4. Austria and CESEE: Growth badly affected by invasion fallout

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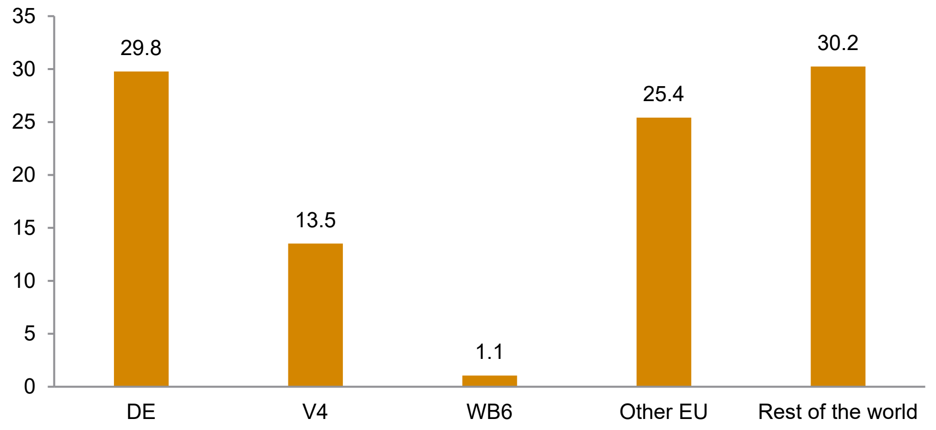
- **The sharp reduction in Russian gas flows to Europe has led to inflation in Austria exceeding the levels of the 1970s. This has dented consumption and business confidence.**
- **Germany and the Visegrád countries – Austria's key trading partners – have been especially badly affected by the fallout from the Russian invasion, due to their previously heavy reliance on Russian gas.**
- **Austria will therefore face serious direct and indirect effects, with manufacturing and tourism bracing themselves for a potentially tough winter.**
- **Central Europe will face a difficult 12-18 months at least, but over the medium term its decoupling from Russian energy, combined with large allocations from NextGenerationEU, will be a powerful driver of the green transition in the region.**

Record inflation has slammed the brakes on private consumption. In Austria, surging prices for food and energy have led private consumption to lose steam. On the back of the recent sharp reduction in Russian gas flows to Europe, in September inflation (measured by the Harmonised Index of Consumer Prices – HICP) hit a record 11% – above the figures observed during the oil price shocks of the 1970s. The consumer confidence indicator fell in September to -64, its lowest since April 2020. Revised estimates for private consumption clearly illustrate the economic consequences: last December, the Austrian Institute of Economic Research (WIFO) forecast growth of 6.3% in private consumption in 2022: in October, the figure was recently revised downwards to 3.8%.

The business outlook has also turned negative, though not overly pessimistic. In 2022, fixed capital investment will likely stagnate, though it may recover slightly in 2023. Recent WIFO estimates are for a 0.5% decline in 2022 and growth of 0.8% in 2023. Investment stagnation is also suggested by the Purchasing Managers' Index for Manufacturing (PMI). Although it fell to 48.8 in August – below the critical 50 points that separates growth and contraction – it did not deteriorate any further in September.

The looming recession in Germany will be a drag on Austria's economic growth. With an export ratio of 55.9% in 2021, Austria is a very open economy. Its most important trading partners remain Germany and the Visegrád region: Germany accounts for almost 30% of all Austrian exports, while 13.5% go to the Visegrád economies (Figure 4.1). Since Germany is expected to face a technical recession in Q4 2022 and Q1 2023 (largely on account of high energy prices), that will have an impact on the Austrian economy both directly and through indirect linkages – especially through the country's important trading partners, such as the Visegrád states. 27.6% of Czech, 23.6% of Hungarian, 26.3% of Polish and 18.9% of Slovak imports originated in Germany in 2021.

Figure 4.1 / Austrian goods exports by destination, Q2 2022, %



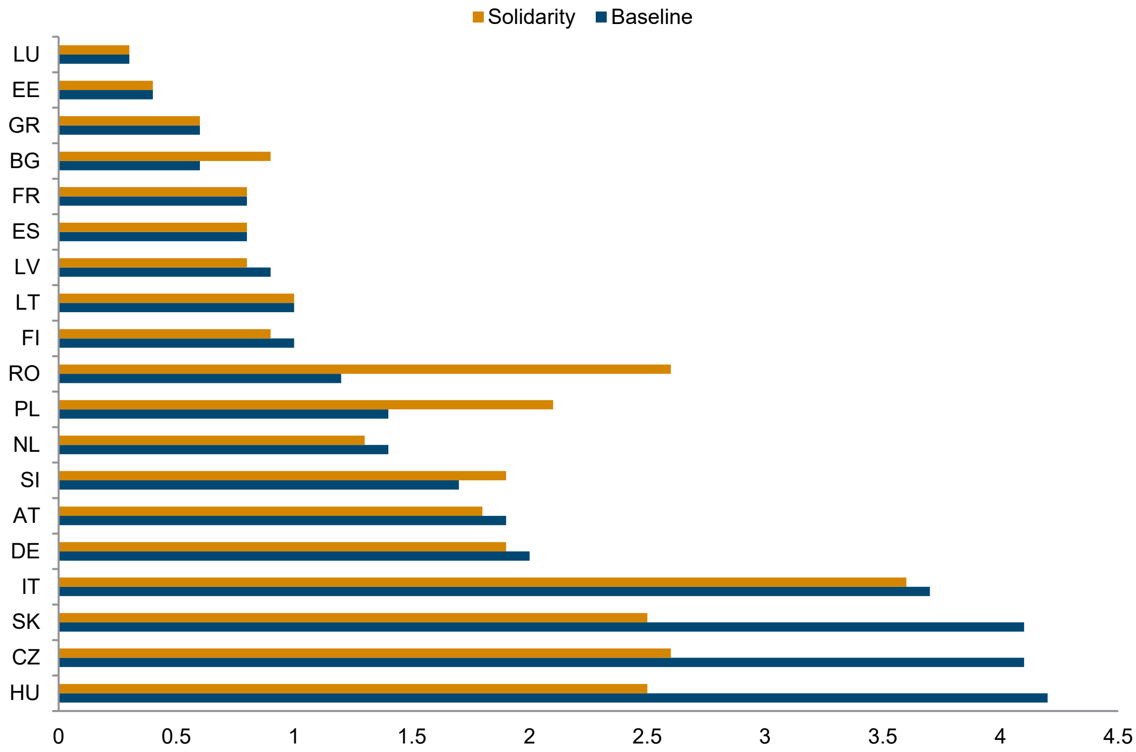
Source: Statistik Austria.

Energy shortages remain at the root of the uncertainty facing the Austrian economy and its key trading partners. This applies above all to industry, which in 2021 accounted for 35% of Austrian gas consumption. The country's most gas-intensive industries are paper, chemicals and steel. Paper production alone accounts for approximately a fifth of all gas consumed by industry in Austria. Surging energy prices have already left their mark on the economy, amid concerns over the gas supply this winter, possible gas rationing and the resultant supply-chain disruptions. This has led an increasing number of businesses to draw up contingency plans for a partial or complete halt to their production. Cellulose-fibre producer Lenzing AG has already announced that it will cut production at one of its plants.

Austria and some of its main trading partners, including Germany and the Visegrád countries, would be among those EU countries hit hardest if Russian gas were to stop flowing altogether. Austria and many of its key trading partners are heavily dependent on Russian gas (see Spring Forecast and the Summer Update). Supply-chain disruptions caused by the current energy crunch have already caused a domino effect across the thoroughly integrated European economies. A recently published International Monetary Fund (IMF) working paper (Di Bella et al., 2022) estimates that a potential full shut-off of Russian gas would lead in Austria to a GDP loss of approximately 2%. This includes both the direct impact (the stoppage itself) and the indirect impact (through spill-over effects) (Figure 4.2). Austria's top trading partners of Hungary, Czechia and Slovakia would be the countries hit hardest. The potential output loss for the worst-hit economy – Hungary – is estimated at 4.2%; for Czechia and Slovakia, the loss would be 4.1%. That is more than double the impact estimated for the entire EU of -1.8%.

Given that much of the Russian gas to Europe has already been shut off, the greater part of this impact has already been incorporated into our (quite pessimistic) baseline projections for Austria's key trading partners (albeit the Hungarian case is more complicated). Our baseline projections for economic growth in the key trading partners of Czechia, Hungary and Slovakia are now close to the negative scenario that we estimated in spring, which assumed a full cessation of Russian gas deliveries. Over the medium term, this will act as a powerful stimulus for the green transition in Central Europe, supported by NextGenerationEU funds; however, it is clear that over the next 12-18 months at least, high gas prices and inadequate supply will act as a brake on economic growth in the region, with negative direct and indirect effects for Austria.

Figure 4.2 / Estimates of GDP losses from a complete shut-off of Russian gas for selected EU economies, in percentage points

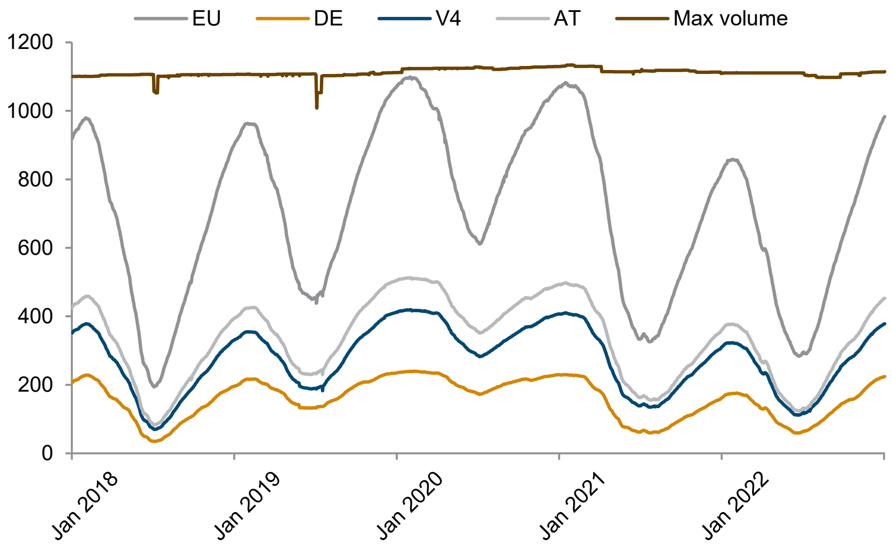


Note: The baseline scenario is based on the assumption of a total cessation of Russian gas supplies to Europe, starting from the end of June 2022 and lasting through the 2022-2023 winter. The scenario is compared to a counterfactual 'no shock' scenario, with consumption extrapolated from 2021 (but adjusted for current high prices). The solidarity scenario is Austria, Bulgaria, Croatia, Germany, Poland, Romania and Slovenia sharing gas with Czechia, Hungary and Slovakia: this would mean an even reduction in gas consumption of 15% for those seven donor countries.
Source: Di Bella et al. (2022).

Burden-sharing between EU member states could relieve the pressure on the worst-affected countries of Central Europe; but how this would work in practice remains very unclear. According to the above-mentioned IMF working paper, possible burden-sharing through a 15% reduction in gas consumption by countries like Germany or Austria could reduce the impact of a Russian gas shut-off on the potentially worst-hit economies of such as Czechia and Slovakia to approximately -2.5%. Recent statements by the German chancellor provide grounds for greater optimism for next winter (2023-2024). Germany expects to be fully independent of Russian gas supplies by the end of 2023, thanks to the provision of liquefied natural gas (LNG) terminals. Gas storage is currently also relatively high, and the amount of gas in storage is continuing to rise. The volume of gas now in storage is already above the maximum level in 2017, 2018 and 2021 (Figure 4.3).

Beyond manufacturing, Austria's tourism sector faces another challenging winter season. Surging energy prices (or even power rationing) could be tough for ski resorts, given their reliance on artificial snowmaking. The expected technical recession in Germany in Q4 2022 and Q1 2023 will also have an impact on the tourism sector: in 2021, 55% of all Austria's tourism services exports went to Germany.

Figure 4.3 / Gas in storage, in terawatt hours (TWh), September 2017 to September 2022



Source: Aggregated Gas Storage Inventory.

REFERENCE

Di Bella, G., Flanagan, M., Foda, K., Maslova, S., Pienkowski, A., Stuermer, M. and Toscani, F. (2022), Natural Gas in Europe: The Potential Impact of Disruptions to Supply. IMF Working Paper 11/283, International Monetary Fund, Washington.