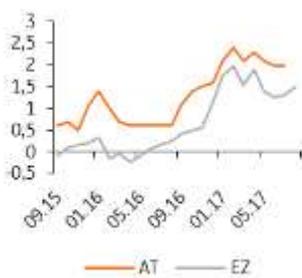


ECONOMICS | Eurozone

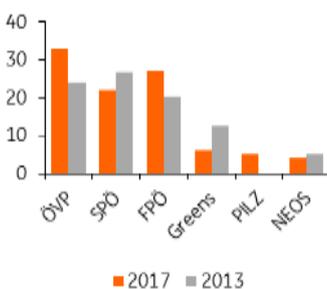
9 October 2017

Growth outlook has improved


Source: Thomson Reuters

Elevated inflation rate (%YoY)


Source: Thomson Reuters

Election forecast for 15 October


Source: Spectra/OÖN, Neuwal

All good things come in fours

Austrian elections could bring a double precedent for the Eurozone

The parliamentary election on 15 October has so far not been on Europe's radar screen. Wrongly so, as Austria could become (once again) the first core Eurozone country with a populist party in government. At the end of a year, in which populist parties had threatened the survival of the entire Eurozone, the Austrian election could be an interesting hint for the entire Eurozone: populism is not dead but the next stage of populism is acceptable populism.

Last year's genuinely exciting presidential election had received lots of international attention as a populist candidate was close to making it into the highest office in a core Eurozone country. This year's parliamentary election has so far not been on Europe's radar screen. Wrongly so, as Austria could become (once again) the first core Eurozone country with a populist party in government.

With three main characters in the run-up to this election – Christian Kern (SPÖ), Sebastian Kurz (ÖVP) and Heinz-Christian Strache (FPÖ) – it might become another exciting one for the Alpine Republic. With the candidacy of Kurz, the tide turned not only for the FPÖ, after having led in the polls for almost two years, but also for the SPÖ, which has lost electorate support in recent months. 31-year-old Foreign Minister Kurz has risen to Austria's most popular politician and has attracted international attention to himself with his hard stance on border policy – a topic which was previously covered by the FPÖ.

So far, however, politics have not had any impact on investment or sentiment. After having been a growth laggard for almost five years, the Austrian economy is powering ahead nicely since last year. In the first half of this year, GDP growth has been robust, with 2Q GDP growth coming in at 2.6% year-on-year. Also the second half of the year is expected to be solid with survey data pointing to an ongoing strengthening of the economy. However, the opportunity for reforms in light of the current cyclical upswing should not be missed. Longer-term targets should come to focus in order to keep up the recent economic strength in light of ageing and digitalisation.

For the Austrian economy, all party programmes imply more stimulus, should the electoral promises be implemented. However, with reciprocal financing being formulated vaguely, the deficit might increase. As regards Europe, tensions between the EU and Austria might heat up with all parties trying to restrict access to the labour market.

Politically, the Austrian election could be an important and interesting hint and precedent for the rest of the Eurozone: a first role model of how a Macron-like movement can take place within an established party and the next stage of populism, with a populist party potentially joining the next government. The exciting political times in the Eurozone continue.

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1. Running on steam...

Favourable economic conditions, driven particularly by robust private consumption...

With sentiment indicators at healthy levels, robust private consumption, a brightening international environment and an improved labour market, the Austrian economy enters its election showdown in a healthy condition. Growth is broad-based with particularly private consumption proving supportive to the economy. The tax reform of January 2016 has boosted real household income and thereby consumption. Low inflation and a pick-up in employment were also beneficial to private consumption. Although its contribution to growth should fade slightly in view of elevated price pressure, private consumption still remains one of the strongest growth drivers for the rest of the year.

...stronger public consumption...

Public consumption, meanwhile, has been an important growth driver as well, partially driven by spending on refugees. In 2015, 6.8% of all first-time asylum applications in the EU from extra-EU28 citizens were made in Austria, the highest number after Germany, Hungary and Sweden in that year. Although the number of applications was halved in 2016, it remains a high figure representing some 0.5% of total population. These exceptional expenditures have boosted GDP growth and continue to do so, although at a somewhat lower level.

...and an uptick in investment

Increased private and public demand has stimulated another economic sector: investment. Not only are existing machines being replaced, investment is also being made to expand production. In order to maintain high levels of investment, the government set up an investment package for SMEs, large companies and communities last year with a total amount of €400m for 2017 and 2018 (0.1% of GDP). Already in April 2017, the subsidies for SMEs were fully exhausted for this year, indicating the high demand for investment.

Austria's strong tourism sector keeps inflation at elevated levels

Contrary to most Eurozone countries, inflation in Austria is a lot closer to the ECB's preferred measure of inflation of "below, but close to 2%". The reasons for Austria's high inflation rate are unit labour costs, administered prices and accelerating inflation in the service sector. Over the last years, real compensation of employees has risen faster than productivity, apparently leading to a pass through into consumer prices. This pattern can clearly be observed in the service sector (mainly in tourism). Given the high importance of tourism for the entire Austrian economy – the sector (including leisure) generates up to 16% of Austria's GDP – it does not come as a surprise that headline inflation is higher than the Eurozone average. Interestingly, digitalization and increased competition does not seem to have reached the Austrian service sector yet.

The labour market is improving

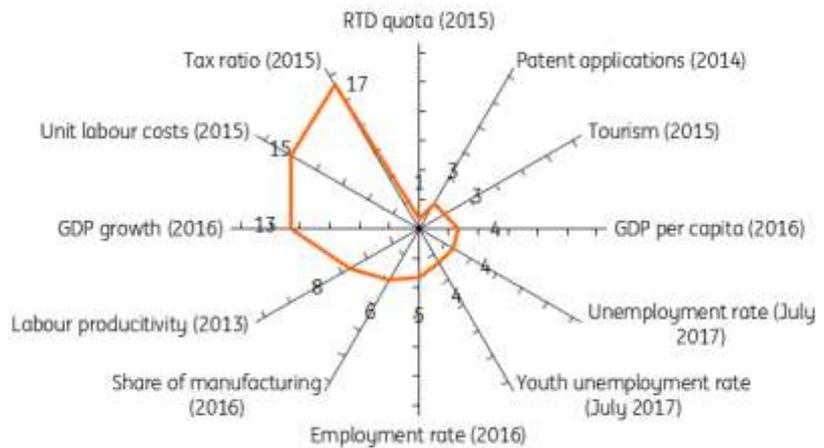
The tourism sector also plays an important role in terms of employment. In 2016, 5.8% of all employees were employed in the hotel and catering industry (marginally employed are not being included). In the entire EU, the share of employed in the accommodation and food service sector is around 4%. Employment in this sector rose by 2.6% compared to the year before. But also overall, the picture is brightening. After having reached an all-time high in terms of unemployment since joining the EU stemming from a rise in market participation of women, older people and immigration, the labour market is slowly improving again. This trend might also be helped by an employment bonus, effective since 1 July. By halving the incidental wage costs for three years for companies who hire formerly unemployed persons, graduates or job changers, 150,000 extra jobs shall be created.¹

¹ However, there is still a catch as the EU has not yet approved funding. Seeing that the bonus is only available to people with an Austrian residence, the bonus might prove discriminatory as it hampers free movement of workers in the EU. The repeated attempts of preferring Austrian citizens is a topic over which the Austrian government is likely to have quarrels with the EU more often (see section 3).

Overall, the Austrian economy is well positioned

Overall, the country is in a healthy condition. What is more, there are many structural factors arguing in favour of strong growth in the years ahead. Austria scores above average in almost all sectors when compared to its Eurozone peers. The country excels in its R&D expenditure, patent applications and has one of the lowest youth unemployment rates.

Fig 1 Austria's competitiveness is high compared to its Eurozone peers



Source: bmwfw

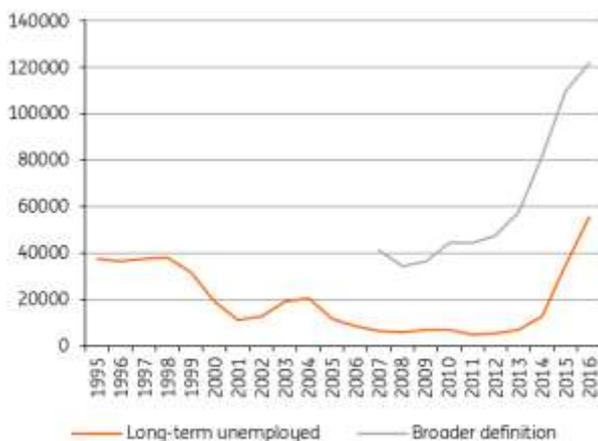
However, there are also caveats. Austria does not score well when it comes to unit labour costs, tax ratio and certain aspects of its labour market.

2. ...but not everything that shines is gold

Structural problems are affecting the labour market...

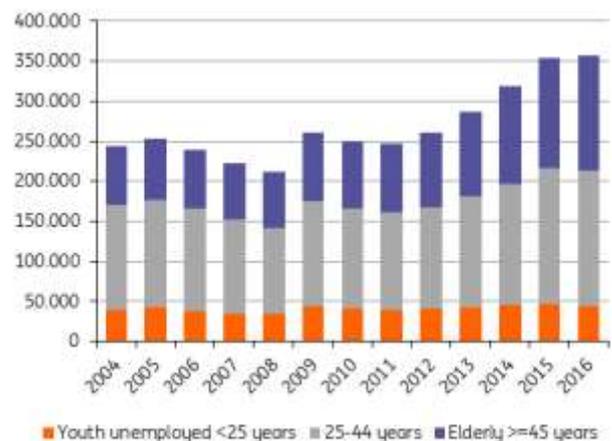
Although Austria still has the lowest unemployment rate in the Eurozone after Germany and Malta as of 2016, there lie structural problems below the surface of the labour market. Especially long-time unemployed as well as older job seekers have a hard time in the job market. While the unemployment rate for unemployed nationals and young people dropped last year, it rose by 6% and by almost 60% for older job seekers and long-time unemployed, respectively.

Fig 2 Not everyone benefits from the ongoing economic recovery



Source: Thomson Reuters, AMS, ING Economics Department

Fig 3 While youth unemployment is stable, the number of elderly being unemployed has increased



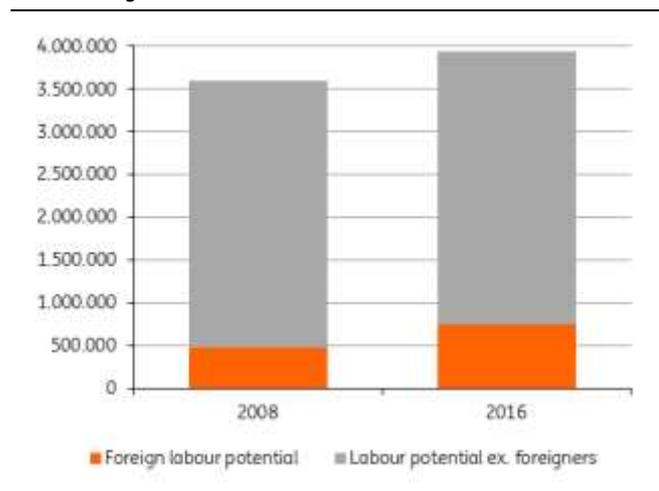
Source: AMS, ING Economics Department

Looking at the broader measurement for long-term unemployed including also training participants or job searchers who do not have taken up a training or job for more than 62 days, the picture is even dimmer.

...caused by sluggish growth in former years and a high labour supply

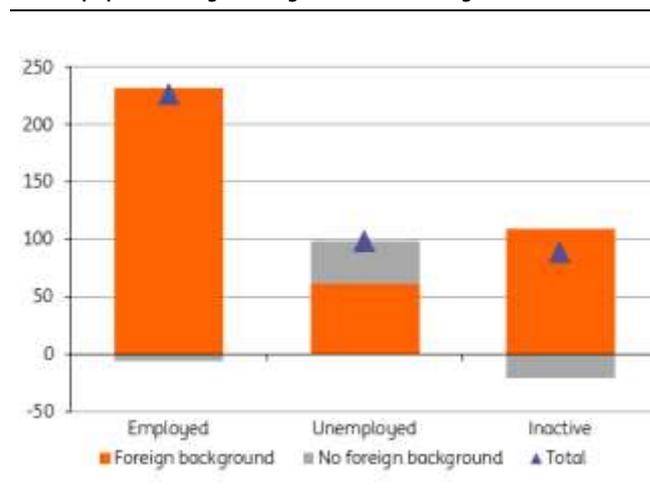
The sluggish growth performance over the last years, a high labour supply, especially from women, older people and migration have led to rising unemployment rates and to unemployment hardening into structural unemployment. As regards labour supply, especially the opening of the EU from 2004 onwards as well as the dissolution of Yugoslavia has attracted foreign workers to Austria as wages and salaries are still significantly lower in Eastern European countries compared to the Alpine republic.

Fig 4 The rise in labour potential has been predominantly driven by foreigners



Source: AMS, ING calculations

Fig 5 Absolute changes between 2008 and 2016 in working age population by activity status and background



Source: OECD Economic surveys: Austria 2017

In order to tackle long-term unemployment, the current government already set up a pilot called "Initiative 20,000" whereby 20,000 additional jobs in municipalities, non-profit organizations or institutions predominantly in the public sector shall be created for people over 50 who have been looking for a job for a year or more.

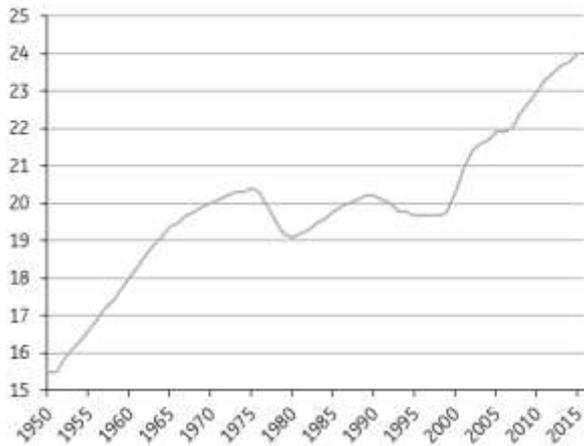
The high tax ratio puts pressure on labour market competitiveness

Another factor weighing on Austria's labour market and its competitiveness is the countries tax system. Compared to its EU peers, Austria has the sixth highest tax pressure which is why it does not come as a surprise that all major parties promise some sort of tax reliefs in their manifestos (see section 3).

Demography and digitalization will weight on Austria's future

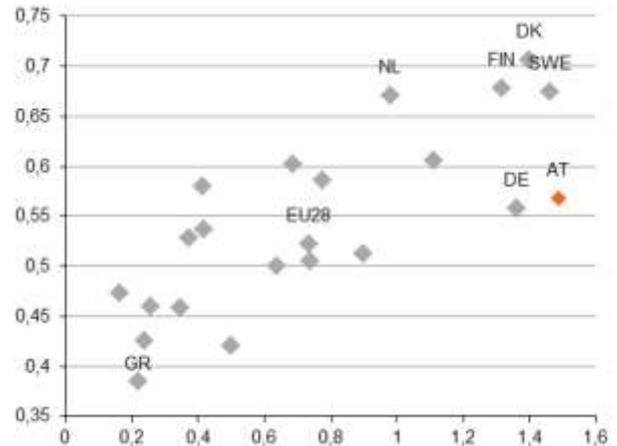
Besides the structural problems in the labour market, additional major trends will weigh on the Austrian economy in the years to come: demography and digitalization. As regards the former, already one-quarter of the Austrian population is 60 years old or more. Demographic expenditure such as pensions, healthcare and care costs already make up around 32% of GDP and are likely to rise in the next decades. Regarding the latter, Austria's digital and business sector digitalization is less mature than would be expected by the amount spent seeing that the country has the highest R&D expenditure rate per capita in the Eurozone and the second highest in the EU.

Fig 6 Proportion of population aged 60 years and more (%)



Source: Thomson Reuters

Fig 7 Digital economy and society indicator (DESI) and R&D expenditure per capita (USD, 2015)



Source: OECD Economic surveys : Austria 2017

Austria has set up a “Digital Roadmap”, concentrating on 12 areas in order to become a leading digital business location. This is a necessary step, seeing that especially enterprises lag behind when it comes to online selling, cloud computing as well as fast broadband subscriptions.

3. Approaching October elections

Only one week away from elections, the election campaign is getting hotter with the three major parties, SPÖ, ÖVP and FPÖ, having presented their party platforms. Just as a reminder, the outgoing coalition consists of the SPÖ and the ÖVP.

The SPÖ started with an updated version of its “Plan A”. Originally planned as an attempt to stimulate the debate with the coalition partner about new measures on how to reshape current economic and social policies at the beginning of the year, it now serves as the party’s manifesto under the motto “I’ll get what I am entitled to”. The manifesto includes several measures to boost investment, foster education, tackle unemployment and increase real wages. A minimum wage of €1,500 in all sectors as well as no taxes for the first earned €1,500 and a tax cut in the amount of €5bn is planned. In total, 200,000 new jobs shall be created. Reciprocal financing shall be done by introducing an inheritance tax for assets worth more than €1m, higher growth, more employment and less unemployed.

Regarding the future of Europe, the SPÖ takes the most favourable stance, calling for a rapid completion of the economic and monetary union. Close cooperation in terms of migration and the distribution of asylum seekers to EU countries, a restructuring of the EU budget, but also reduced resources in case of serious violations of the EU’s values are under discussion. But the manifesto includes also a much more controversial idea: in sectors with high unemployment, EU foreigners should be employed only if no suitable Austrian worker can be found. This is a clear sign that the SPÖ is trying to capture some populist ideas.

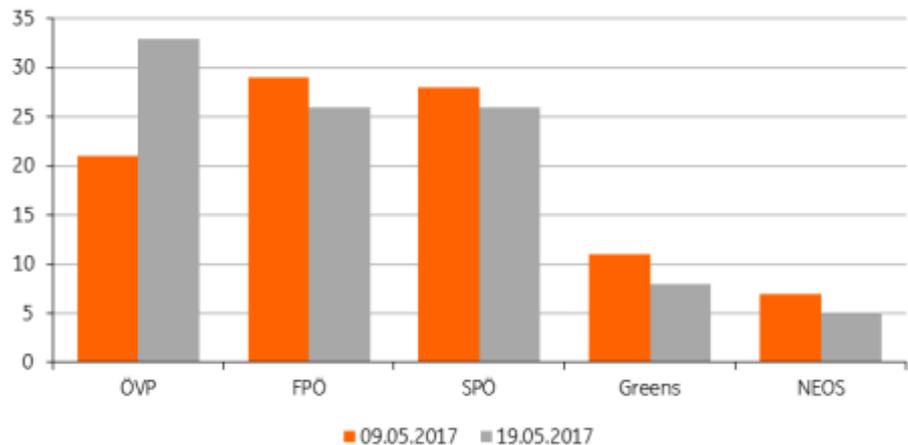
Nevertheless, the party is not scoring as well as its former junior coalition partner, the ÖVP. Before Foreign minister Kurz’s candidature for the chancellorship, current chancellor Christian Kern (SPÖ) had a good chance to remain in his position with his party scoring well in polls. Kern, former chief executive of Austria’s Federal Railway Company, became chancellor only in 2016 after the resignation of Werner Fayman. However, since Kurz entered the political limelight, tides turned. Prior to the dissolution of the coalition, the FPÖ was leading in the polls, closely followed by the SPÖ. After Kurz became chairman of the ÖVP, the party shot up more than 10%-points in polls, and has been leading since then.

The SPÖ’s motto: I’ll get what I am entitled to

A rapid completion of the economic and monetary union is warranted

Kurz turned the tides by entering the election campaign

Fig 8 Polls before and after Sebastian Kurz (ÖVP) entered the election campaign (%)



Source: Market/Der Standard, Unique Research/Heute, Neuwahl

The incorporation of populist ideas has helped the ÖVP getting back in polls

Interestingly, Kurz has copied some populist trends from other countries and brought them into the traditional ÖVP. Like Macron for example, founding a new party, Kurz has initiated a small revolution from the inside entering the election with his own list of candidates, controlling the party's contents and the personnel. But he is not only relying on leftist concepts, but has also taken on a topic usually covered by right-wing parties by having a clear and hard stance on refugee policy – a topic which was previously covered by the FPÖ in Austria.

The ÖVP's motto: "The new way."

The ÖVP's election pledges are manifold. Access to social services is only to be allowed after having spent five years in Austria, of which 12 months are to be full-time employed. Asylum-seekers or people granted subsidiary protection shall receive a minimum protection of €560 per month, while in general the minimum protection shall be standardized to €1,500 for a household in need. On the economic front, a tax relief in the amount of €12bn to €13bn is foreseen by cutting wage and income taxes as well as corporate taxes. Higher economic and employment growth, a slowdown of government expenses as well as the digitization of administrative processes will stem tax reductions. As regards Europe, a departure from the extremely expansionary monetary policy is advocated as well as a reform of the EU's tax system. The closure of borders and cutting the accession negotiations with Turkey are mentioned as well.

The FPÖ might tip the scales in this election. It's motto: "Fairness – Freedom – Progress"

Apart from the two major parties, there is another player in the limelight. With the former coalition partners not being necessarily driven to work together for another five years, the right-wing party FPÖ might tip the balance in this election. The party takes clear stances towards migration and in putting Austria's interests first (the party's general manifesto has the challenging title "Austria first" – way before Trump was even close to coming to power). In order to reduce labour migration, access for foreigners to the Austrian labour market shall be restricted, social benefits and other expenses for economic migrants shall be minimized. Having the Austrian citizenship is a prerequisite for receiving minimum benefits. In order to tackle structural long-term unemployment of non-citizens, after 26 weeks of unemployment benefits, an application has to be made in the home country, while after 52 weeks the responsibility for social assistance falls back to the home country.

Europe? Yes, but...

As regards Europe, the party is least positively disposed. According to the FPÖ, the EU needs to take the principle of subsidiarity and direct democratic elements more into account. A debt union or sovereignty of taxes is a no-go, while a common currency only makes sense, if economies have similar structures.

In line with the ÖVP, the party wants to cut taxes for individuals and companies, target multinationals and wants to reduce social spending.

Fig 9 A thorough check-up of the party platforms

| | | SPÖ | ÖVP | FPÖ |
|-----------------------------|--|---------|---------------------------|---|
| Taxes | Reduce wage and income tax | ✓ | ✓ | ✓ |
| | Elimination of cold progression | X | ✓ | ✓ |
| | Tax-free income (€) | 1,500 | X | X |
| | Reduce VAT for overnight stays | X | ✓ | ✓ |
| | Inheritance tax | >1mln | X | X |
| | Reduce/eliminate corporate tax | X | ✓ 0% | ✓ 12.5% |
| | Reduce incidental wage costs | ✓ | ✓ | ✓ |
| | Tax relief in the amount of (€ bn) | ✓ 5.4 | ✓ 11.7-12.7 | ✓ 12 |
| Labour market | Restrict access to the labour market | ✓ | ✓ | ✓ |
| | Raise minimum wage | ✓ 1,500 | X | ✓ 1,700 |
| | Quote of women | ✓ | X | X |
| Social benefits | Equalize to (€) | X | ✓ 1,500 | X |
| | Differing for asylum-seekers (€) | X | ✓ 560 | ✓ 0 |
| Domestic security | Police officers | ✓ 2,500 | ✓ more training positions | X |
| Europe | Less Europe | X | X | ✓ |
| | Euro | ✓ | ✓ | Only for countries with similar economies |
| | Reform of the Posting of Workers Directive | ✓ | ✓ | ✓ |
| Reciprocal financing | Total (€ bn) | 9.75 | 12-14 | 13.2-16.2 |
| | By higher growth | 2.45 | 4-5 | 3 |
| | Adjustment of taxes | 3 | 0.8 | 1 |
| | Cost savings/optimization | 4.3 | 7.2-8.2 | 12.2 |

Note: FPÖ's proposal on minimum wage is not included in the manifesto (Source: DerStandard, APA).

Source: Party manifestos and economic programmes, ING Economics Department as of 10/04/2017. X=Refusal or no written indication.

GDP growth is a must in order to stem the parties' proposals

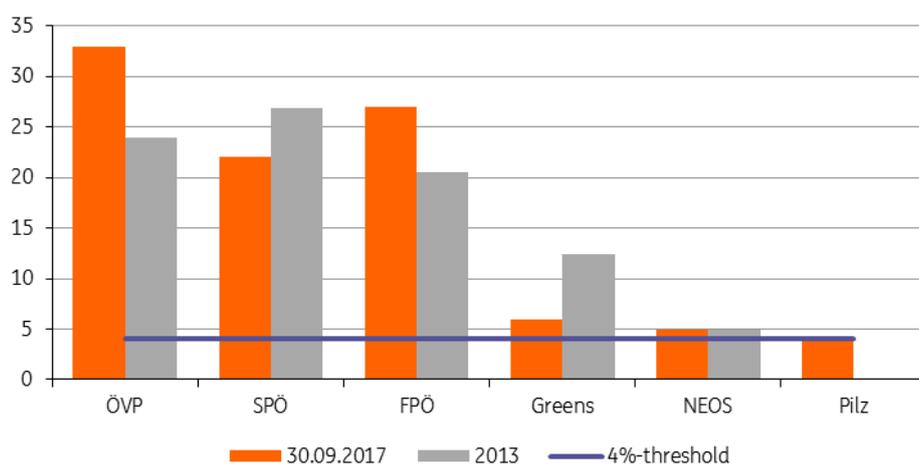
With all three programmes relying heavily on the continuation of robust growth performance, financing of the fiscal measures is standing on rather shaky legs. With government debt amounting to 83.6% of GDP, and a budget balance of -1.6%, chances for a higher deficit rise when looking at the proposals. Although last year's tax reform pushed private consumption and the growth outlook for this year and next year is favourable, it might not be enough to stem tax relief.

4. Who is up for the challenge?

On paper there are few coalition possibilities, but the reality looks somewhat different

Judging from the latest opinion polls, Sebastian Kurz and his ÖVP have a good chance to come in as the biggest winner making the race for the number two spot more exciting with the SPÖ and FPÖ being neck and neck. Additionally, three minor parties might enter the government by beating the four percent threshold. Although on paper there are few coalition possibilities, the reality looks somewhat different. With another grand coalition currently not being debated on the basis of its dissolution – at least not with the current party leaders – the FPÖ's chances of becoming a junior coalition partner are high. Although the ÖVP has not committed itself to any partner, just a brief glance at the parties' manifestos reveals multiple matches with the FPÖ. While the SPÖ on the other hand even made a resolution at a party convention not to form a coalition with Strache's party, nothing is ever set in stone. Even Chancellor Kern's statement of going into the opposition if his party became second, might crumble if his preferred coalition with the Greens and NEOS would become a real possibility. However, a look at the polls reveals that this minority government is currently not an option at all, being only marginally stronger than the ÖVP.

Fig 10 Kurz' ÖVP is ahead in the polls (%)



Source: Neuwal, Spectra/OÖN.

History will not repeat itself as mainstream politics across the globe have changed

Having said that, the FPÖ might actually tip the scales in favour of Sebastian Kurz (ÖVP) or Christian Kern (SPÖ). Already from 2000 to 2006, the FPÖ was part of the government, building a coalition with the ÖVP. However, the 14 EU-members at that time were all but happy with the FPÖ's front man Jörg Haider and imposed sanctions against Austria until September 2000 in the form of neither operating nor accepting official bilateral contacts at the political level with the Austrian government. That EU-members would repeat such measures this time, seems highly unlikely. And in the end, the FPÖ might not even become part of the official government as there is one other option on the table, proposed by Sebastian Kurz (ÖVP): He is thinking of not forming any coalition at all, but to work on shared visions with as many parties as possible. Whether this French-styled model might become reality for Austria, depends on the coalition talks after October 15.

Economic stimulus in the pipeline, but reciprocal financing is vague

Turning to economics, all party programmes imply more stimulus for the Austrian economy, should the electoral promises be implemented. However, with financing of fiscal measures being formulated vaguely, the deficit might increase. As regards Europe, tensions between the EU and Austria might heat up with all parties trying to restrict access to the labour market.

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