Outlook for Austria

17 Eurozone countries

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Muted domestic demand keeping economy afloat as external demand remains weak

Despite growth stagnating in Q1 this year, conditions for a domestically driven recovery remain intact. Business investment is supported by favorable financing conditions and strong corporate cash reserves, while consumers are benefiting from falling inflation, which improves their purchasing power.

• Austria is less affected than other Eurozone economies by the now weaker outlook for the Eurozone, because of its broad diversification of export destinations. For this reason, and its relatively good competitiveness, we expect Austria to maintain its share in world exports in the medium term — one of the very few Eurozone countries to do so.

• The fiscal deficit for 2012 turned out to be lower than expected, due mainly to strong adjustment by the regional governments. But because of weaker revenue growth and higher social expenditure this year, further strong improvement is likely to be delayed until after 2014. We expect the deficit to narrow to 0.9% of GDP in 2016. But while this implies the Government will not meet its target of a balanced budget, this does not pose a threat to fiscal sustainability, given the strong track record of fiscal discipline and comparatively low debt levels.

• Although the Austrian banking sector still has a large exposure to Central and Eastern Europe, the European Bank Coordination Initiative, a framework for safeguarding the financial stability of emerging Europe, has had a stabilizing effect on the banking systems in the region and, as a result, the risk of contagion to the banking sector has eased.

• Overall, risks to our forecast are on the downside, but have moved further towards balance. If European Union (EU) policy-makers send strong signals that they have a firm grip on the Eurozone crisis, this could raise both consumer and industry confidence more quickly than we currently expect. This in turn would stimulate spending and growth beyond our current forecasts.
Muted domestic demand keeping economy afloat as external demand remains weak

Domestic conditions for recovery remain intact ...
Despite growth stagnating in Q1 this year, domestic conditions for a stronger recovery remain intact, both for businesses and consumers. But persistent uncertainty dampens confidence and weighs on spending decisions. And external demand, which generated a large chunk of overall growth in pre-crisis times, remains weak. As a result, we continue to forecast GDP growth of just 0.7% in 2013, before it accelerates to 1.8% in 2014, when uncertainty eases and the external environment improves. For 2015–17, we expect GDP growth to average 1.5% a year.

... but persistent uncertainty delays investment decisions ...
Conditions for business investment remain favorable compared with the rest of the Eurozone. Interest rates are very low (2.3% on new one- to five-year loans in May 2013) and access to funding is better than in most other Eurozone countries, despite a slight tightening in credit conditions reported by the banks since the beginning of the year. Over the past few years, companies have also accumulated considerable cash reserves, so in many cases funding should not be an obstacle to investment.

But businesses are reluctant to invest while uncertainty about the outlook remains high. In 2012, investment still grew by 1.8%, but, due to a favorable carryover from last year, this hides an underlying weakness: average quarterly growth was just 0.1%. In view of an environment largely unchanged from last year, it is unlikely investment growth will pick up much this year. Total investment growth is also dampened by less public investment (as part of the Government's ongoing consolidation effort). We expect investment growth of 1.2% this year. As the outlook improves, and currently postponed plans start being implemented from next year, investment should grow at average rates of a little over 2% a year in 2014–17.

... and dampens consumption
Similarly, the macroeconomic environment points to robust growth in consumption, at least once uncertainty abates. In 2013, consumers will benefit from increased purchasing power following the strong wage negotiation outcomes last year and the recent fall in inflation.

As pressure from energy prices has started to ease, inflation (on the EU-harmonized measure) has seen a rapid decline over the past few months, falling to 2.1% in April from 2.9% in December 2012. We expect inflation to fall further this year. Indeed, the level of domestic producer prices has been falling recently – in April they were 0.8% lower than a year earlier. The decline in wholesale prices is even sharper, at 1.6% on an annual basis. This should continue to feed through to consumer prices. We forecast inflation will be down to 1.7% at the end of the year.

Table 1
Austria (annual percentage changes unless specified)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tbody>
<tr>
<td>GDP</td>
<td>0.8</td>
<td>0.7</td>
<td>1.8</td>
<td>1.5</td>
<td>1.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Private consumption</td>
<td>0.4</td>
<td>0.4</td>
<td>1.3</td>
<td>1.5</td>
<td>1.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>1.8</td>
<td>1.2</td>
<td>2.8</td>
<td>2.4</td>
<td>2.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Stockbuilding (% of GDP)</td>
<td>1.8</td>
<td>1.6</td>
<td>1.0</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Government consumption</td>
<td>0.4</td>
<td>0.5</td>
<td>1.6</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>1.8</td>
<td>1.7</td>
<td>5.7</td>
<td>5.4</td>
<td>4.6</td>
<td>4.5</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>1.2</td>
<td>1.4</td>
<td>4.8</td>
<td>5.4</td>
<td>5.4</td>
<td>5.3</td>
</tr>
<tr>
<td>Consumer prices</td>
<td>2.6</td>
<td>2.2</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>Unemployment rate (level)</td>
<td>4.4</td>
<td>5.1</td>
<td>5.0</td>
<td>4.6</td>
<td>4.5</td>
<td>4.5</td>
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<tr>
<td>Current account balance (% of GDP)</td>
<td>1.8</td>
<td>1.7</td>
<td>2.5</td>
<td>2.5</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Government budget (% of GDP)</td>
<td>-2.5</td>
<td>-2.5</td>
<td>-1.7</td>
<td>-1.2</td>
<td>-0.9</td>
<td>-0.8</td>
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<tr>
<td>Government debt (% of GDP)</td>
<td>73.4</td>
<td>74.2</td>
<td>73.7</td>
<td>72.6</td>
<td>71.2</td>
<td>69.8</td>
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<tr>
<td>ECB main refinancing rate (%)</td>
<td>0.9</td>
<td>0.6</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Euro effective exchange rate (1995 = 100)</td>
<td>115.5</td>
<td>118.5</td>
<td>115.6</td>
<td>112.0</td>
<td>111.1</td>
<td>110.9</td>
</tr>
<tr>
<td>Exchange rate ($ per €)</td>
<td>1.28</td>
<td>1.29</td>
<td>1.21</td>
<td>1.17</td>
<td>1.17</td>
<td>1.17</td>
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</table>

Source: Oxford Economics.
At the same time, Austria also enjoys the lowest unemployment rate in the Eurozone (on the International Labour Organization measure). Although unemployment has increased from 4.7% at the end of last year to 4.9% in April, this is to a large extent due to the fact that more people are looking for a job, rather than more becoming unemployed. We think the jobless rate could increase further to 5.1% this year, but this will be low compared with the expected Eurozone average of over 12%.

These comparatively benign conditions should provide a basis for continued consumption growth. But persistent uncertainty is likely to see households increase their precautionary savings at the cost of more dynamic spending. Consumer confidence had seen a relatively strong improvement in the first few months of this year, but has recently declined again, largely due to worries about the general economic outlook, rather than the financial situation of households. We expect this to translate into muted consumer spending growth of 0.4% in 2013, before it accelerates to an average of 1.5% a year during 2014-17.

Exports suffer from external weakness …

Austria’s economy will feel the impact of the weaker outlook for the Eurozone than envisaged in our March 2013 report and weaker external demand as a result. Exports are expected to suffer in particular in the first half of the year, before activity in the Eurozone and external demand accelerate in the second half and lift export growth for the year as a whole to 1.7%, well below pre-crisis growth rates. External trade will contribute about 0.2 percentage points to growth this year – the smallest contribution since 2009.

However, Austria is less affected than other Eurozone economies by weaker external demand from the Eurozone due to its broad diversification of export destinations. For this reason, as well as its relatively good competitiveness position, we expect Austria to maintain its 1% share in world exports in the medium term – one of the very few Eurozone countries to do so. As external demand picks up from next year, we forecast growth in exports to accelerate to 5.7% in 2014 and then average close to 5% a year during 2015-17.

… while the Government is saving

The fiscal deficit for 2012 turned out to be smaller than expected, at 2.5% of GDP, owing mainly to strong adjustment by the regional governments. However, due to weaker revenue growth and higher social spending this year, further strong improvements are likely to be delayed until 2014 and beyond. We expect the deficit to narrow to just under 1% of GDP in 2016.

But while this implies the Government will undershoot its target of a balanced budget by 2016, this does not pose a threat to fiscal sustainability, given the strong track record of fiscal discipline and comparatively low debt. Financial markets continue to reward Austria’s fiscal discipline with low interest rates on government debt – as low as 1.65% in May, only 35 basis points above German bunds.
Banking sector risks from Central and Eastern Europe decreased ...

The Austrian banking sector still has, via its subsidiaries, considerable exposure to Central and Eastern Europe, with loans to the region making up 12% of total loans issued by domestic banks (compared with 0.6% in Germany) and more from subsidiaries directly.

Last year, the financial regulator ruled that domestic banks cannot use domestic funds to prop their foreign subsidiaries’ balance sheets, in order to avoid contagion from any potential fallout. In addition to that, the re-launch in May this year of the European Bank Coordination “Vienna” Initiative (Vienna 2.0) is aimed at preempting uncoordinated repatriation of bank funding from abroad to avoid a destabilization of the banking sector in emerging Europe (which could require parent banks to step in). Vienna 2.0 should further mitigate the risk of contagion to the banking sector.

The soundness of the Austrian banking sector has also improved in other respects. The capital ratio (regulatory capital as a percentage of risk-weighted assets) has increased from 15% in Q4 2008 to 17% in Q4 2012, one of the highest ratios in the Eurozone, and non-performing loans have remained at a comparatively low 3% (of total gross loans).

... and overall risks also closer to balance

There is a chance that confidence – of both consumers and industry – improves more quickly than we currently expect, which in turn would stimulate spending and investment, and thus growth, beyond our current forecast. However, this depends on how EU policy-makers can increase confidence in the market by demonstrating their firm grip of the crisis.

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