

SLOWLY BUT SURELY

In 2004-2005, the expected return of growth in Germany will underpin Austrian exports. This will boost investment, which was the main engine of growth in 2003. Consumers should gradually regain their confidence despite the surge in inflation. On balance, growth should reach 1.5 % this year and rise slightly above 2 % in 2005.

Growth was saved by investment in 2003 and will be steady in 2004-2005...

With net exports making a negative contribution to growth, the strength of the Austrian economy in 2003 was due to domestic demand, which after stagnating in the previous two years, grew more than 2 %. This rebound is almost solely due to the sharp increase in investment (+4.5 %) – the main beneficiary of a stimulus programme which was initiated in late 2002. Spending on machinery and equipment was boosted by the introduction of a 10 % “investment premium” offered to firms who had invested more than average amounts over the past three years.

These measures also helped the construction sector, as did the reconstruction work needed after the floods of summer 2002 and the government’s “strategic programme” for 1999-2006 aimed at improving Austria’s transport infrastructure. This is a substantial programme owing to the country’s mountainous landscape and is a prerequisite for the development of international trade and for transporting energy across the country. An estimated EUR 20 billion has been put aside to improve transport (20 % on trunk roads, 33 % on motorways and 47 % on rail).

This investment support programme will lose some of its impact this year. However, capital expenditure is likely to remain supported by the government’s plans to lower the corporate tax rate to 25 % in 2005 from 34 % at present (equivalent to 0.5 % of GDP) and by the fact that the monetary environment will remain favourable to investment. Furthermore, the capacity utilisation rate, which has started to improve, should rise further because of the increase in foreign orders. All things considered, investment is likely to grow 3.25 % in 2004 and some 4 % in 2005.

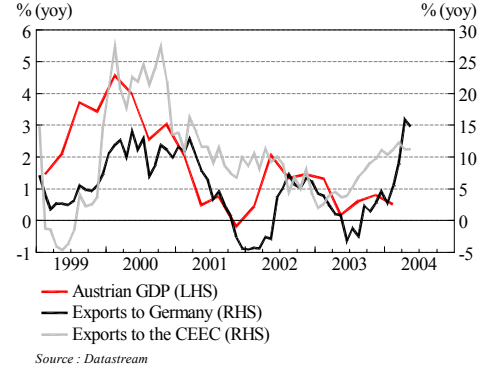
... thanks to the renewed vitality of exports...

The recovery that began in Germany in late 2003 has produced a rebound in Austrian exports, with sales from Austria to Germany growing almost 14 % yoy during the spring. Furthermore, Austria continues to benefit from strong demand from its preferred market, the Central and Eastern European Countries. (Exports to the CEEC have grown more than 10 % yoy since the beginning of the year). Over recent years, Austria has systematically diversified its trade relationships in order to gain full benefit from the strong performances of neighbouring economies. For example, Vienna has taken part in 84 accession partnerships under the PHARE twinning programme (a financial instrument put in place by the EU in 1989 to assist CEEC in their transition to democracy and the market economy). These twinings, which are a means of encouraging regional cooperation, are focused on the two areas in which Austria has specific expertise, namely justice and internal affairs (JIA) and the environment. Austria has also announced its desire to build a “regional partnership” in various fields, such as the environment, energy and transport, with the Czech Republic, Hungary, Slovakia, Poland, based on the Benelux model or the “Nordic dimension”.

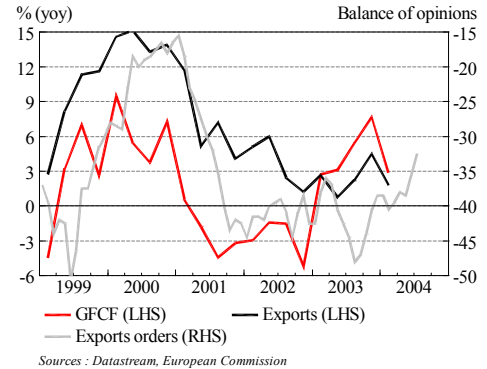
Because Austria is highly dependent on exports, the government is encouraging small businesses to become involved in international trade by providing assistance totalling EUR 50 million per year in 2003 and 2004.

Finally, exports could grow more than 4 % in volume this year and contribute slightly to GDP growth. The significant pick-up in exports should also help reduce the current account deficit, which should fall from 0.9 point of GDP in 2003 to 0.25 point in 2004. However, as in 2003, the decline in price competitiveness will reduce Austria’s market share by around 2 points.

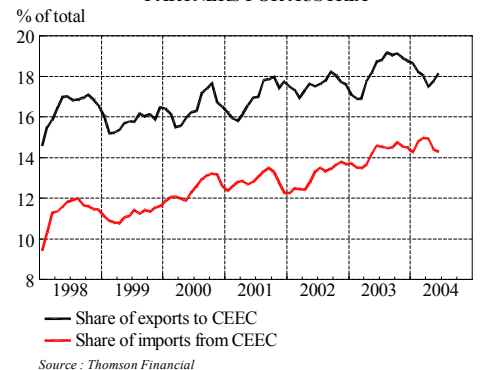
THE RECOVERY BEGAN IN MID-2003 LED BY EXPORTS TO GERMANY AND THE CEEC



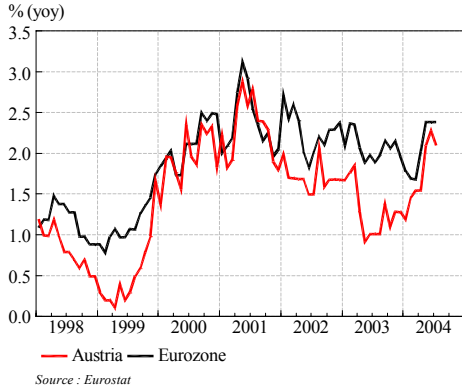
THE INCREASE IN ORDERS: A GOOD SIGN FOR A CONTINUING RECOVERY



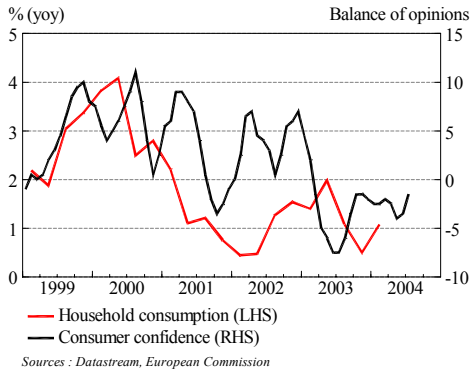
THE CEEC: INCREASINGLY IMPORTANT PARTNERS FOR AUSTRIA



SURGE IN PRICES SINCE THE BEGINNING OF 2004



ENCOURAGING EXPECTATIONS SHOULD BOOST PRIVATE CONSUMPTION IN 2005

HOURLY LABOUR COST IN INDUSTRY AND SERVICES
IN 2000 (IN EUROS)

EU15	22.70
Germany	26.54
France	24.39
Austria	23.60
10 new acceding countries	4.21
Czech Republic	3.90
Hungary	3.83
Poland	4.48
Slovakia	3.06
Slovenia	8.98

Source: Eurostat, 2003

... which is offsetting the persistent weakness of consumer spending

Since 2001, household consumption has been persistently sluggish. Certainly, consumer confidence is showing signs of improving from the weak levels recorded in 2003, but it remains depressed because of:

- the sharp rise in energy prices in Q2-04 associated with the increase in both oil and gas prices ;
- a 2.2 % yoy surge in service prices in Q1 and Q2 2004 ;
- a very moderate increase in wages (+0.5 %) following the annual revaluation in May. This is the smallest increase since 1998 ;
- the depressed labour market. The economic downturn of the past three years has knocked the wind out of job creation. The harmonised unemployment rate has reached levels rarely seen in the past, having risen from 3.4 % in early 2001 to 4.2 % today.

All in all, the purchasing power of disposable income is practically at a standstill, even though EC opinion polls show that consumers had previously hoped to maintain a high level of saving. The savings rate has risen 1 percentage point since 2001 to 8.5 % of disposable income in 2003. Nevertheless, several indicators point to a future pick-up in consumer spending. New car registrations have shown a yearly cumulative increase of 4-5 % since the beginning of the year, despite a dip in July. Retail sales are now showing a sharp rise of 1.2 % yoy (3 mma), after falling significantly in late 2003 to early 2004.

Future governmental measures including cuts on personal income tax (0.5% of GDP) and an increase in family benefits (0.1 % of GDP) should also have a positive influence on private consumption in 2005.

Austria faces a difficult challenge in terms of fiscal and social policy

In order to nurture competitiveness, the government has launched a 2-year package of measures worth EUR 3 billion (1.3 % of GDP), aimed at increasing labour productivity and reforming both the goods and services and the capital markets. Taxes and social security contribution will fall to under 43 % of GDP in 2005 versus 44 % in 2003. Despite the fiscal reform being undertaken in Austria, the majority of new EU member states tax firms at a significantly lower rate (16 % in Hungary, 19 % in Poland and Slovakia and 25 % in the Czech Republic and Slovenia in 2005).

Low labour costs in the CEEC, whether for skilled or unskilled labour, represent a double threat to Austrian wage earners:

- large-scale immigration, particularly to border areas, which are highly developed throughout Austria. Furthermore, price competition is likely to be strong, which may lead to Austrian consumers choosing to buy from the CEEC.
- the process of relocating labour-intensive industries may accelerate, leading to upward pressure on Austrian unemployment and downward pressure on wages.

All things considered, the costs and benefits derived by Austria from EU enlargement will vary across economic sectors and geographical regions. The enlargement is imposing enormous changes on the Austrian economy. This has a cost in addition to that of the Community development assistance provided to the CEEC. However, these short-term costs should be offset by sustained benefits in the medium-to-long term. According to a study carried out by the National Bank of Austria, CEEC accession will have a positive effect on Austrian growth in the long term equal to between 0.75 and 1.50 points of GDP.

Florian LEFEBVRE – +33 1 42 14 27 96

WORTH WATCHING

Confidence and private consumption could remain depressed and significantly slow down the recovery : the expansion may not create enough jobs, largely because of competition from new EU countries. This could dampen consumer confidence and purchasing powers, thereby prolonging the period of weak consumption.

%	2001	2002	2003	2004(f)	2005(f)
GDP in volume	0.8	1.3	0.7	1.5	2.4
Consumer prices (CPI)	2.3	1.7	1.3	1.7	1.5
Unemployment rate	3.6	4.2	4.2	4.2	4.2
Current acc. bal. (% GDP)	-1.9	0.4	-0.9	-0.3	0.1
Public balance (% GDP)	0.2	-0.2	-1.3	-1.4	-1.9

All opinions and estimations included in the report represent the judgment of the sole Economics Department of Société Générale and do not necessarily reflect the opinion of the Société Générale itself or any of its subsidiaries and affiliates. These opinions are subject to change without notice. It does not constitute a commercial solicitation, a personal recommendation or take into account the particular investment objectives, financial situations.

Although the information in this report has been obtained from sources which are known to be reliable, we do not guarantee its accuracy or completeness. Neither Société Générale nor its subsidiaries/affiliates accept any responsibility for liability arising from the use of all or any part of this document.

Société Générale may both act as a market maker or a broker, and may trade securities issued by issuers mentioned in this report, as well as derivatives based thereon, for its own account. Société Générale, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any issuer mentioned in this report.

Additional note to readers outside France : The securities that may be discussed in this report, as well as the material itself, may not be available in every country or to every category of investors.

© [2005] Société Générale, All rights reserved.

