20. AUSTRIA

Private consumption driving growth as income tax reform unfolds

Austria's GDP growth is expected to rise to about 1½% in the next years. Private consumption has become the main growth driver following the income tax reform, which increased the net disposable income of households. Public finances, which are impacted by the spending on refugees and the tax reform, are expected to recover on the back of the positive economic cycle.

Consumption is the main driver of growth

In the first half of the year, Austria's economy maintained the upward growth trend, which started at the end of 2015. Growth has mainly been driven by private consumption, which has significantly increased since the start of 2016 when an income tax reform kicked in. With consumption picking up, investment activity has also been increasing, most notably in machinery and equipment. Exports were weak in the first half of the year, whereas imports rose markedly on the back of accelerating investment. Consequently, the contribution of net exports to growth has decreased.

Improved growth outlook

In the third and fourth quarter of 2016, economic growth is expected to continue to be driven by stronger private consumption and equipment investment. As a result, Austria's GDP growth is expected to grow by 1.5% this year, compared to just 1.0% in 2015.

In 2017 and 2018, growth is expected to stabilise at 1.6%, still benefitting from the increase in private consumption and investment following the income tax reform. These effects are expected to gradually fade away and, in the absence of similar measures, a stronger contribution from other sources will be required to maintain this level of growth.

The Austrian export industry is expected to grow steadily, even though the world economy and demand from emerging markets remain weak. Investments in new technologies and the further digitalisation of the industry are expected to help rein in market share losses and help to improve price competitiveness. Imports are expected to grow strongly both this and the next year due to increased domestic demand from private consumption and equipment investment. The current account balance is expected to remain in surplus and to grow steadily over the forecast horizon.

Investment growth, especially in machinery and equipment, should further benefit from increased private consumption and increased replacement needs in the coming years. Construction investment is projected to rise, driven by strong demand, as the population continues to grow due to immigration, including from refugees. This higher demand for housing is also pushing up house prices.

Strong labour force and employment

Employment continues growing steadily in Austria supported by the higher supply of labour coming from both the inflow of asylum-seekers and strong migration from other EU countries. Compared to 2015, the number of refugees arriving in Austria this year has decreased. The impact of asylum-seekers on the labour market is expected to be gradual, as asylum procedures and language training take time to run their course. The supply of labour is also benefiting from greater participation by women and elderly workers, which is a result of the measures to reduce early retirement. Over the forecast horizon, the unemployment rate is thus expected to increase only gradually from 5.7% in 2015 to 5.9% in 2016 and 6.1% in the outer years.

Stronger inflation as oil prices increase

The effect of low oil prices continues to weigh on HICP inflation in 2016, which is expected to reach 1.0% after 0.8% in 2015. As this effect fades, HICP inflation is projected to accelerate to 1.8% in 2017 and 1.6% in 2018. Increasing prices in the service sectors, mainly in the tourism sector (hotel, restaurants), help maintain a positive inflation rate in Austria above the EU average. Core inflation is projected to remain stable at around 1.6% in the coming years.

Public finances expected to recover after the tax reform and the peak in refugee spending

The 2015 general government deficit was revised down from 1.2% to 1.0% of GDP, mainly due to lower expenditure for social security. The deficit is forecast to increase to 1.5% of GDP in 2016. This year, revenues from taxes on income and wealth declined significantly due to the tax relief measures that took effect in January this year. At the same time, measures against tax fraud have so far not yielded the expected results, partly due to delays in their implementation. In addition, the increase in taxes on capital gains led to an anticipatory effect in 2015 that lowered revenues in 2016. On the contrary, yields from corporate income taxes picked up, as did social security contributions, which benefited from the rise in employment and the update of the upper contribution threshold. On the expenditure side, costs for bank support are expected to fade while the spending related to refugees is forecast to increase significantly, mainly due to the high number of arrivals at the end of 2015 and the length of the application procedure.

In 2017, revenues from income and wealth taxes will still be affected by a deferred impact of the tax relief, but are expected to gradually recover on the back of the positive economic cycle and the projected increase in employment. Yields from capital gains taxes are expected to normalise also thanks to the rate increase. Expenditure for refugees is forecast to decline only slightly despite the lower number of applications, mainly due to a shift in spending from first aid to means-tested benefits for recognised refugees. Overall, in 2017, the deficit is expected to decline to 1.3% of GDP. Given the acceptance of the buy-back offer for HETA's liabilities covered by Carinthia's guarantees, risks of further negative spillovers from the banking sector to public finances have been considerably reduced, although the possibility of additional contingent costs cannot be excluded. On the contrary, the possibility of a deferred effect from the measures against tax fraud represents an upward risk. In 2018, revenues are expected to continue recovering and social spending on refugees to decrease more tangibly, leading to a lower projected deficit.

The structural balance is expected to decline from a balanced position in 2015 to around -1.0% of GDP in 2016 and to remain broadly stable in 2017. After reaching 85.5% of GDP in 2015, the general government debt is projected to decline from 2016 onwards, mainly due to the progressive divestment of impaired assets from distressed financial institutions included in the government accounts.

Table II.20.1:

Main features of country forecast - AUSTRIA

	2015		Annual percentage change						
	bn EUR Curr. prices	**% GDP**	**97-12**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
GDP	339.9	100.0	2.0	0.1	0.6	1.0	**1.5**	**1.6**	**1.6**
Private Consumption	179.1	52.7	1.5	-0.1	-0.3	0.0	**1.3**	**1.2**	**1.1**
Public Consumption	67.7	19.9	1.6	0.7	0.8	2.1	**1.2**	**0.9**	**0.7**
Gross fixed capital formation	76.8	22.6	1.0	2.2	-0.9	0.7	**3.1**	**2.3**	**1.7**
of which: equipment	25.3	7.5	1.3	2.4	-1.0	3.6	**5.1**	**2.9**	**2.3**
Exports (goods and services)	180.3	53.1	5.3	0.5	2.3	3.6	**2.7**	**2.9**	**3.2**
Imports (goods and services)	166.7	49.1	4.2	0.7	1.3	3.4	**3.3**	**2.7**	**2.5**
GNI (GDP deflator)	338.0	99.5	2.0	0.3	0.6	0.2	**1.5**	**1.6**	**1.6**
Contribution to GDP growth:	Domestic demand		1.4	0.6	-0.2	0.6	**1.6**	**1.3**	**1.1**
	Inventories		0.1	-0.5	0.3	0.0	**0.0**	**0.0**	**0.0**
	Net exports		0.5	0.0	0.5	0.2	**-0.1**	**0.2**	**0.5**
Employment			-	0.3	0.9	0.6	**0.8**	**0.8**	**0.9**
Unemployment rate (a)			4.7	5.4	5.6	5.7	**5.9**	**6.1**	**6.1**
Compensation of employees / f.t.e.			2.1	2.1	1.9	1.9	**1.4**	**1.6**	**1.6**
Unit labour costs whole economy			1.1	2.3	2.1	1.5	**0.8**	**0.8**	**0.9**
Real unit labour cost			-0.4	0.8	0.4	-0.3	**-1.1**	**-0.8**	**-0.8**
Saving rate of households (b)			15.3	12.6	12.6	13.0	**14.1**	**13.2**	**12.3**
GDP deflator			1.5	1.6	1.8	1.9	**1.9**	**1.7**	**1.7**
Harmonised index of consumer prices			1.8	2.1	1.5	0.8	**1.0**	**1.8**	**1.6**
Terms of trade goods			-0.4	-0.1	0.5	1.8	**1.2**	**-0.3**	**-0.1**
Trade balance (goods) (c)			-0.6	-0.5	0.2	0.6	**0.6**	**0.5**	**0.7**
Current-account balance (c)			1.2	1.6	2.6	2.5	**2.8**	**2.9**	**3.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			1.1	1.5	2.4	2.0	**2.7**	**2.7**	**2.8**
General government balance (c)			-2.6	-1.4	-2.7	-1.0	**-1.5**	**-1.3**	**-1.1**
Cyclically-adjusted budget balance (d)			-2.6	-1.0	-2.2	-0.5	**-1.1**	**-1.1**	**-1.0**
Structural budget balance (d)			-	-1.2	-0.7	0.0	**-1.0**	**-0.9**	**-1.0**
General government gross debt (c)			69.8	81.3	84.4	85.5	**83.5**	**81.1**	**79.2**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.

Note : Contributions to GDP growth may not add up due to statistical discrepancies.