

## Austria

### Worrisome trends

- The Austrian economy is currently experiencing a modest upswing, supported by lower energy prices and income tax reform.
- Growth is expected to decelerate in 2017, because of reduced fiscal stimulus, slowing investment and a less supportive external environment.
- The Grand Coalition between conservatives and social democrats might lose the majority in parliament at the next general election, scheduled to be held by October 2018.

The Austrian economy is currently experiencing a modest upswing. Business cycle indicators have been improving since last February, although remaining well below levels seen before the Great Recession. After having grown in the past four years below 1%, which is about the country's potential growth rate, GDP grew by 1.4% in the first half of 2016. For the year as a whole, economic growth is expected to reach 1.3%.

The main drivers have been common with other European countries, i.e. low energy prices and the easier financial conditions. Two specific domestic drivers are the income tax reform effective from 1 January and the extra expenditure related to the inflow of refugees and asylum seekers.

The economic climate is set to deteriorate somewhat in 2017 as the support of some of the tailwinds is diminishing or even turn into headwinds. Private consumption will be less supported by the income tax reform. Moreover, rising energy prices will weigh on purchasing power. Inflation is expected to accelerate to 1.4%, which is among the highest in the eurozone. The corporate sector will be confronted with slower growth in its major export markets such as Germany. Moreover, the uncertainty created by Brexit might weigh on investment decisions. All in all, GDP growth is expected to slow to 1.1%.

#### Households benefit from income tax reform

Consumer spending was rather sluggish in recent years. Between 2012 and 2015, it even contracted by 0.4%. The main reason was the decline in disposable income during this period by -1.7%. To limit the impact on consumption, households had to dig into their saving, and as a consequence, the net savings rate declined from 8.7% to 7.4%.

Several factors were responsible for the weakness in income and spending. First, inflation proved stickier than in other eurozone countries. Between 2012 and 2015 consumer prices increased by 4.4%. Second, the government pursued a tight fiscal policy. The OECD estimates that between 2012 and 2015, the cyclically adjusted fiscal balance improved by more than 2 percentage points of GDP.

During this period, job creation was quite buoyant, as employment increased by 1.5%, including many part-time jobs. Nevertheless, the

#### Forecast Summary

Annual growth, %	2015	2016 e	2017 e
GDP	1.0	1.3	1.1
Private consumption	-0.0	1.1	0.9
Gross Fixed Capital Formation	0.5	3.5	1.7
Exports	3.6	1.8	3.1
Consumer Price Index (CPI)	0.8	1.0	1.4
CPI ex food and energy	1.7	1.6	1.5
Unemployment rate	5.7	6.1	6.3
Current account balance	8.6	9.4	10.4
Gen. Govt. Balance (% of GDP)	2.5	2.7	2.9
Public Debt (% GDP)	85.5	83.2	80.9

e: BNP Paribas Group Economic Research (estimates & forecasts)

#### Industrial confidence well below pre-crisis level



unemployment rate actually edged up, reaching 6.2% in August, due to the rapid increase in the labour force, following the arrival of immigrants and cross-border workers. Still, the unemployment rate is one of the lowest in the EU.

In 2016, the main supports for household spending are the low level of energy prices and the income tax reform. The latter will provide tax relief, estimated at EUR 5 billion (1.5% of GDP) per annum. This is compensated by an increase in the withholding tax on capital gains to 27.5% and an increase in the reduced VAT rate from 10% to 13% for certain goods and services. In addition, disposable income will be supported by public expenditure for refugees. In total, household real disposable income might increase by more than 2%. As the additional income generated by the income tax reform might not be immediately spent, the savings rate is likely to increase in 2016. Nevertheless, the savings rate is expected to resume its decline in the following years.



### Slow recovery in the non-financial corporate sector

Thanks to the moderate growth pick-up that started in 2015, profitability in the non-financial corporate sector has started to improve. In real terms, the gross operating surplus of the non-financial sector was 1% higher in the first half of 2016 from a year earlier, thanks to the increase in activity. Moreover, production costs moderated because of moderate wage growth and lower prices for oil and other commodities. This was partly offset by weak selling prices. Consequently, the downward trend in the profit ratio, i.e. gross operating surplus as percentage of gross value added, came to a halt at 41.3%, but remains well below levels observed before the financial crisis (46.5% on average during the period 2004-2008).

The increase in profits was accompanied by an increase in investment. In the first half of 2016, investment in equipment and machinery was almost 3% higher from a year earlier. However, despite high levels of corporate financial assets and favourable external financing conditions, investment is likely to cool quickly. In particular, entrepreneurs are hesitant to expand their businesses due to the moderate growth outlook of Austria's main trading partners. We expect the German economy to slow to 1.3% in 2017 from 1.8% in the preceding year. In addition, the uncertainties surrounding the negotiations concerning Brexit and the free trade agreements with the US and Canada are weighing on investment.

By contrast, housing investment might pick up in the coming years, spurred by the rapid increase in house prices and the government's housing initiative. However, the timing is rather uncertain given the lengthy preparation period.

### Public sector spending in a straightjacket

The grand coalition between the conservatives (ÖVP) and the social-democrats (SPÖ) follows an orthodox fiscal policy. A major objective of the government is to reduce the government deficit to 0.5% of GDP in 2020. In 2015, the deficit fell to only 1.2% of GDP from 2.7% in the previous year. But this was due to some special factors such as the anticipatory effects of the increase in the withholding tax on dividends. In 2016 and 2017 the government deficit is expected to widen again to around 1.6% of GDP, which is still well below the 3% norm of the Maastricht treaty.

The federal budget is benefiting from the extraordinary low interest rate environment. On the other hand, expenditure has to be increased to cope with the inflow of refugees and asylum seekers. Since the outbreak of the migration crisis in 2015, Austria has taken in about 110,000 asylum seekers, almost 1% of the population. The budgetary costs are expected to rise to 0.6% of GDP per year. Moreover, the deterioration of the labour market

### Presidential election on 4 December

On 4 December, the Austrians will go to ballot box to vote for a new president for a six-year term. The choice is between Norbert Höfer (FPÖ, far-right) and Alexander Van der Bellen (Independent candidate supported by The Greens). It is a re-run of the second round held in May, which was narrowly won by Mr. Van der Bellen. After having discovered irregularities in the counting of the votes in several constituencies, the constitutional court annulled the election and ordered a new vote.

The role of the president is largely ceremonial, although, according to the Austrian constitution, the president has far reaching powers. He can appoint and dismiss the Chancellor and the government, and dissolve the National Council (Nationalrat), the lower house of parliament. For this reason, the French jurist Maurice Duverger called the Austrian president "a sleeping giant".

Mr Höfer has announced that, if elected, he will make more use of these extensive powers. However, as previous presidents, he might discover that the presidential prerogatives are limited by political realities. For example, the government need the support by a majority in parliament. The risk is that a more proactive presidency might come at a heavy cost by upsetting the constitutional balance.

might entail an increase in expenditure on unemployment benefits.

Government debt is relatively high at 86% at the end of 2015 compared with only 65% in 2007 before the financial crisis. The main reason for the deterioration is that the authorities were forced to provide participation capital and liquidity boosting funds to Austrian banks. The support measures might have amounted to EUR 21 billion or 6% of GDP. For 2017, the government aims at reducing the debt ratio to 80.9% of GDP.

### The grand coalition might lose its majority

As in many European countries, the Austrian political scene has become rather polarised since the advent of populist parties such as the far-right FPÖ. In the re-voting in the second round of the presidential elections in December, the candidate of the FPÖ is facing the candidate of the Greens (see box).

The next general election is scheduled to be held by October 2018. According to the latest polls, the Grand Coalition would lose its majority and the FPÖ would be the big winner with a third of the vote. In that case, the Grand Coalition may need to be made even grander by including other parties such as the Greens or the young liberals (NEOS).