3. Austria and CESEE: Resilience of Southeast Europe benefiting Austrian exporters, but ties with Russia yet to break

BY RICHARD GRIEVESON

› **The impact of the war and inflation on the Austrian economy is high by Western European standards, but moderate in the context of CESEE.**

› **Austria's trade with CESEE has held up well and continues to outperform its trade with the rest of the world.**

› **Austrian exports to Southeast Europe grew particularly strongly last year, reflecting the relative economic resilience of that region.**

› **Most of the CESEE region will only recover gradually from the war, with negative implications for Austria. Of Austria's main CESEE trading partners, only Romania, Czechia and Slovakia will surpass their 2018-2022 average growth rates in the next two years.**

› **Austrian exports to Russia held up better than EU exports to Russia as a whole in 2022, as Austria exports many non-sanctioned products to Russia, such as food.**

› **Almost two thirds of Austrian firms in Russia are so far continuing operations, despite the invasion – a larger share than in most neighbouring and peer Western countries. A further 16% have reduced operations and are holding off on new investments.**

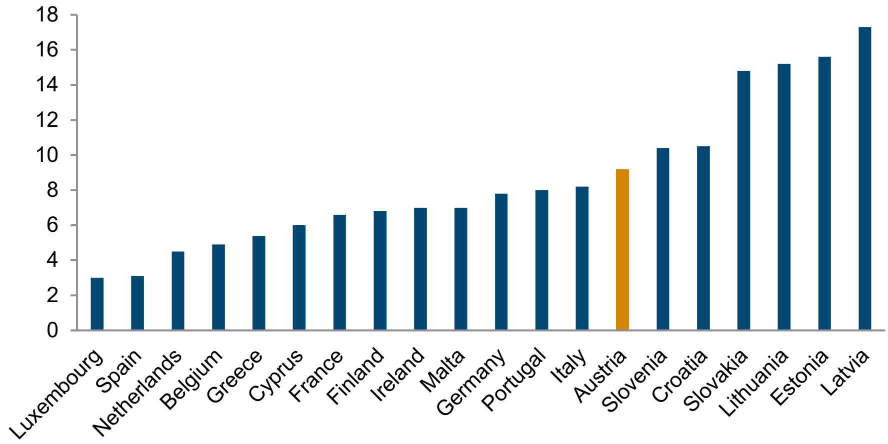
› **Austria remains one of the most important foreign investors across CESEE, but its relative importance has declined in most of the region since 2013, with its share of the total inward FDI stock falling in 16 of the 23 CESEE countries covered by wiiw between 2013 and 2021.**

› **Relative to its GDP, Austria's financial support for Ukraine since the invasion has been average by EU standards, but it is heavily focused on humanitarian aid, in line with the country's neutral status.**

Austria is much more integrated into the CESEE region than almost any other Western country, and as such has been heavily exposed to the fallout from the war. The EU economy slowed almost to a standstill over the winter, above all due to energy supply disruptions and skyrocketing inflation that is partly driven by the fallout from the war and the exchange of sanctions between Russia and the West; yet it is clear that Central and Eastern Europe has been especially badly affected, compared to Western Europe. According to the European Commission's Winter Forecast, the worst-performing economies in the EU in 2023 will include large parts of EU-CEE, as well as the Nordic countries, Germany and Austria. The euro area's highest rates of inflation are also all in EU-CEE, with Austria not far behind

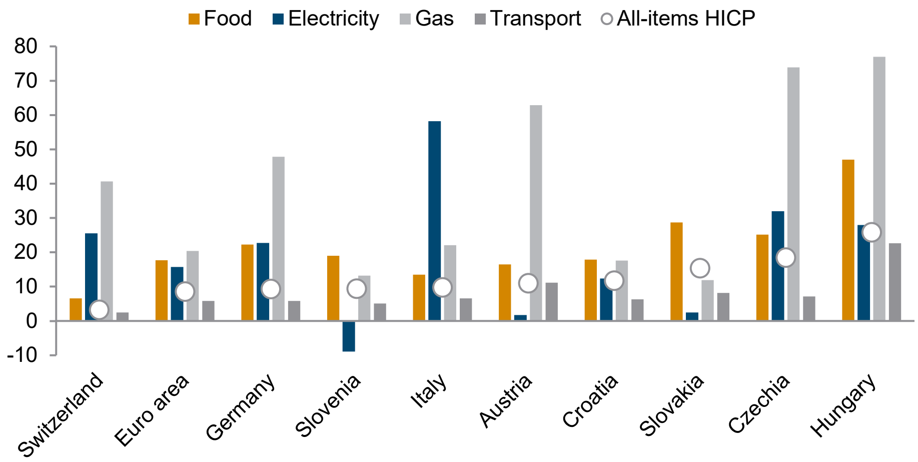
(Figure 3.1). As well as being geographically closer to the conflict, the Central European manufacturing core – of which Austria is a key component – has been affected by higher energy prices (although industry overall has been resilient, given the scale of the external shock).

Figure 3.1 / HICP, percentage change, year on year, March 2023



Source: Eurostat.

Figure 3.2 / HICP and selected sub-components, percentage change, year on year, February 2023



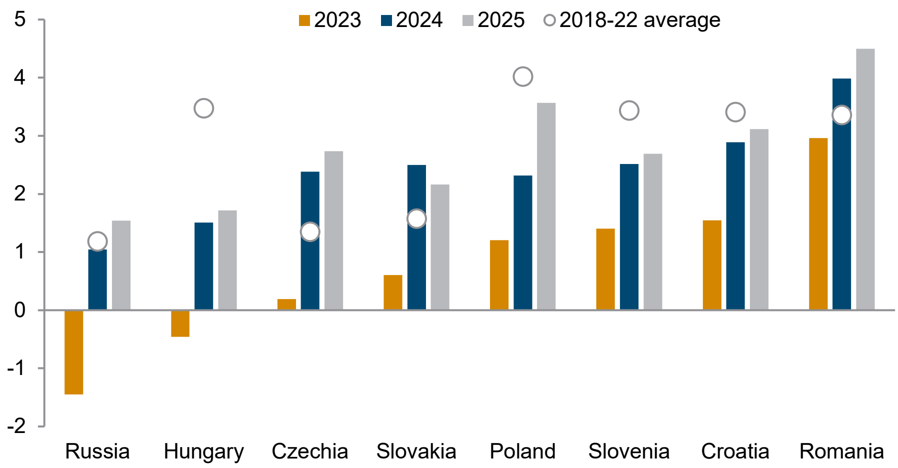
Note: February data are the latest available for the full HICP breakdown.
Source: Eurostat.

The most important direct impact has been via inflation, to which the war contributed via higher energy prices in Europe. Austrian inflation in March 2023 – as measured by the EU harmonised index of consumer prices (HICP) – rose by 9.2%, down from previous months, but still much higher than the 6.9% recorded for the euro area as a whole or Germany's 7.8%. Austria's inflation rate is substantially higher than most Western European countries, but is well below the levels of CESEE's euro countries (Figure 3.1). Austrian industrial producer prices also show continued pressure, rising by 17.4% year on year in February (latest data available), compared with 13.2% for the euro area as a whole. Relative to its neighbours, Austria has fairly ‘average’ headline inflation; while it has higher transport and (especially) gas price inflation, electricity price inflation is very low by regional standards (Figure 3.2).

The impact of tighter financial conditions on house prices has also become visible, although so far Austria’s real estate market has been much less affected than its regional peers. Austrian house prices fell by 0.6% between Q3 and Q4 2022, but this decline was much less than in Germany (5%) or in the euro area as a whole (1.7%).

The macroeconomic situation in those parts of CESEE most important to Austria has deteriorated substantially as a result of the war and its fallout, and this will have repercussions for the Austrian economy. In trade and investment terms, Austria’s key partners in the region are the Visegrád countries, Romania, Slovenia, Croatia and Russia. All those economies are currently growing at rates well below both their pre-COVID level and what most of them managed during the post-COVID recovery of 2021. Most are struggling with especially high inflation, as outlined above. Of Austria’s main CESEE trading partners, only Romania, Czechia and Slovakia will surpass their 2018-2022 average growth rates in the next two years; and in the case of the latter two, growth this year will be barely positive (Figure 3.3). Austria has benefited from the fact that most of its key CESEE economic partners had five very good years (even taking into account the 2020 recessions); but in the coming years only Romania looks capable of continuing to expand at a similar rate. The outlook for Russia is particular bleak, but other countries (such as Hungary and Poland) also appear set for fairly lacklustre rates of expansion in the coming years – at least compared to the recent past. Nevertheless, during the forecast period the region will grow more rapidly than the euro area, meaning that convergence will continue.

Figure 3.3 / Real GDP growth, percentage change per year



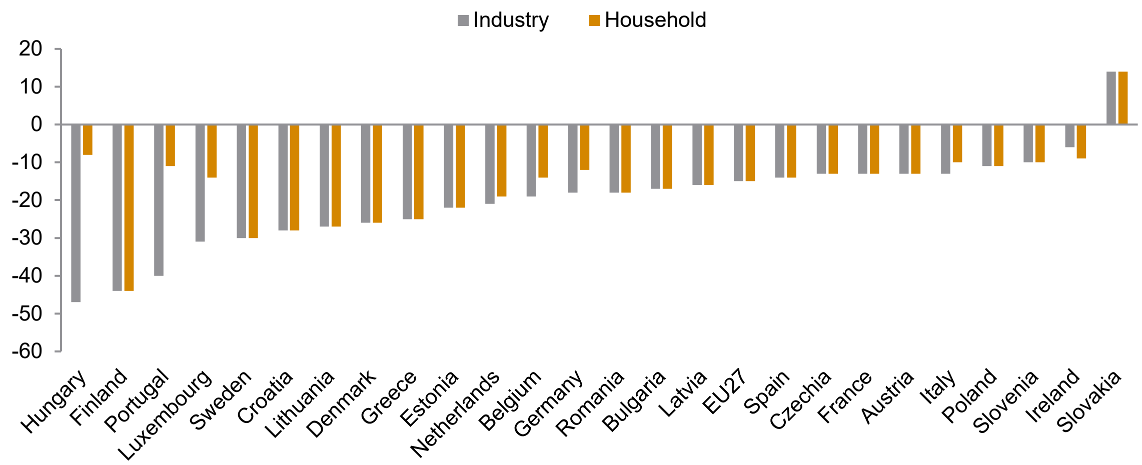
Sources: National sources, wiiw forecasts.

For all the difficulties, however, there has been notable resilience in Austria and CESEE. Compared with some of the doom-laden projections for the region’s economies published immediately after the Russian invasion of Ukraine, much of the region’s economy has held up well. Industry has made impressive reductions in gas demand, without corresponding declines in output. Certain countries of Southeast Europe – Romania, Croatia and Slovenia – are showing a higher level of relative resilience, to the benefit of Austrian firms with exposure in those countries. Those businesses heavily involved with the Visegrád countries should be prepared for a lacklustre 2023, before the recovery kicks in from the end of this year.

One of the most important channels of economic integration between Austria and CESEE is trade, and preliminary data for 2022 show that, despite the war, Austrian trade with CESEE grew strongly last year, easily outstripping the increase in foreign trade as a whole. The total value of imports from Eastern European[7] countries increased by 28% year on year (compared with 19.8% for imports as a whole), while exports to that region were up by 20.6% (compared with 17.2% for exports as a whole). Both exports to and imports from this region account for over 20% of the total for Austria, making CESEE collectively its most important trading partner after Germany. Exports to key partners in Southeast Europe, in particular, grew very strongly last year, especially to Slovenia (41.2%), Croatia (28%) and Romania (25.8%) – three countries that have shown a high degree of resilience to the fallout from the war.

Austria's trade with Russia has held up considerably better than the EU average. Imports from Russia increased by 76% year on year in 2022 (largely on account of higher gas prices),[8] while exports fell by 8%. Although that 8% decline reflects the impact of the sanctions, it was only a fraction of last year's 38.1% drop in exports from the EU as a whole to Russia. Austria's exports to Russia seem to have held up better than the EU's for a variety of reasons – including the fact that sanctions were phased in only gradually: Austrian exports to Russia fell far more sharply in the final months of 2022. In addition, Austria exports many non-sanctioned products to Russia, such as food.[9] Last year's trade data nevertheless suggest that even as Austrian exports to CESEE as a whole remain strong, there is a relative reorientation away from Russia and towards more nearby parts of the region.

Figure 3.4 / Change in gas demand in 2022 versus 2019-2021 average, %



Source: Bruegel. https://www.bruegel.org/dataset/european-natural-gas-demand-tracker

7 Defined by Statistik Austria as EU-CEE, the Western Balkans, Belarus, Moldova and Russia.

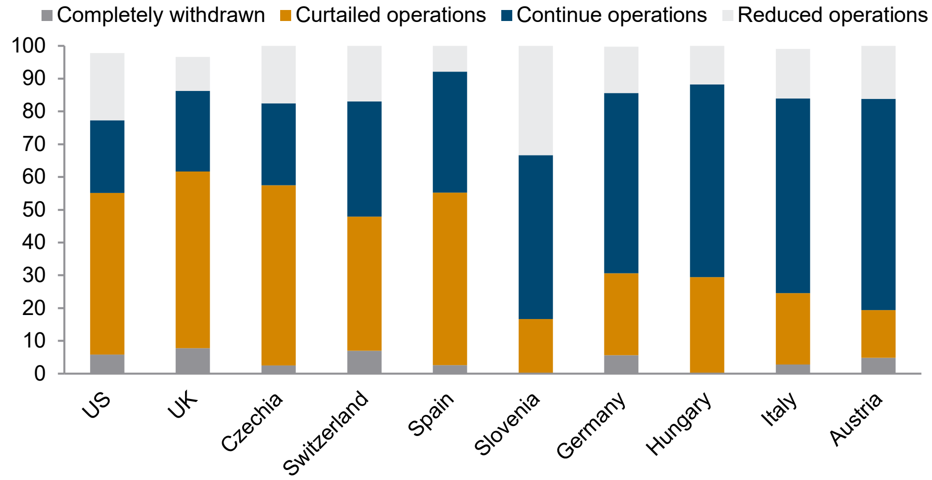
8 Trade data should be treated cautiously, given the sharp divergence between the growth of volumes and prices, as outlined by Statistik Austria in its press release accompanying the January 2023 trade data. For example, in January the total value of Austrian gas imports increased by 2.7% year on year, yet the volume of these imports declined by 11.3%.

9 https://www.derstandard.at/story/2000145403487/trotz-scharfer-sanktionen-gingen-oesterreichs-exporte-nach-russland-nur-leicht

Relative to the 2019-2021 average, Austrian demand for gas fell by 13% last year among both households and industry – a fairly small decline in the EU context (Figure 3.4). This is despite the fact that Austrian gas price inflation is so high (see above), and in all likelihood points to generous government support measures in the EU context, which have probably kept demand higher than would otherwise have been the case, as well as to a lack of alternative fuel supplies (given Austria's geographical position as one of the few land-locked countries in Europe). Austria is hence also one of the countries that has continued to receive large volumes of Russian gas, with deliveries from Russia making up 71% of total gas imports in December, according to ENTSOG and E-Control (although one-off factors did distort the data somewhat).[10]

Almost two thirds of Austrian firms in Russia are still continuing operations, despite the invasion – a higher share than in most neighbouring and peer Western countries (Figure 3.5). Although very few firms from any country have withdrawn fully from Russia, given the huge difficulties involved (see the Russia country report), the majority of companies active in Russia from such countries as the US, the UK, Czechia and Spain have either withdrawn or curtailed their operations. By contrast, only 20% of Austrian firms in Russia have done either; meanwhile 65% have continued operating (the rest have reduced operations and are holding off on new investments). However, this should be considered in the context of large-scale Austrian divestments from Russia since the annexation of Crimea, with the value of Austrian foreign direct investment (FDI) in Russia before the 2022 invasion substantially lower than a decade ago – in stark contrast to Germany or the EU as a whole. However, while Austria remains one of the most important foreign investors across CESEE, its relative importance has actually declined in most of the region since 2013: its share of total inward FDI stock fell in 16 of the 23 countries in CESEE covered by wiiw between 2013 and 2021 (Figure 3.6).

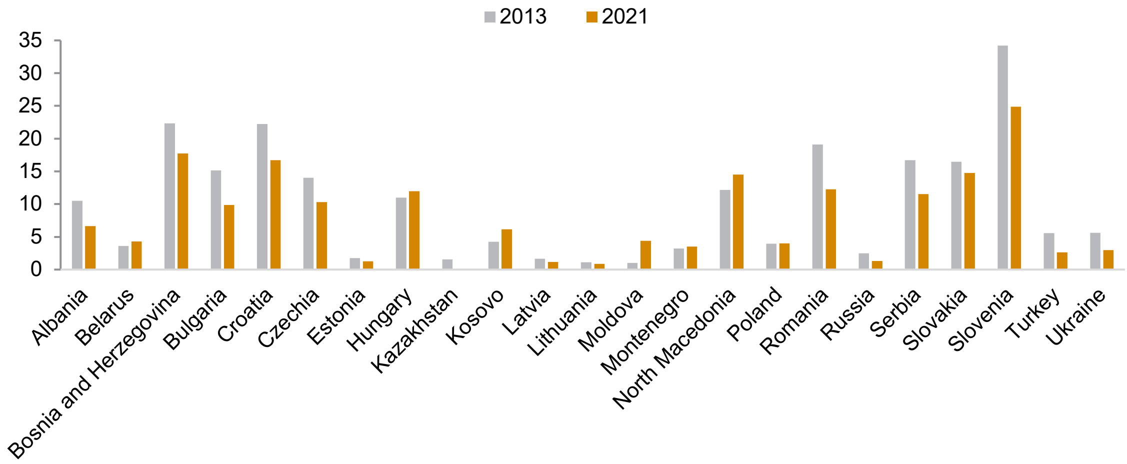
Figure 3.5 / Actions of firms active in Russia since the invasion, percentage of total, by country



Source: Kyiv School of Economics.

[10] https://www.euractiv.com/section/politics/news/austria-slides-back-into-dependence-on-russian-gas/

Figure 3.6 / Inward FDI stock, percentage from Austria



Sources: National sources, wiiw.

Austrian banks retain their strong position in CESEE, but the invasion has created serious problems for Raiffeisen in Russia. Raiffeisen Bank International is one of only two foreign banks included on Russia's list of 13 systemically important credit institutions. So far, the bank has been unable or unwilling to leave Russia, and is continuing to generate big profits there.[11] It also now handles 40-50% of all money flows in and out of Russia, according to the *Financial Times.*[12] The US is currently investigating Raiffeisen over its Russian operations,[13] and the European Central Bank has put pressure on the bank to leave Russia.[14]

Austria has come in for heavy international criticism since the war started on account of its profound ties with Russia and its apparent unwillingness to relinquish them; but proportionately speaking, it has sent as much money to Ukraine as its EU peers. Connections between Austria and Russia before the war were strong,[15] and factors such as the continued role of Raiffeisen, the relative resilience of Austria-Russia trade and – perhaps especially – the decision by many deputies to skip Ukrainian President Zelensky's speech to the Austrian parliament have led to criticism of Austria in the international media. It is also notable that the invasion has not triggered any great questioning of the country's neutral status, in stark contrast to the situation in Finland and Sweden (or even Switzerland, which has strengthened its ties with NATO since the invasion). This has reinforced the perception that Austria is unwilling to break its ties with Russia and adapt to the new reality of European security.[16] However, none of this has stopped the country supporting Ukraine financially. As a share of GDP, Austria's contribution to the support for Ukraine has been around the average for EU countries and roughly comparable with its peers, such as Spain, Germany, Portugal and Sweden (Figure 3.7). As a share of its

11 https://www.reuters.com/business/finance/austrias-rbi-earns-growing-share-profit-russia-2023-02-01/

12 https://www.ft.com/content/1cea1f08-83ac-4471-9fa4-1cdfcc86fcb0

13 https://www.reuters.com/business/finance/raiffeisen-stock-slumps-after-us-sanctions-authority-asks-about-russia-business-2023-02-20/

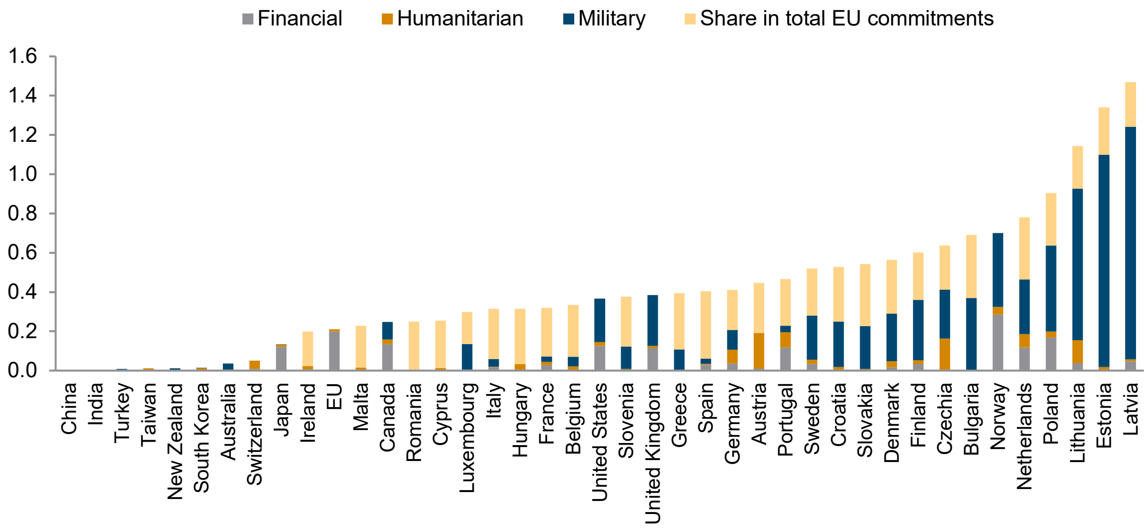
14 https://www.reuters.com/markets/europe/ecb-pressures-austrias-raiffeisen-bank-quit-russia-sources-2023-03-23/

15 https://www.intellinews.com/the-view-from-mitteleuropa-austria-and-russia-ending-the-special-relationship-272854/

16 https://www.ft.com/content/a9b95774-52fc-4bba-b7a2-0e9c69b32005

GDP, since the invasion Austria has pledged more humanitarian support to Ukraine than any other country, while its military spending commitments have been negligible, in line with its continued neutrality.

Figure 3.7 / Total support to Ukraine, percentage of 2021 GDP



Source: Kiel Institute for the World Economy Ukraine Support Tracker.