Austrian economy enters election month on weak economic footing

The cautious, consumption-driven recovery that started at the beginning of the year has proven to be short-lived as cyclical and structural problems have not been so easy to overcome

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Following economic growth of 0.2% quarter-on-quarter in the first three months of the year, the Austrian economy contracted by 0.4% in the second quarter of 2024. The cautious, consumption-driven recovery that started at the beginning of the year was ultimately short-lived as cyclical and structural problems have proven difficult to overcome. Austria's international competitiveness has suffered significantly over the past years, and looking ahead, there is little hope of a swift trend reversal.

Industry remains under pressure from weak global demand

Industrial production has weakened for more than a year now. In June, industrial production was down by 4.9% year-on-year from -5.5% in May. Given the ongoing weakness in industrial production, particularly for some of Austria's most important export goods such as cars and car parts, it does not come as a surprise that exports fell by more than 5% YoY in the first five months of 2024. Austrian exports to the rest of the eurozone recorded one of the sharpest declines, at almost -9% YoY, and exports to Germany, one of Austria's most important trading partners, were down by 7% YoY. Austrian exports to the US, on the other hand, were higher than a year ago, growing by 11% YoY between January and May. As the US economy is gradually losing steam and the economic recovery in the eurozone is slowing, both Austrian industry and trade are likely to remain under pressure. This is also reflected in survey-based leading indicators. The European Commission's most recent industry survey revealed that order books are still thinning out, while inventories remain at a historically high level.

Strong wage growth looks set to improve service sector outlook

Optimism has recently been fading not only in industry, but also in the service sector. In August, weak demand over the past three months prompted sentiment among service companies to fall to its lowest level since January. Looking ahead, however, businesses are expecting demand to improve. And indeed, prospects in the services sector should improve, as private consumption is likely to recover in the months ahead. At the same time, however, another trend could increasingly weigh on private consumption: the ongoing rise in the number of insolvencies. In the second quarter, the number of insolvencies reported was up by almost 25% YoY, fuelling prospects of a labour market slowdown. Accordingly, the willingness to spend remains relatively low and the preference for precautionary savings high. However, strong wage growth of almost 8% YoY in 2023 and a further increase of almost 9% YoY in the first seven months of 2024 suggest at least a certain improvement in consumers' spending mood. Particularly as inflation has finally started to slow and the sharp rise in nominal wages is increasingly translating into real wage growth, thereby gradually restoring consumers' purchasing power.

Inflation is finally slowing

Headline inflation dropped to 2.5% YoY in August, down from 2.9% in July. This is the lowest inflation reading since April 2021. However, as details for the July reading show, the recent slowdown in inflation is predominantly driven by favourable base effects in energy prices. Although price increases in some categories, such as clothing, not only slowed but even reversed, prices for leisure and cultural activities as well as for hotel and restaurant stays continued to rise. Therefore, Austrian headline inflation continues to be mainly driven by price increases in the services sector - while goods inflation was only 0.25% YoY in July, services inflation still stood at 5.5%. Looking ahead, Austrian inflation is likely to continue to decelerate, but the pace of the decline is expected to slow. Although selling price expectations in both the manufacturing and service sectors have recently fallen and are now below their long-term average, a majority of companies still anticipate further price increases in the months ahead.

Structural drivers to keep inflation elevated and limit economic growth in the years ahead

In the longer term, additional price pressure will be created by structural challenges such as demographic change, the green transition of the economy and changing trade patterns. At the same time, these structural challenges will also weigh on economic growth. Targeted investments and reforms are needed to break out of this extraordinary economic cycle in which a downturn is followed by stagnation rather than an upswing.

Austria's competitiveness, or rather ways and means to improve it, has also been a key issue in the run-up to the national elections in just over three weeks' time. Both the right-wing populist FPÖ

(Austrian Freedom Party), which is currently leading in the polls and the current governing ÖVP (Austrian People's Party) are committed to strengthening Austria's economy by increasing competitiveness, in particular by reducing non-wage labour costs.

The challenges the Austrian economy is currently facing are so multifaceted that a few measures alone will not be enough to bring the country back onto a higher growth path.

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