

L. 5. 2

RFD 565

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 3, 1965

Economic Developments in Austria,
June-November 1965

20 pages

Carl H. Stem

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors. It was prepared primarily for internal circulation within the Federal Reserve System, and must not be cited, quoted, or reprinted without permission.

December 3, 1965

Carl H. Stem

Economic Developments in Austria, June-November 1965

Summary

Business activity in Austria continued at high levels during the period under review, but the rate of expansion showed signs of moderating.^{1/} Seasonally-adjusted industrial output has increased only slightly since the first quarter. Although export demand is still a vigorous stimulant to the economy, domestic demand--especially for consumer goods--is generally more laggard than last year. Gross national product (GNP)--deflated for price increases--advanced only 3 per cent at an annual rate in the second quarter, compared with 4.5 per cent in the first quarter, and 6 per cent in the year 1964. For the current year, GNP is expected to rise between 3.5 per cent and 4 per cent, and a 4 per cent growth rate is predicted for 1966.

Sharp increases in prices and wages--aggravated primarily by supply problems--continued to exert destabilizing pressures on the Austrian economy. Retail prices in mid-September were 5 per cent above year-earlier levels. In mid-July they had been almost 7 per cent above the first quarter; short supplies of some food items pushed prices as much as 50 per cent above year earlier levels. Spiraling prices

^{1/} For a review of earlier developments, see "Economic Developments in Austria, December 1964-May 1965," dated June 2, 1965.

have kept alive demands for higher wages: increases of 13 per cent were realized in the first six months of the year. Government employees recently filed claim for a salary increase to be considered in the 1966 budget which would be in addition to the 7 per cent raise they received in June.

On the monetary front, the unusually vigorous expansion in bank credit and money supply appeared to level off in the third quarter as economic expansion moderated somewhat. In late June, the central bank took measures to reduce liquidity in the banking system, but these are expected to have only a mildly restrictive effect on further monetary expansion. According to monetary authorities, ample funds should continue to be available to finance further advances in business activity as they develop.

The coalition government resigned in late October over a dispute over fiscal policy, but was reappointed on a provisional basis pending elections in March. The 1966 Federal government budget presented by the Finance Minister--a member of the conservative Peoples' Party--calls for lower expenditures and higher revenues than the Socialist members of the government found acceptable. Currently, the Federal government is operating on a provisional budget that provides only for expenditures required by law.

Austrian foreign payments--as measured by changes in official reserves and commercial bank net foreign assets--showed a \$90 million surplus in the first 8 months of the year, and for the whole year are expected to be in near balance. A small capital outflow continues; however, the trade deficit is expected to improve as imports slacken while exports should continue to boom. It is further expected that larger net receipts from tourism will offset more of the trade deficit than in previous years.

Official reserves increased \$20 million equivalent between December 31, 1964 and November 15, 1965. Gold reserves increased \$100 million while foreign-exchange holdings declined by \$79 million. The gold ratio rose from 48 per cent at the end of last year to 55 per cent at mid-November.

Business activity continues high but expansion moderates

The Austrian economy continued to operate at a very high level during the June-November period, but the rate of expansion moderated. During the summer months, business activity was affected by divergent influences. On the one hand, tourism was unexpectedly heavy; in addition, the building sector operated at full capacity, making up for the delay caused by bad spring weather and repairing the extensive damage caused by spring flooding. On the other hand, vacations cut back output more sharply than usual with the widespread introduction of the three-week leave period, and some sectors experienced more than the usual summer slackness in sales. However, business was steadier in the autumn--bought by good weather--and prospects are bright for a continued high level of activity through the end of the year.

So far this year, the business cycle upswing underway in Austria since early 1963 has shown a tendency to flatten out. Industrial production--interrupted in the second quarter by flooding estimated to have done more than \$200 million in damage--has levelled off and shown very little increase (on a seasonally-adjusted basis) since the first quarter. (See Table 1.) Although investment demand picked up temporarily earlier in the year, it has continued to lag behind last year, particularly in the public and consumer goods sectors. Demand for consumer goods has also been laggard through most of the year although it is expected to pick

up as the fall buying season gets under way. However, export demand, particularly for capital goods, continues to be the major stimulant to the current high level of industrial output: about two-thirds of the overall increase in industrial output so far this year has gone in to exports.

Table 1. Austria: Industrial Production
(1960=100; seasonally adjusted)

<u>Period</u>	<u>Total</u>	<u>Final Manufactures</u>		<u>Intermediate Manufactures</u>
		<u>Consumer goods</u>	<u>Investment goods</u>	
<u>1964</u>				
I	118.3	121.5	109.5	105.5
II	120.1	123.5	111.7	109.1
III	120.4	124.5	111.1	111.7
IV	122.4	124.8	115.0	112.3
<u>1965</u>				
I	123.7	128.4	114.7	109.6
II	123.7	128.7	115.4	107.0
April	122.8	128.4	114.8	107.1
May	124.0	128.5	116.5	107.3
June	124.3	129.1	114.8	106.5
July	123.6	126.6	113.8	106.4

Source: OECD, Main Economic Indicators.

Gross national product, deflated for price increases, grew at an annual rate of 4.5 per cent in the first quarter, compared with 6 per cent for the year 1964. The growth rate dropped to 3 per cent in the second quarter. For the current year, GNP is expected to advance between 3.5 per cent and 4 per cent over 1964.

The Austrian Institute for Economic Research predicts that in 1966 GNP will advance about 4 per cent, or in line with the current year's performance. All sectors of the economy are expected to maintain high levels of output; increased investment in building and new equipment is expected to offset a smaller increase in official consumption than in the current year.

Labor supply continues strained; productivity gain slows

Only the flattening out of economic growth has prevented the continued shortage of labor from becoming more acute. Although unemployment was higher in the second quarter because of bad weather, the unemployment ratio in January-September was still below the same period of 1964. (See Table 2.) Moreover, the strength in the current level of business activity is clearly reflected in the large number of registered job vacancies. In the third quarter, when the demand for labor usually hits a seasonal peak, registered job vacancies were greater by 50 per cent than the number of unemployed in the country.

Austrian employers have turned to an increasing extent to foreign labor this year, although the foreign labor contingent is still quite small. In April, as the spring build-up in employment began, 13,300 foreign workers were employed, nearly 50 per cent more than in the previous year. By the end of August--the peak employment period--this number had grown to over 31,000, nearly 13,000 more than in 1964. Higher wages and the release of foreign workers from Switzerland have made it easier for Austrian firms to recruit in the competitive European labor market.

Table 2. Austria: Labor Market Data
(end-of-month averages)

	1964		1965		Monthly Averages	
	<u>II</u>	<u>III</u>	<u>II</u>	<u>III</u>	Jan. - Sept.	
					1964	1965
Labor force (millions)	2.42	2.46	2.44	2.48	2.43	2.45
Employment (millions)	2.37	2.41	2.39	2.43	2.36	2.38
Unemployment (thousands)	51.3	50.1	52.9	50.7	75.2	74.3
Unemployment as per cent of labor force	2.1	2.0	2.2	2.1	3.1	3.0
Vacancies (thousands)	68.8	70.6	75.5	77.4	63.0	69.1
Vacancies as per cent of unemployed	134	140	143	153	83.8	93.0

Source: Oesterreichische Nationalbank, Mitteilungen.

Because of the levelling off of the economy's growth rate and the severe interruption in output caused by the spring flooding, industrial productivity gains this year are expected to be sharply below last year's very high increase. In the second quarter, the year-to-year productivity gain (output per worker) was only 4 per cent, compared with 6 per cent in the first quarter and 9.3 per cent for the year 1964. (See Table 3.) The increase in industrial productivity for 1965 as a whole is not expected to be more than 5 per cent.

Table 3. Austria: Industrial Production, Employment and Productivity
(percentage change from previous year)

	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u> ^{1/}
Production	+2.2	+4.2	+7.6	+5.0
Employment	+1.1	-1.4	-0.3	0.0
Productivity (per worker)	+1.3	+4.4	+9.3	+5.0
Productivity (per hour worked)	+3.5	+6.8	+7.8	+4.5

1/ Estimates for year.

Source: OECD, Main Economic Indicators and Monatsberichte des Oesterreichischen Institutes für Wirtschaftsforschung.

Prices recede from high summer levels; wage rates rise sharply

Prices moved generally downward in a seasonal pattern in August-September from peak July levels, but in mid-September consumer prices were still 5 per cent above year-earlier levels. (See Table 4.) In the spring, consumer prices shot up rapidly as acute shortages developed in supplies of some seasonal foods, partly because of bad weather. In mid-July, the consumer price index published by the Austrian Institute for Economic Research was almost 7 per cent higher than the first quarter average, and the food component was over 12 per cent higher. In mid-summer, vegetables, fruits, eggs and potatoes cost as much as 50 per cent more than at the same time last year. However, the non-seasonal components of the retail price index have also been edging upward due to demand pressures and higher labor costs; since June, prices of these items have registered increases of 0.1 per cent to 0.2 per cent monthly.

Table 4. Austria: Selected Wages and Price Indices
(1960=100, month or monthly average)

<u>Date</u>	<u>Consumer prices^{1/}</u>			<u>Wholesale prices^{2/}</u>	<u>Hourly wage rates^{3/}</u>
	<u>Total</u>	<u>Non-food</u>	<u>Food</u>		
1963 Year	111	110	112	106	117.9
1964 Year	115	114	117	112	123.9
I	114	113	114	109	123.9
II	116	114	117	111	123.9
III	116	114	118	113	123.9
IV	116	115	116	113	123.9
1965 I	117	116	117	113	129.6
II	122	117	127	115	136.1
July	125	117	131	119	141.2
August	123	117	127	118	141.2
September	122	n. e.	127	117	141.2

^{1/} Urban worker's family expenditure pattern.

^{2/} Crude food and raw materials.

^{3/} Vienna region minimum industrial rates net of tax and social insurance and excluding family allowances.

Source: OECD, Main Economic Indicators.

Wholesale prices also rose to peaks in July--again, due mostly to the food products component of the index--but the rise was more moderate than for retail prices. Between the first quarter and mid-July, the overall index posted a 5 per cent gain. Since July prices have fallen, though, and at mid-September the wholesale price index was down to a level only 3 per cent above the average first-quarter level.

Since mid-summer the wages situation in Austria has been relatively stable, although the rising cost of living has kept alive demands for wage and salary increases over and above those granted in the first six-months of the year. Over 1.8 million employed persons received wage increases during that period, and the index of wage rates (minimum industrial rates) exclusive of family allowances in the Vienna region rose over 13 per cent. (See Table 4.) The wage-price spiral continues to show strength: government employees, who received a 7 per cent salary increase effective June 1, have already filed claim for a new unspecified increase to be considered in the 1966 budget. Other labor groups will doubtlessly follow suit.

Credit expansion levels off in third quarter; loan demand continues strong

The expansion of bank credit in Austria levelled off in the third quarter, although the continued strong demand for new loans attests to the underlying strength of the current pace of business activity. In July-September, new loans extended amounted to Sch 2.69 billion, down

slightly from Sch 2.84 billion in the same period of 1964. Outstanding loans increased 3 per cent during the period--compared with 5 per cent in the second quarter and over 4 per cent in the first quarter--to a volume of Sch 88.26 billion. (See Table 5.)

The expansion in money supply also slowed down in the July-September period, compared both with earlier quarters of this year and the same period of 1964. On the other hand, savings deposits expanded vigorously, reflecting in part the sizeable increase in receipts from tourism. Commercial banks placed larger amounts of these funds abroad, building up their net foreign asset position by Sch 690 million from the end of June to the end of September. (See Table 5.)

The particularly high demand for credit and the concurrent build-up in price-wage pressures in the first half of the year led the Austrian National Bank to take additional restraining measures in late June.^{1/} In preparation for the expected increase in liquidity during the third quarter, it raised minimum reserve requirements by 1/2 of 1 per cent to 12 per cent on demand and time deposits and 10 per cent on savings deposits. As a concession to the banks, the National Bank reduced the primary liquidity requirements prescribed by the existing voluntary credit control agreements--15 per cent for individual credit

^{1/} This vigorous demand for credit was a result not only of the general business expansion but, additionally, of a shifting of the demand for credit from foreign to domestic institutions and of a need to finance reconstruction following the heaving flooding in the spring. The shifting in loan demand was due in part to higher interest rates and lessening credit availability abroad and in part to official encouragement to finance domestic needs domestically and lower interest rates at home.

Table 5. Austria: Selected Monetary Statistics
(billions Austrian schillings)

<u>End of period</u>	<u>Money supply^{1/}</u>	<u>Total deposits of non-banks</u>	<u>Cash reserves of credit Insts.^{2/}</u>	<u>Net fgn. assets of credit Insts.^{3/}</u>	<u>Net official gold & fgn. exch. holdings^{4/}</u>	<u>Loans outstanding</u>
<u>1964</u>						
I	45.0	81.92	8.39	1.20	29.82	69.00
II	46.4	83.41	9.54	1.51	30.03	71.95
III	48.4	88.41	10.64	3.38	30.99	74.79
IV	47.7	90.59	12.32	-.03	31.90	78.40
<u>1965</u>						
I	47.5	94.24	11.49	1.31	30.48	81.58
II	50.2	96.18	10.82	.90	30.94	85.57
July	50.7	96.96	10.77	1.02	32.05	86.58
August	51.5	98.95	11.06	1.35	32.86	87.47
September	52.1	100.34	10.82	1.59	32.42	88.26

^{1/} Notes and currency outside banks, commercial bank sight liabilities (excluding interbank deposits), and minor liabilities of the Austrian National Bank to the private sector.

^{2/} Cash plus deposits with the Austrian National Bank.

^{3/} Credit institutions' holdings of liquid foreign assets minus liquid foreign claims against them.

^{4/} Austrian National Bank holdings of gold, foreign exchange and foreign notes less liabilities to foreign credit institutions.

Source: Oesterreichische National Bank, Mitteilungen.

1965 Federal revenues lag; 1966 budget controversy brings down government

Because of the slowing rate of economic expansion, Federal revenues have fallen considerably short of budget estimates this year. In the first nine months, Federal fiscal receipts were up only 8.5 per cent from their 1964 level but had been expected to be 15.2 per cent higher. In fact, Federal receipts were off so sharply in the first half-year that Finance Minister Schmitz, who is publicly committed to an "economically neutral" budget under the current inflationary conditions, instituted an austerity program for government expenditures; this program included "freezing" some Sch 1,350 million of funds already appropriated to the various ministries. A pick-up in cash revenue in July and August made it unnecessary to implement a further announced cut of 3.7 per cent in expenditures. However, actual revenue for the year is expected to be Sch 1.5 billion below estimates, resulting in a budget deficit somewhat larger than the Sch 3.0 billion (exclusive of debt repayment) planned for the year.

Despite heavy political pressures for larger central government expenditures, the 1966 budget proposals presented by Finance Minister Schmitz reflected his position that government expenditures should not exert additional strain on the economy in view of the current serious price/wage situation. The 1966 budget estimates hold the increase in government expenditures to 4.6 per cent, a little less than the increase expected in GNP. At the same time, projected revenues are to increase by

almost 6 per cent through selected excise tax increases and higher prices on government-supplied services, such as rail and bus fares. Expenditures of Sch 69.9 billion and revenues of Sch 67.5 billion were proposed, resulting in a Sch 2.45 billion deficit--about equal to the amount budgeted for debt repayment. The Socialists, however, would not agree to a budget which intended "to resolve the country's inflationary problems by adding new financial burdens to the already high cost of living." The coalition government resigned in late October, and a provisional government was appointed pending elections on March 6, 1966. In the meantime, a six-month provisional budget will cover only those expenditure commitments fixed by law for the Federation and Federal enterprises.

Balance of payments for first half-year shows modest deficit

In the first half of 1965, Austria's balance of payments showed a modest deficit, much reduced from the adverse position in the final quarter of 1964, when the reversal in Austria's capital accounts produced the first substantial payments deficit since 1955. Between January and June the deficit in foreign payments amounted to \$19.6 million, compared with a surplus of \$68.7 million in the same period in 1964.

(See Table 6.)

The continuing deficit was due almost entirely to deterioration in the capital account; whereas the January-June 1964 capital account registered a \$74.4 million surplus, there was a \$24.9 million deficit this year. (See Table 7.) The volume of Austrian borrowing from abroad

Table 6. Austria: Balance of Payments, 1963-64
(in millions of U.S. dollars)

	1964			1965
	<u>Year</u>	<u>I-II</u>	<u>IV</u>	<u>I-II</u>
Goods and services				
Exports	1,444.4	680.5	394.6	755.2
Imports	1,863.3	893.4	512.6	979.6
Trade balance	<u>-418.9</u>	<u>-212.9</u>	<u>-118.0</u>	<u>-224.4</u>
Travel balance	385.2	149.8	46.0	168.6
Other services				
Balance	<u>37.2</u>	<u>25.5</u>	<u>5.1</u>	<u>15.7</u>
Total goods and service balance	<u>3.5</u>	<u>- 37.6</u>	<u>- 66.9</u>	<u>- 40.1</u>
Unilateral payments (net)	<u>53.9</u>	<u>30.7</u>	<u>16.0</u>	<u>32.1</u>
Capital transactions balance	<u>24.3</u>	<u>74.1</u>	<u>- 40.9</u>	<u>- 25.7</u>
Errors and Omissions	<u>- 21.2</u>	<u>1.5</u>	<u>- 11.6</u>	<u>14.1</u>
Surplus (+) or Deficit (-)	<u>60.5</u>	<u>68.7</u>	<u>-103.4</u>	<u>- 19.6</u>
Financed by:				
Drawing rights on IMF (increase-)	- 35.0	- 15.0	- 20.0	0.0
Miscellaneous capital (net) 1/ Austrian National Bank (increase-)	+ 28.5	- 76.7	+155.4	- 13.4
Foreign exchange	+ 10.0	+ 79.0	- 24.0	+ 96.0
Gold	<u>- 64.0</u>	<u>- 56.0</u>	<u>- 8.0</u>	<u>- 63.0</u>
Total	<u>- 60.5</u>	<u>- 68.7</u>	<u>+103.4</u>	<u>+ 19.6</u>

1/ Includes sums in the process of clearing plus foreign exchange assets of Austrian credit institutions minus freely usable schilling assets of foreigners.

2/ Preliminary.

Source: Oesterrichische Nationalbank, Mitteilungen; IMF, International Financial Statistics.

contracted sharply compared to previous years; neither the Federal Government and other public agencies nor industry resorted to foreign borrowing to the same extent as in the two previous years. (The electric power industry, on the other hand, contracted for foreign loans to much the same extent as in the first half of 1964 and 1963.) At the same time, repayments on foreign loans increased almost \$19 million over January-June 1964. In addition, Austria's export promotion lending to foreign parties--primarily Eastern Bloc countries--increased substantially and produced a further drain on the capital accounts.

The \$40 million deficit on current account (trade and services) during January-June was only slightly larger than in the year-earlier period. (See Table 6.) Net receipts from tourism were up sharply over the 1964 period, but a larger trade deficit, increased interest payments abroad and lower net receipts on "other services" account offset the gain from tourist receipts. Tourism, however, continued to increase its contribution to the current account balance. In the first half of this year, it offset 75 per cent of the foreign trade deficit, compared to 70 per cent in 1964 and 65 per cent in 1963.

Preliminary data for July-September suggest that the third-quarter current-account payments balance should be quite favorable. The trade deficit will be up only slightly--probably between \$4 and \$5 million--from the first-half year monthly level while net receipts from tourism should show a good increase.

Table 7. Austria: Balance of Payments, 1964 - 1965

CAPITAL ACCOUNT
(in millions of U.S. dollars)

	1964			1965
	<u>Year</u>	<u>I-II</u>	<u>III-IV</u>	<u>I-II</u>
Credits to Austria	+73.9	+69.2	+ 4.7	+10.6
Credits to non-residents	-52.3	-17.0	-35.3	-64.5
Non-resident trans- actions <u>1/</u>	+26.5	+19.4	+ 7.1	+23.3
Resident transactions <u>1/</u>	-16.5	- 9.0	- 7.5	- 8.4
Other transactions	<u>- 7.4</u>	<u>+11.8</u>	<u>-19.2</u>	<u>+14.1</u>
Total	+24.2	+74.4	-50.2	-24.9

1/ Direct investment, shares, bonds and real estate.
Source: Oesterreichische Nationalbank, Mitteilungen.

Foreign trade up sharply; deficit increases

Austrian foreign trade increased sharply in the second and third quarters, reflecting strong domestic activity and increased foreign demand for Austrian manufactured goods. Seasonally-adjusted exports averaged 5.4 per cent per month more in the April-August period than in the previous six months. During the same period, imports registered an even greater increase--6.7 per cent--and pushed the trade deficit still higher. (See Table 8.)

Exports, which recently have been showing their highest rates of growth since the boom of 1960, were particularly strong in the third quarter: they were 7.3 per cent higher--on a monthly average basis--than

in the January-June period and 13 per cent higher than in the same quarter of 1964. (See Table 8.) Export demand for capital goods, electrical appliances and transport equipment continues particularly strong from Eastern European countries and developing countries in the Middle and Far East. Common Market and EFTA countries, on the other hand, have reduced their share in Austrian exports compared with previous years.

Table 8. Austria: Foreign Trade
(seasonally adjusted, in millions
of U.S. dollars, month or monthly average)

	1964		1965			
	<u>III</u>	<u>IV</u>	<u>I</u>	<u>II</u>	<u>July</u>	<u>Aug.</u>
Imports, c.i.f.	155	166	161	171	176	185
Exports, f.o.b.	<u>123</u>	<u>126</u>	<u>130</u>	<u>129</u>	<u>141</u>	<u>137</u>
Balance	-32	-40	-31	-42	-35	-47

Source: OECD, Main Economic Indicators; Neue Zurcher Zeitung.

Higher imports have been due mostly to increased demand for finished and semi-finished goods--particularly consumer items, such as house furnishings, luggage and leather goods, and clothing; and capital items, such as electrical machinery and transport equipment. The reduction of tariffs within the EFTA trade area has especially increased buying from these countries.

Official gold and foreign exchange holdings grow

Reserves of gold and foreign exchange held by the Austrian National Bank increased \$54 million between June 30 and November 15, reflecting a seasonally favorable balance of payments surplus. (See Table 9.) However, this gain in official reserves was considerably larger than the \$28 million registered in the same period of 1964 and may reflect other than seasonal factors.

New gold purchases during the period raised holdings \$37 million and pushed the ratio of gold to total reserves to 55 per cent, compared with 48 per cent at the end of 1964 and 52 per cent at the end of the first quarter of this year.

Table 9. Austria: Official Gold and Foreign Exchange Reserves
(end of month, million U.S. dollars)

	1964	1965					
	<u>Dec.</u>	<u>Mar.</u>	<u>June</u>	<u>July</u>	<u>Aug.</u>	<u>Sept.</u>	<u>Nov. 15</u>
Gold	595	619	657	669	683	694	694
Foreign exchange	645	564	549	577	594	567	566
Total	<u>1,240</u>	<u>1,183</u>	<u>1,206</u>	<u>1,246</u>	<u>1,277</u>	<u>1,261</u>	<u>1,260</u>
Change	+49	-57	+23	+40	+31	-16	-1
	(for year)						
Gold as % of reserves	48	52	54	54	53	55	55
Exchange rate (par value: U.S. 3.846 cent/schilling)	3.871	3.869	3.874	3.875	3.875	3.865	n. a.

Source: Oesterreichische Nationalbank, Wochenausweise.