to increase relatively slowly – compared to global trade – since export volumes of crude oil and oil products are not likely to grow. That said, anticipated increases in natural gas deliveries and in exports of Russia's other basic commodities will partly alleviate the situation.

In 2010, Russia's imports recovered considerably faster than forecast, with import volumes rising by 25% from a crevasse of –30% in 2009. The import surge partly stemmed from a disturbance to production during the summer. Import growth eased again last winter and is forecast to slow down gradually toward the fourth quarter of 2012, but it is still expected to roll on at about 15% in 2011 and around 10% in 2012. In any case, imports continue to be propped up by the Russian ruble's real exchange rate, which is likely to further appreciate as the current account will remain in surplus.

This forecast, like that of September 2010, is based on the assumption of strong growth in the world economy and world trade. The oil market price is assumed to be high (even if flat), which implies high prices for Russia's other main exports, i.e. fuel oils, gas and metals. The forecast is surrounded by considerable uncertainty. The associated risk is mostly on the upside, as prices could rise even higher due to uncertainty concerning the extent and timing of supply reactions to growing demand and given that exports continue to account for 30% of Russia's GDP. Yet the Russian government may delay spending the additional tax revenues generated because of the rise in oil prices. Global uncertainties may entail considerable swings in financial inflows and outflows. In Russia, faster-than-expected inflation would further erode real consumption growth but boost real appreciation and support the propensity to import.

Delayed Recovery in Croatia Backed by Nascent Domestic Demand

Economic conditions remained weak in Croatia in 2010, with GDP contracting by 1.2% year on year as domestic demand continued to decline (albeit at a diminishing rate). However, while investment activity (in particular in the construction sector) remained depressed throughout the year, private consumption showed tentative signs of recovery in the latter part of 2010, following a personal income tax reform and the abolition of a crisis tax on household income. At the same time, public consumption remained subdued against the background of increasing fiscal constraints. Net exports continued to contribute positively to economic growth, although somewhat less so than in 2009, given gradually firming import growth toward end-2010.

The Croatian economy is forecast to grow by 1.4% in 2011, with both domestic demand and net exports contributing to economic growth. Investment activity is expected to turn marginally positive, driven by strengthening credit growth and improving business sentiment. Private consumption should gather momentum as the impact of the tax reform fully materializes and first signs of improving labor market conditions become apparent. Even though 2011 is an election year, no major stimuli are to be expected from public consumption given the freezing of budget expenditures for 2011 at the level of the revised 2010 budget. Export growth is expected to stay firm in 2011, but will be accompanied by a further acceleration of import growth in light of strengthening domestic demand. Accordingly, the positive contribution of net exports to GDP growth is likely to diminish further.

In 2012, GDP growth is expected to accelerate to 2.3% driven by strengthening domestic demand. In particular, gross fixed capital formation is forecast to pick up on the back of increased FDI inflows ahead of the envisaged EU accession.

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	141,414	142,663	144,379	146,157	+1.1	+0.9	+1.2	+1.2
Government consumption	49,385	49,761	50,139	50,628	-0.1	+0.8	+0.8	+1.0
Gross fixed capital formation	52,415	54,366	56,053	57,960	-1.1	+3.7	+3.1	+3.4
of which: Investment in plant and equipment	21,409	22,761	23,908	24,777	-0.4	+6.3	+5.0	+3.6
Residential construction investment	10,141	10,046	10,153	10,334	-2.7	-0.9	+1.1	+1.8
Investment in other construction	20,935	20,767	21,391	22,249	-2.9	-0.8	+3.0	+4.0
Changes in inventories (including statistical discrepancy)	2,165	3,944	3,995	4,021	x	x	x	x
Domestic demand	245,379	250,733	254,566	258,765	+0.7	+2.2	+1.5	+1.6
Exports of goods and services	144,699	159,222	170,113	182,424	+10.4	+10.0	+6.8	+7.2
Imports of goods and services	128,038	139,409	147,807	157,570	+8.3	+8.9	+6.0	+6.6
Net exports	16,661	19,813	22,307	24,854	x	x	x	x
Gross domestic product	262,040	270,546	276,873	283,619	+2.2	+3.2	+2.3	+2.4

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

Table 13

Demand Components (Current Prices)

	2010	2011	2012	2013	2010	2011	2012	2013
	EUR million				Annual change in %			
Private consumption	153,223	158,753	163,783	168,854	+2.6	+3.6	+3.2	+3.1
Government consumption	55,799	57,282	59,173	61,047	+2.9	+2.7	+3.3	+3.2
Gross fixed capital formation	59,170	62,586	65,762	69,283	+1.9	+5.8	+5.1	+5.4
Changes in inventories (including statistical discrepancy)	2,313	4,768	4,941	5,055	x	x	x	x
Domestic demand	270,505	283,389	293,658	304,239	+3.3	+4.8	+3.6	+3.6
Exports of goods and services	157,023	177,756	193,893	211,795	+12.8	+13.2	+9.1	+9.2
Imports of goods and services	143,629	161,763	175,274	190,133	+12.6	+12.6	+8.4	+8.5
Net exports	13,394	15,993	18,619	21,663	x	x	x	x
Gross domestic product	283,899	299,382	312,278	325,902	+3.8	+5.5	+4.3	+4.4

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

Table 14

Deflators of Demand Components

	2010	2011	2012	2013	2010	2011	2012	2013
	2005 = 100				Annual change in %			
Private consumption	108.3	111.3	113.4	115.5	+1.5	+2.7	+1.9	+1.8
Government consumption	113.0	115.1	118.0	120.6	+2.9	+1.9	+2.5	+2.2
Gross fixed capital formation	112.9	115.1	117.3	119.5	+3.0	+2.0	+1.9	+1.9
Domestic demand (excluding changes in inventories)	110.3	112.9	115.2	117.4	+2.1	+2.4	+2.1	+1.9
Exports of goods and services	108.5	111.6	114.0	116.1	+2.2	+2.9	+2.1	+1.9
Imports of goods and services	112.1	116.0	118.6	120.7	+3.9	+3.5	+2.2	+1.8
Terms of trade	96.8	96.2	96.1	96.2	-1.6	-0.6	-0.1	+0.1
Gross domestic product	108.3	110.7	112.8	114.9	+1.6	+2.1	+1.9	+1.9

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

Table 15

Labor Market

	2010	2011	2012	2013	2010	2011	2012	2013
	Thousands				Annual change in %			
Total employment	4,119.5	4,191.1	4,243.3	4,296.2	+1.0	+1.7	+1.2	+1.2
of which: Private sector employment	3,586.5	3,658.8	3,711.7	3,765.2	+1.1	+2.0	+1.4	+1.4
Payroll employment (national accounts definition)	3,527.6	3,588.0	3,630.3	3,675.7	+0.8	+1.7	+1.2	+1.2
	<i>% of labor supply</i>							
Unemployment rate (Eurostat definition)	4.4	4.3	4.3	4.1	x	x	x	x
	<i>EUR per real output unit x 100</i>							
Unit labor costs (whole economy) ¹	63.6	64.3	65.4	66.3	+0.1	+1.1	+1.8	+1.3
	<i>EUR thousand per employee</i>							
Labor productivity (whole economy) ²	63.6	64.6	65.2	66.0	+1.2	+1.5	+1.1	+1.2
	<i>EUR thousand</i>							
Real compensation per employee ³	37.3	37.3	37.6	37.9	-0.2	-0.1	+0.9	+0.7
	<i>At current prices in EUR thousand</i>							
Gross compensation per employee	40.4	41.5	42.7	43.8	+1.3	+2.6	+2.9	+2.5
	<i>At current prices in EUR million</i>							
Total gross compensation of employees	142,639	148,831	154,930	160,830	+2.1	+4.3	+4.1	+3.8

Source: 2010: Eurostat; 2011 to 2013: OeNB June 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	10,112.0	14,609.4	17,762.1	19,141.7	3.6	4.9	5.7	5.9
Balance on goods	-3,216.0	-1,896.3	-494.6	636.9	-1.1	-0.6	-0.2	0.2
Balance on services	13,328.0	16,505.8	18,256.7	18,504.8	4.7	5.5	5.8	5.7
Balance on income	-290.0	-1,061.8	-1,355.9	-1,366.6	-0.1	-0.4	-0.4	-0.4
Balance on transfers	-2,065.0	-1,668.6	-1,546.1	-1,493.6	-0.7	-0.6	-0.5	-0.5
Current account	7,757.0	11,879.0	14,860.1	16,281.4	2.7	4.0	4.8	5.0

Source, 2010, Eurostat; 2011 to 2013: OeNB June 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															
<i>Annual change in %</i>															
HICP	+3.2	+2.1	+1.9	+3.0	+3.5	+3.2	+3.1	+2.4	+1.9	+2.1	+2.0	+2.0	+2.0	+1.9	+1.8
HICP (excluding energy)	+2.4	+2.1	+1.9	+2.2	+2.8	+2.4	+2.3	+2.1	+1.9	+2.2	+2.1	+2.0	+2.0	+1.9	+1.8
Private consumption expenditure (PCE) deflator	+2.7	+1.9	+1.8	+2.5	+2.9	+2.8	+2.6	+2.2	+1.8	+1.9	+1.9	+1.8	+1.9	+1.8	+1.8
Gross fixed capital formation deflator	+2.0	+1.9	+1.9	+2.0	+1.9	+2.0	+2.0	+1.9	+1.9	+1.9	+1.9	+1.9	+1.9	+1.9	+1.8
GDP deflator	+2.1	+1.9	+1.9	+1.9	+2.2	+2.2	+2.2	+2.2	+1.8	+1.8	+1.9	+2.0	+2.0	+1.8	+1.8
Unit labor costs	+1.1	+1.8	+1.3	-0.9	+0.5	+2.0	+2.8	+2.9	+2.1	+1.3	+0.8	+0.9	+1.2	+1.5	+1.7
Nominal wages per employee	+2.6	+2.9	+2.5	+1.4	+2.2	+3.1	+3.7	+3.5	+3.1	+2.6	+2.3	+2.3	+2.4	+2.6	+2.8
Productivity	+1.5	+1.1	+1.2	+2.3	+1.7	+1.0	+0.9	+0.6	+1.0	+1.3	+1.5	+1.4	+1.2	+1.1	+1.1
Real wages per employee	-0.1	+0.9	+0.7	-1.1	-0.7	+0.2	+1.1	+1.3	+1.2	+0.8	+0.4	+0.4	+0.5	+0.8	+0.9
Import deflator	+3.5	+2.2	+1.8	+4.8	+3.6	+3.0	+2.6	+2.1	+2.4	+2.2	+2.1	+1.8	+1.7	+1.7	+1.7
Export deflator	+2.9	+2.1	+1.9	+3.1	+2.8	+2.9	+2.8	+2.6	+2.2	+1.8	+1.8	+1.8	+1.9	+1.8	+1.9
Terms of trade	-0.6	-0.1	+0.1	-1.6	-0.7	+0.2	+0.5	+0.5	-0.2	-0.4	-0.3	+0.0	+0.2	+0.1	+0.1
Economic activity															
<i>Annual and/or quarterly changes in % (real)</i>															
GDP	+3.2	+2.3	+2.4	+1.0	+0.5	+0.5	+0.6	+0.6	+0.6	+0.5	+0.5	+0.6	+0.6	+0.7	+0.7
Private consumption	+0.9	+1.2	+1.2	+0.2	+0.1	+0.3	+0.3	+0.3	+0.4	+0.3	+0.3	+0.3	+0.3	+0.3	+0.4
Government consumption	+0.8	+0.8	+1.0	+0.0	+0.9	+0.4	+0.2	+0.1	+0.0	+0.0	+0.2	+0.3	+0.3	+0.4	+0.4
Gross fixed capital formation	+3.7	+3.1	+3.4	+0.9	+0.6	+0.8	+0.8	+0.8	+0.8	+0.8	+0.8	+0.8	+0.9	+0.9	+1.0
Exports	+10.0	+6.8	+7.2	+3.4	+1.4	+1.5	+1.6	+1.7	+1.8	+1.8	+1.7	+1.7	+1.8	+1.8	+1.8
Imports	+8.9	+6.0	+6.6	+2.4	+1.4	+1.5	+1.3	+1.4	+1.5	+1.6	+1.6	+1.6	+1.7	+1.6	+1.6
<i>Contribution to real GDP growth in percentage points</i>															
Domestic demand	+1.4	+1.4	+1.5	+0.3	+0.4	+0.4	+0.4	+0.3	+0.3	+0.3	+0.3	+0.4	+0.4	+0.4	+0.5
Net exports	+1.2	+0.9	+0.9	+0.7	+0.1	+0.1	+0.3	+0.3	+0.3	+0.2	+0.2	+0.2	+0.2	+0.3	+0.3
Changes in inventories	+0.7	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0	+0.0
Labor market															
<i>% of labor supply</i>															
Unemployment rate (Eurostat definition)	4.3	4.3	4.1	4.5	4.3	4.2	4.2	4.3	4.4	4.4	4.3	4.3	4.2	4.0	3.9
<i>Annual and/or quarterly changes in %</i>															
Total employment	+1.7	+1.2	+1.2	+0.4	+0.4	+0.5	+0.5	+0.3	+0.2	+0.2	+0.2	+0.3	+0.4	+0.4	+0.4
of which: Private sector employment	+2.0	+1.4	+1.4	+0.4	+0.5	+0.6	+0.5	+0.3	+0.2	+0.2	+0.2	+0.4	+0.5	+0.5	+0.5
Payroll employment	+1.7	+1.2	+1.2	+0.5	+0.3	+0.4	+0.5	+0.3	+0.2	+0.2	+0.2	+0.3	+0.4	+0.4	+0.4
Additional variables															
<i>Annual and/or quarterly changes in % (real)</i>															
Real disposable household income	+0.5	+2.1	+2.5	-0.6	+0.1	+0.5	+0.7	+0.6	+0.5	+0.4	+0.5	+0.6	+0.7	+0.8	+0.8
<i>% of real GDP</i>															
Output gap	0.2	0.4	0.7	0.1	0.2	0.2	0.4	0.3	0.6	0.4	0.4	0.5	0.6	0.8	1.1

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

Comparison of Current Economic Forecasts for Austria

Indicator	OeNB			WIFO		IAS		OECD		IMF		European Commission	
	June 2011			April 2011		April 2011		May 2011		April 2011		May 2011	
	2011	2012	2013	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
<i>Annual change in %</i>													
Key results													
GDP (real)	+3.2	+2.3	+2.4	+2.5	+2.0	+2.3	+2.1	+2.9	+2.1	+2.4	+2.3	+2.4	+2.0
Private consumption (real)	+0.9	+1.2	+1.2	+1.1	+1.1	+0.8	+1.1	+0.9	+1.2	x	x	+1.1	+1.1
Government consumption (real)	+0.8	+0.8	+1.0	+1.0	+1.0	+0.2	+0.5	+0.3	+0.4	x	x	+0.8	+0.8
Gross fixed capital formation (real) ¹	+3.7	+3.1	+3.4	+2.6	+2.7	+2.5	+2.1	+3.0	+2.5	x	x	+3.0	+2.9
Exports (real)	+10.0	+6.8	+7.2	+7.4	+6.5	+7.4	+5.9	+9.6	+6.8	x	x	+7.0	+6.8
Imports (real)	+8.9	+6.0	+6.6	+6.1	+6.0	+5.7	+4.8	+7.7	+6.0	x	x	+5.9	+6.3
GDP per employee	+1.5	+1.1	+1.2	+1.1	+1.3	+1.2	+1.2	x	x	x	x	+1.6	+1.3
GDP deflator	+2.1	+1.9	+1.9	+2.0	+2.1	+2.0	+2.0	+1.7	+1.6	x	x	+1.7	+1.8
CPI	x	x	x	+2.8	+2.4	+2.7	+2.3	x	x	+2.5	+2.0	x	x
HICP	+3.2	+2.1	+1.9	+2.9	+2.4	x	x	+3.1	+1.8	x	x	+2.9	+2.1
Unit labor costs	+1.1	+1.8	+1.3	+1.4	+1.6	x	x	x	x	x	x	+1.0	+1.4
Payroll employment	+1.7	+1.2	+1.2	+1.6	+0.9	+1.1	+0.9	x	x	x	x	+0.8	+0.7
<i>% of labor supply</i>													
Unemployment rate (Eurostat definition)	4.3	4.3	4.1	4.1	4.0	4.3	4.3	4.2	4.0	4.3	4.3	4.3	4.2
<i>% of nominal GDP</i>													
Current account	4.0	4.8	5.0	3.7	4.3	x	x	3.1	3.8	3.1	3.1	2.6	2.8
Budget balance (Maas-tricht definition) ²	-3.0	-2.6	-2.3	-3.4	-3.0	-3.0	-2.5	-3.7	-3.2	-3.1	-2.9	-3.7	-3.3
External assumptions													
Oil price in USD/barrel (Brent)	111.1	108.0	103.7	100.0	100.0	112.0	115.0	120.0	120.0	107.2	108.0	117.4	117.2
Short-term interest rate in %	1.5	2.3	2.8	1.3	2.3	1.6	2.2	1.3	2.0	1.7	2.6	1.6	2.5
USD/EUR exchange rate	1.42	1.43	1.43	1.35	1.30	1.39	1.40	1.43	1.43	1.37	1.36	1.43	1.45
<i>Annual change in %</i>													
Euro area GDP (real)	+1.5 to +2.3	+0.6 to +2.8	x	+1.5	+1.5	+1.8	+1.7	+2.0	+2.0	+1.6	+1.8	+1.6	+1.8
U.S. GDP (real)	+2.6	+2.7	+2.8	+2.9	+3.0	+2.9	+2.7	+2.6	+3.1	+2.8	+2.9	+2.6	+2.7
World GDP (real)	+4.1	+4.2	+4.3	+4.2	+4.4	x	x	+4.2	+4.8	+4.4	+4.5	+4.0	+4.1
World trade	+8.0	+7.8	+7.6	+8.0	+8.5	+8.0	+7.0	+8.1	+8.4	+7.4	+6.9	+7.3	+7.4

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

¹ For IAS: Gross investment.² Taking into account the revisions made at the end of March 2011 (EDP report). IHS and IMF; not taking revisions into account.