

Sticky inflation hurts Austria's competitiveness

While other eurozone countries are recording significant declines in headline inflation, the downward trend in Austrian inflation is, optimistically speaking, sluggish. This decreases Austria's attractiveness, both in terms of industry and tourism, and will ultimately lead to a decline in the country's competitiveness



Better than expected, but far from good

After the first flash estimates indicated that the Austrian economy had contracted slightly by 0.3% quarter-on-quarter in the first quarter of 2023, the final revision revealed a small increase of 0.1% quarter-on-quarter, which could be considered stagnation rather than growth. While the construction sector and other economic services supported economic activity in the first three months of 2023, the slowdown in activity in the manufacturing, trade and transport sectors had a negative impact.

As in the rest of the eurozone, Austria is witnessing a divergence between industry and services. Looking ahead, however, this divergence doesn't look sustainable. In fact, due to the loss of consumers' purchasing power and accelerating service inflation, the outlook for the services sector is also expected to become gloomier.

Sticky inflation to weigh on services sector

While other eurozone economies have recorded significant declines in headline inflation, the downward trend in Austrian inflation has been sluggish so far. In June, headline inflation in Austria came in at 7.8% year-on-year, against 5.5%YoY in the eurozone. Compared with the peak reached in October last year, headline inflation in the monetary union fell by 5.1 percentage points. In Austria, the decline in headline inflation between October 2022 and May this year was 3.8 percentage points only – the disinflationary trend beginning to unfold in other eurozone economies is being sought in vain in Austria.

This will affect the service sector in two ways. First, private consumption will suffer from persistently high price levels, especially since part of the cost of living is determined by administered prices, which in Austria are mostly indexed and thus increased based on inflation. This applies, amongst others, to public services, the rent of social housing or telecommunications. Moreover, services inflation is tending to accelerate, and there is no sign of an easing of price pressures in the sector.

Second, persistently high inflation will cause Austria's tourism sector to lose competitiveness. The hotels and restaurants component of the inflation basket recently became 13.1% more expensive year-on-year, and recreation and culture went up by 7%. In the eurozone, inflation in these categories was 8.4% and 5.7% respectively. If tourism in Austria becomes significantly more expensive than in other eurozone countries, tourists might switch to other holiday destinations.

Inflation in the services sector is also likely to be amplified by wage increases. Wages in the Austrian accommodation and food services sector increased by around 28% between the fourth quarter of 2019 and the first quarter of 2023. In the eurozone, wages in the sector came up by 16% over the same period. Strong wage growth in this sector was probably the result of a particularly high lack of skilled workers.

Austria's competitiveness will suffer

Increased costs are having a negative impact on competitiveness, not only in services but also in the manufacturing sector. Most Austrian exports are machines and vehicles, followed by processed goods and chemical products. While the competitive outlook for vehicles has improved recently, the results of DG ECFIN's industry survey in both the energy-intensive chemical products sector and the machinery sector point to a loss of competitiveness, both in relation to countries within and outside the EU.

Until the green transformation has comprehensively arrived in Austrian industry, no growth miracles are to be expected for Austrian industry or foreign trade. Consequently, the overall economic outlook is far from rosy. We expect economic growth in Austria to be significantly below potential both this year and next. Accordingly, the government debt ratio, which stood at 78.4% at the end of 2022, is likely to decline only slowly. After all, despite the frequent calls for a return to budget discipline, there has been no talk so far of either tax increases or significant spending cuts.

Overall, the outlook for the Austrian economy is clearly clouded and persistently high inflation will be an additional burden this year and next.

The Austrian economy in a nutshell (%YoY)

	2022F	2023F	2024F	2025F
GDP	4.9	0.5	0.6	1.5
Private consumption	4.4	0.5	2.0	1.5
Investment	0.3	0.3	1.2	2.0
Government consumption	2.9	-0.1	0.5	1.0
Net trade contribution	-0.1	-0.3	0.8	1.4
Headline CPI	8.6	7.0	2.4	2.0
Unemployment rate (%)	4.8	4.9	4.5	4.4
Budget balance as % of GDP	-3.2	-2.8	-1.3	-1.0
Government debt as % of GDP	78.4	77.0	75.0	72.0

Source: Refinitiv Datastream, all forecasts ING estimates

Author

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.