Austrian economy in a moderate recovery, while CESEE economies are cooling down

Declining inflation drives moderate economic recovery in Austria[1]

GDP will grow by 0.3% in 2024, by 1.8% in 2025, and by 1.5% in 2026, according to the OeNB's June 2024 Economic Outlook for Austria.

The risks to the growth forecast are balanced. Geopolitical tensions and Austria's dependence on Russian gas represent downside risks, while a stronger recovery in domestic demand represents an upside risk.

The Austrian economy was in recession in 2023. This was due to persistently high inflation, the very weak external economic environment and the resulting poor sentiment.

The OeNB expects the economy to stabilize in 2024. Private consumption is recovering due to a significant rise in real wages, and exports are also contributing positively to economic growth. Gross fixed capital formation, by contrast, will shrink again. High financing costs and poor profit expectations are dampening investment in residential construction and equipment, which is very sensitive to economic cycles. The OeNB's Economic Indicator signals slight quarter-on-quarter growth of 0.3% for the second quarter of 2024 and 0.4% for the third quarter. In 2025 and 2026, the economy is forecast to grow by 1.8% and 1.5%, respectively, amid an improvement in the external economic environment, but above all due to very strong growth in real consumption.

The labor market is proving resilient to the crisis. After the unemployment rate rises slightly to 6.7% (national definition) in 2024, it will be down at 6.3% again in 2026.

In 2024, the public budget balance will deteriorate to –3.1% of GDP (2023: –2.7%) and thus slightly exceed the Maastricht limit. The main reason for this is the delayed impact of the inflation shock on public finances. While deteriorating further in 2025, the budget balance will improve again to

Table 1

OeNB June 2024 Economic Outlook for Austria – main results

	2023	2024	2025	2026
	Annual change in % (real)			
Gross domestic product (GDP)	–0.7	0.3	1.8	1.5
Harmonised Index of Consumer Prices (HICP)	7.7	3.4	2.7	2.5
	%			
Unemployment rate (national definition)	6.4	6.7	6.5	6.3
	% of nominal GDP			
Current account balance	2.7	2.8	2.9	2.9
Budget balance	–2.7	–3.1	–3.3	–3.0
Government debt	77.8	77.3	77.6	78.2

Source: 2023: Statistics Austria; 2024 to 2026: OeNB June 2024 outlook.

[1] *This text is based on Fritzer et al. 2024. Economic outlook for Austria – Declining inflation drives economic recovery. OeNB Report 2024/7.*

–3.0% in 2026. The debt ratio falls to 77.3% of GDP in 2024 but is expected to increase in the following years, to reach 78.2% in 2026.

HICP inflation is expected to fall by more than half, to 3.4% in 2024 (7.7% in 2023), according to the OeNB's June 2024 Economic Outlook for Austria. In 2025 and 2026, the inflation rate will edge down further, to 2.7% and 2.5%, respectively.

The core inflation rate, i.e. HICP inflation excluding energy and food, will also drop significantly, to 4.2% in 2024, 2.9% in 2025 and 2.6% in 2026. It will, however, remain above HICP inflation over the entire forecast horizon. From 2024 to 2026, both overall inflation and the core inflation rate will therefore remain well above their long-term averages (from 2011 to 2019: 1.9% and 2.0%, respectively).

The risks to the inflation forecast are on the upside. Geopolitical tensions, Austria's dependence on Russian gas and a stronger recovery in domestic demand could lead to stronger-than-expected inflation.

The decline in the inflation rate in 2024 is attributable to all main components of the HICP, but above all to industrial goods excluding energy as well as energy and food. This is due to weak demand and falling producer prices. In addition, household energy prices are expected to go down further in the second half of 2024. In the case of services, the dynamic development of wage costs is counteracting a stronger decline in the inflation rate.

Fiscal measures primarily influence energy and service inflation. At the beginning of 2025, the expiry of fiscal policy measures (electricity price brake, reintroduction of the electricity and natural gas levy, reintroduction of the renewables levy) and the increase in the CO2 price will raise the HICP inflation rate by around 0.6 percentage points. The cap on rent increases implemented by the government in August 2023 and the suspension of the fee adjustment will slightly reduce service inflation in 2024 and the following years.

Austria's inflation difference to the euro area narrowed substantially during recent months. The inflation differential between Austria and the euro area average was 2.3 percentage points on average in 2023. In May 2024, the inflation differential was only 0.7 percentage points. The decline is primarily attributable to energy, but also to industrial goods excluding energy. In 2025 and

Table 2

OeNB June 2024 Economic Outlook – inflation

	2023	2024	2025	2026
	Annual change in %			
HICP inflation	7.7	3.4	2.7	2.5
Food	10.0	4.0	3.5	2.3
of which: unprocessed food	*7.6*	*2.3*	*2.7*	*x*
of which: processed food	*10.6*	*4.4*	*3.7*	*x*
Industrial goods excluding energy	6.4	1.6	1.3	x
Energy	6.9	–4.7	–0.5	2.6
Services	7.8	5.7	3.7	x
HICP excluding energy	7.8	4.2	3.0	2.5
HICP excluding energy and food	7.3	4.2	2.9	2.6

Source: 2023: Statistics Austria; 2024 to 2026: OeNB June 2024 outlook.

2026, the inflation differential will return to the long-term average (2011–2019) of 0.6 percentage points. One reason for the normalization of the inflation differential is the pass-through of lower wholesale prices for household energy to end consumers. Furthermore, services inflation will decline significantly in 2025 and contribute to the narrowing of the inflation gap.

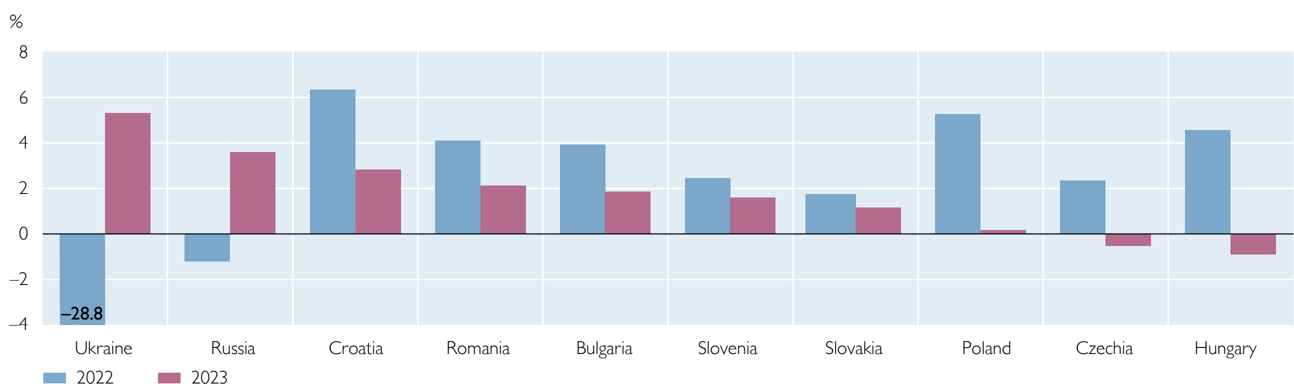
CESEE economies within the EU cool down, while economic growth in Ukraine and Russia recovers moderately from the war-induced slump

Real economic growth in the EU member states of Central, Eastern and Southeastern Europe (CESEE) fell significantly in 2023, averaging a subdued 0.4% in the region. In 2022, real economic growth had still amounted to 4.1%. Weak economic dynamics were mainly due to the effects that Russia's invasion of Ukraine had on (energy) prices, sentiment and the broader international environment. The region's vital industrial sector went into recession in early 2023 amid rising energy bills, lower international demand and a large-scale depletion of partly pandemic-related stocks. Consequently, exports contracted, and imports shrank even more. Declining real import demand reflected weak private consumption. Consumers were less able to spend because of high inflation rates eating into real incomes. Also, they were less willing to spend, as sentiment soured to levels last observed at the peak of the COVID-19 pandemic. In the second half of 2023, however, we saw some improvement among households. Wage growth accelerated and consumers became less pessimistic about their economic situation. This positive trend was based, among other things, on the resilience of the region's labor markets. They mastered the growth slowdown with virtually no increase in unemployment. To the contrary, companies frequently reported labor shortages throughout the economy. Robust investment spending likewise helped avoid an even sharper decline in GDP dynamics. The CESEE EU member states recorded increasing inflows of foreign direct investments and EU funds.

The wave of inflation observed in the CESEE EU member states from mid-2021 peaked at the beginning of 2023. The average inflation rate fell from peaks of over 16% to close to 4% in February 2024. The decrease was strongly influenced by declining energy and food price inflation. The disinflationary

Chart 1

Real GDP growth in CESEE



Source: Eurostat, national statistical offices, wiiw.

process, however, was much broader based and encompassed large parts of the consumption basket. In February 2024, some 80% of all items within the HICP reported falling inflation rates. These trends were based on three factors: First, weaker cyclical demand pressures and inflation expectations supported the restrictive monetary policy stance. Second, declining producer and commodity prices were slowly feeding through the price chain. Third, upstream price pressures generally decreased and external supply shocks faded.

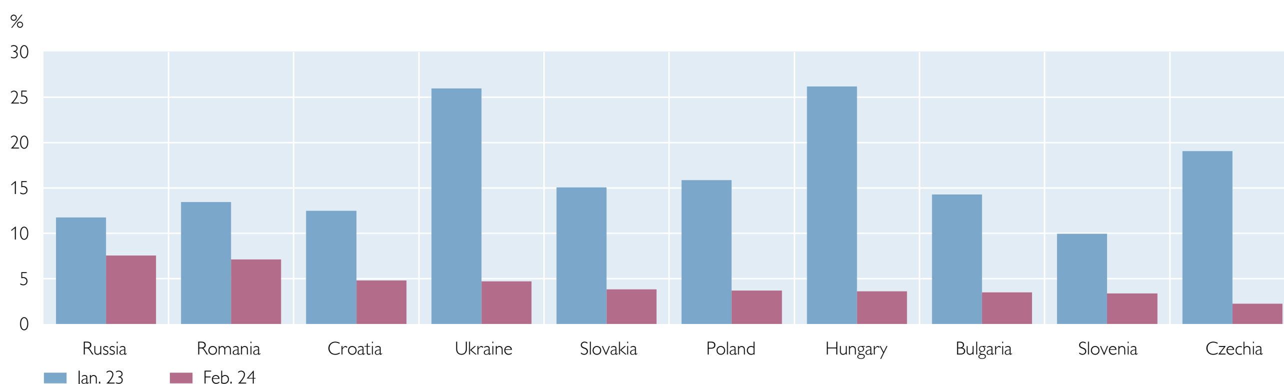
This enabled the region's central banks to end their interest rate hike cycles, with some central banks initiating a turnaround. In Hungary, the effective policy rate was reduced from 18% at the beginning of 2023 to 8.25% in April 2024. In Poland, the policy rate was lowered from 6.75% to 5.75% in the same period, and in Czechia, it was cut from 7% to 5.75%. By February 2024, inflation rates in all three countries had returned to their respective target rates.

Ukraine's economy recovered and grew by 5.3% in 2023, after GDP had contracted by 28.8% in the first year of the war. Remarkably, the recovery clearly exceeded earlier projections. Better-than-expected growth was due to a strong harvest, a rather stable situation in the energy sector as well as the establishment of export routes. In general, loose fiscal policy supported domestic demand: investments were underpinned, among other things, by defense spending and reconstruction, consumer demand through social programs and military allowances. Wage growth in the private sector also backed private consumption, while the private sector in turn contributed to soaring investment growth. Ukraine's success in creating its self-managed Black Sea corridor facilitated exports not only of grain, but also of other goods.

Nonetheless, the Ukrainian economy continues to deal with an immense burden as a result of Russia's aggression. First, the energy infrastructure is exposed to constant threats. Second, labor supply is constrained due to migration and mobilization. Third, the public deficit is deeply in the red, which reflects high expenditure needs and revenue losses. External financial support, however, helps build up international reserves and – in tandem with high real interest rates – stabilizes the foreign exchange market. A further considerable disinflation was brought about by an only moderate depreciation of the hryvnia, a

Chart 2

Inflation in CESEE



Source: Eurostat, wiiw.

good harvest, lower global energy prices and a moratorium on raising some utility tariffs.

The Russian war economy drove up output growth to 3.6% in 2023. Substantially rising budgetary outlays, a sharp increase in consumer spending and growing capital expenditure contributed to accelerating growth in the second half of 2023. Hence, the recovery rested on booming war-driven armaments production, rising household incomes and dynamic lending. The economy has clearly been showing signs of overheating, however. The unemployment rate declined to below 3% in early 2024, i.e. a new post-Soviet record low, and real wages reached record levels. This indicates a very tight labor market saddled with persisting shortages of skilled staff. Price growth was fueled by this as well as swelling consumer demand, the expansionary fiscal stance and the substantial decline of the ruble. By February 2024, inflation had moved up to 7.7%, after having declined to 2.3% in April 2023. The monetary authority reacted energetically with a series of tightening steps, bringing the key rate from 7.5% in June 2023 to 16% in April 2024 – a level more than twice as high as ten months earlier.