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Austria's Focus on Eastern Europe: A Source for Fragility and Asymmetric Shocks?

This presentation argues that most Eastern European countries have a sound economic basis and that shocks coming from Western Europe could hurt the Austrian economy much more than shocks coming from the "new" Member States.

This short paper follows the sequence of the charts as presented at the session on May 15, 2009 (see below). Eastern Europe has shown an impressive economic performance over the last years. Slovenia has a per capita GDP of more than 80% of the average of EU-15. The Czech Republic has also been very successful, with a per capita GDP already higher than two thirds of the EU-15 average and surpassing the per capita GDP of Portugal. Even the youngest EU members, Romania and Bulgaria, have shown an impressive record of per capita GDP in the last years.

All over Europe industrial production, in particular exported investment goods, decreased by very high rates in 2008/2009. In Hungary, for example the industrial production declined by 26% between February 2009 and February 2008. However, looking at the charts, we see that also Western nations are confronted with a similar problem: the reduction of the industrial production in the same period in Germany and Italy was 22%. It seems that countries which have high export ratios and high ratios of investment goods in their exports have been hit more severely than countries with smaller export/GDP ratios and smaller shares of investment goods in their exports. Poland and Denmark have done relatively well during the crisis so far.

Given the decline in industrial production, the negative growth rates of many Eastern European countries seem relatively modest compared to Western Europe. One striking fact is that the decline in GDP shows a very heterogeneous picture of Eastern Europe. While the Baltic States, Latvia, Lithuania, Estonia, have very high negative growth rates of more than 10%, countries like Poland and Bulgaria are doing much better. In the 2009 spring forecast of the European Commission the decline of the GDP of Poland in 2009 is estimated at not more than 1.4%. The Ukraine also has a very high negative growth rate, similar to the Baltic States, but the data are not very reliable. According to the 2009 spring forecast of the European Commission, growth in the new Member States in 2009 will on average not be lower than minus 2.5%, whereas the decline in the EU-15 will be minus 4%.

Another argument which shows that the dependence of Austria on Western Europe is much higher than on Eastern Europe is the structure of Austrian exports according to export destination. Nearly 30% of all Austrian exports go to Germany. Germany is followed by Italy with 8.6%, and Switzerland and France with each a share of 3.8%. The relevant Eastern European nations have smaller shares, as illustrated in the charts. The total share of all export to Eastern Europe is 23.3%, while the total share of exports going to the euro area is 50.4%. These figures constitute a strong argument for the assertion that economic problems in Western Europe affect the Austrian economy much stronger than similar problems in the East. Until recently growth in the East was higher than in Western countries and also declines less sharply at present. Moreover, Austria's share of exports to these countries has been small and therefore the likelihood that the Austrian economy will be affected by a shock from the East is much smaller.

Some people have argued that these facts may be true for the real economy and exports of real goods, but that the problems rather lie in the exposure of Austrian banks in Eastern European Countries, in the Austrian foreign direct investment stocks in those countries, in the indebtedness of households and companies in Eastern European countries, and in the devaluation of the national currencies in Eastern Europe. We proceed by discussing each of these issues one after the other:

The Austrian FDI stock is relatively evenly distributed over many countries in the world. Germany again has the largest share with more than 13.8% of the FDI stock, but as the chart 6 shows, the Austrian FDI stock is not concentrated in certain areas. Central and Eastern European Countries take a total share of 45.8%, and the EU-15 a total share of 34.8%. Problems that might emerge from decreasing prices of real estate (e.g. business centers, hotels, etc.) in a particular country, or even in a group of countries, would be com-

pensated for by positive developments in other parts of the world.

The exposure of Austrian banks in Eastern Europe seems to be large. But there are several reasons why we do not expect a catastrophe for one of the three major banks active in this area: Raiffeisen International, Erste Bank and Bank Austria. First, exposure of Austrian banks is dispersed over 20 post-communist countries. The largest share, allocated to the Czech Republic, is about 20%. The second-largest, with only 15%, is allocated to Romania. Some of these countries, like Poland, which has a share of about 6%, are – as mentioned above – doing particularly well in the crisis. Second, exposure in countries where the crisis has up to now been particularly severe, i.e. the Ukraine and the Baltic States, the allocation of resources is quite small. Raiffeisen International has bought the second-largest bank in the Ukraine, AVAL Bank. The exposure of this bank is approximately EUR 5 billion. If we would assume an extremely high loss of 20% of total exposure in this country, it would still not be much higher than the net profit of this company in 2008, which was close to EUR 1 billion. All three banks have made a lot of money in recent years in Eastern Europe. They will therefore be able to cover a large part of the expected losses out of their own profits. Beyond that, all three of them have reserves in the total of the corporation to which they belong. Moreover, the Austrian government has committed to help with government funds.

One of the most erroneous arguments has been that Eastern European households and companies are highly indebted. The contrary is true. Loans to households and companies with respect to GDP are in all countries of Eastern Europe smaller than in the average of the euro area or in Austria (chart 8). The gross debt of governments in Eastern Europe is, again with the exception of Hungary, smaller than indebtedness in Western Europe. None of the East European countries (with the exception of Hungary) will reach the debt limit of 60% of the GDP in 2009, while nearly all western European countries are above this notorious strategic figure. The Czech Republic, e.g., will have about 34%, Slovakia close to 32%, and Poland 54%. Representative examples for the West are France with close to 80%, Germany over 70%, Greece over 100%, and Italy more than 110%. Exceptions in the West are Denmark with 33%, Sweden with 44%, and Spain with about 50%.

One of the great dangers for Eastern European countries has been capital flight. Since summer 2008 more or less all Eastern European currencies (chart 10) have depreciated with respect to the euro. After the intervention of the IMF in spring 2009, a slight revaluation has started and stabilized the currencies of the whole area.

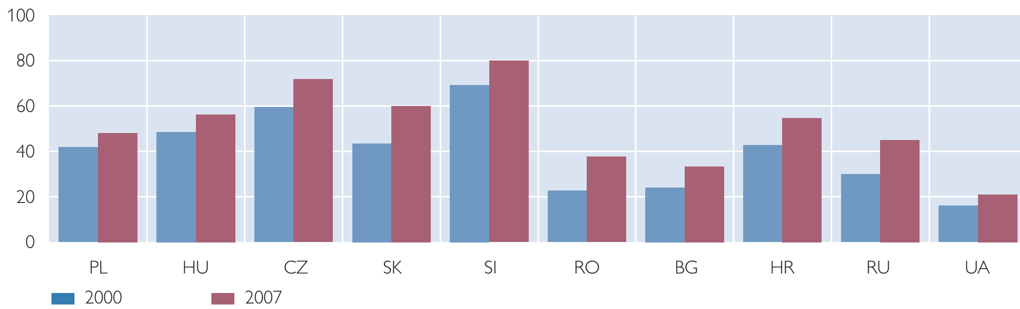
In summary we can conclude that the trading partners of Austria in the East and the exposure of Austrian banks in the East are in much better shape than claimed by many uninformed sources. Many countries of Eastern Europe have a good chance to survive the crisis better than Western Europe, and shocks coming from this area constitute a much lesser threat for Austria than shocks coming from the West. The three large Austrian banks engaged in Eastern Europe will have to endure unusually large losses in the East, but Austria is far from a systemic risk and an existential problem for the country.

Appendix

Chart 1

Catching-up Process of GDP per Capita in the CESEE and CIS Countries

% of the EU-15 average

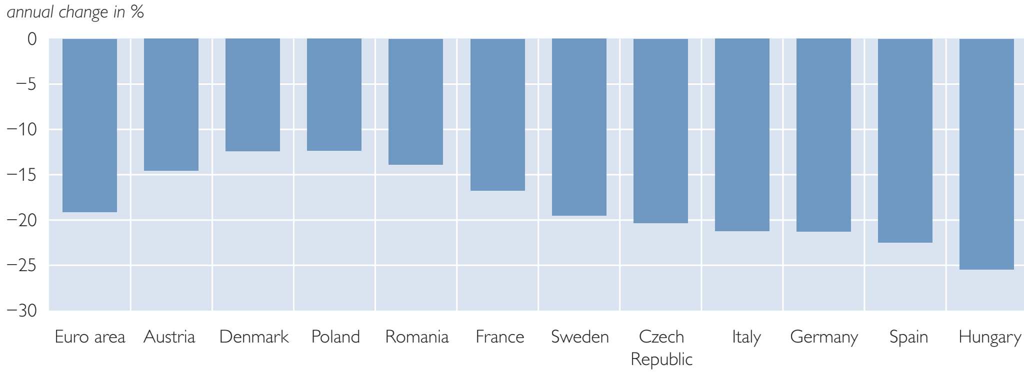


Source: Eurostat, Raiffeisen.

Chart 2

Industrial Production – Rates of Change to Same Month of Previous Year (February 2009)

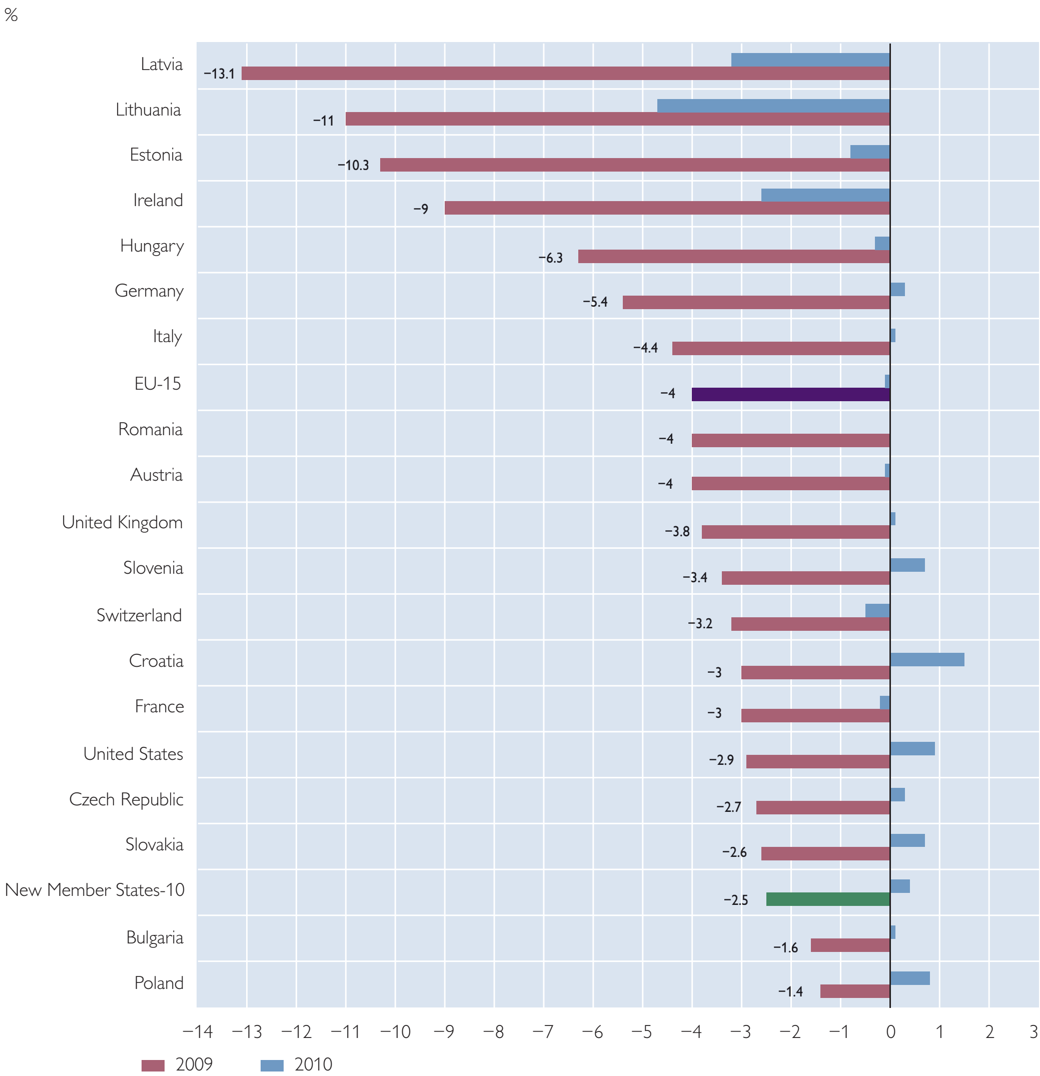
annual change in %



Source: Eurostat.

Chart 3

General Government: Consilidated Gross Debt

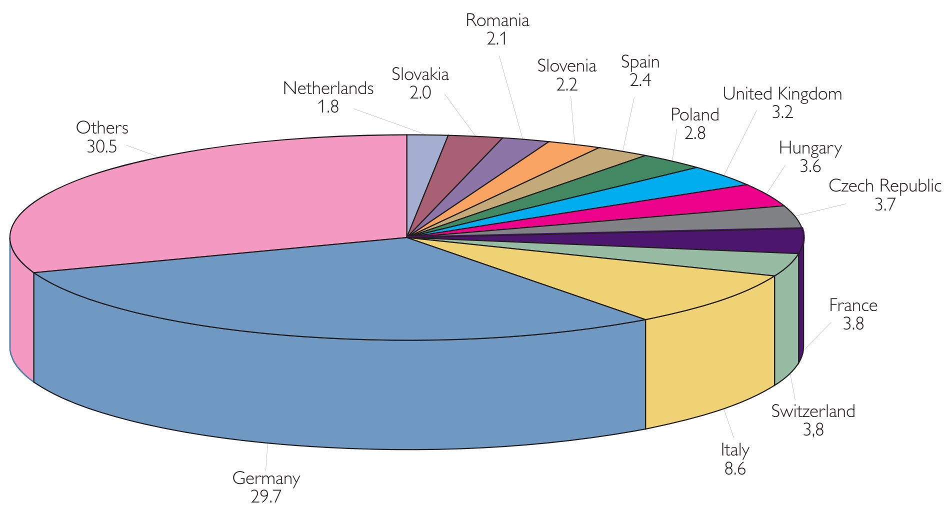


Source: European Commission, Spring Forecast.

Chart 4

Export Structure Austria – According to Export Destination

%

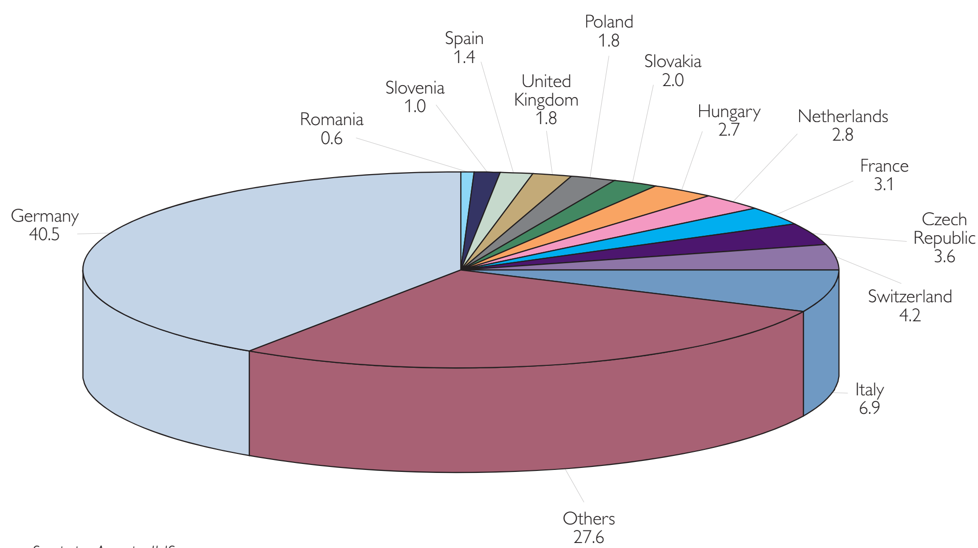


Source: Statistics Austria, IHS.

Chart 5

Import Structure Austria – According to Import Source

%

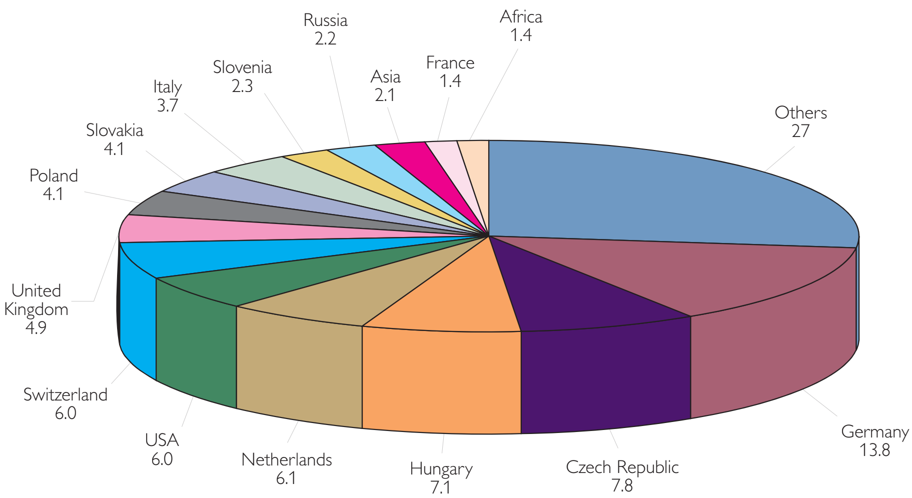


Source: Statistics Austria, IHS.

Chart 6

Austrian FDI Stock in 2006

%

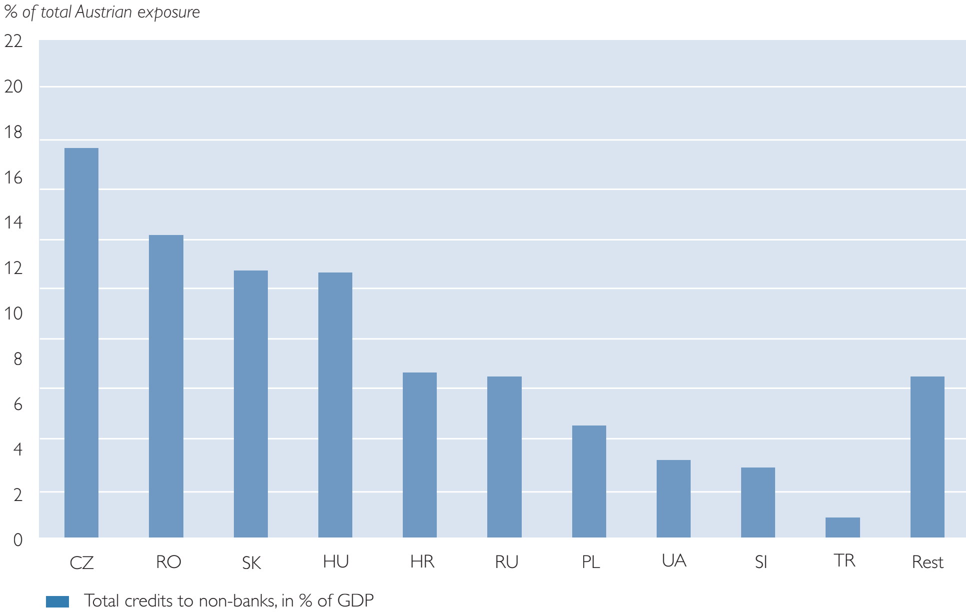


Source: OeNB, IHS.

Chart 7

Allocation of Exposure of Austrian Banks in CEE Countries

% of total Austrian exposure

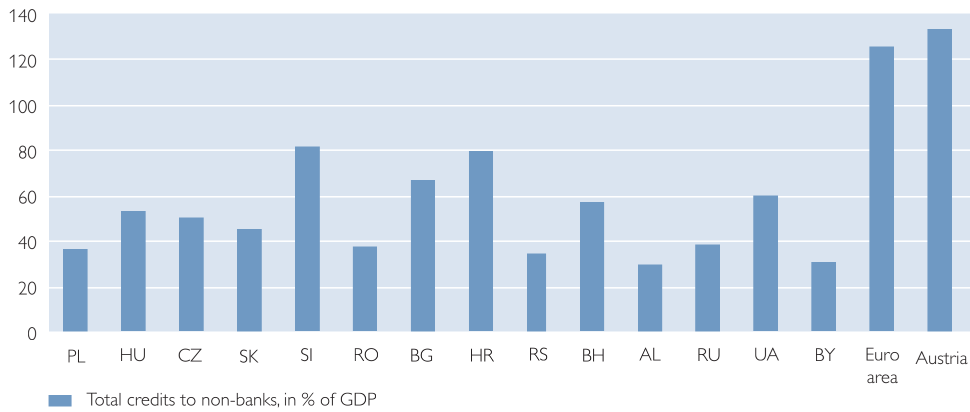


Source: OeNB (2008/3).

Chart 8

Loans to Households and Companies in 2007

in % of GDP

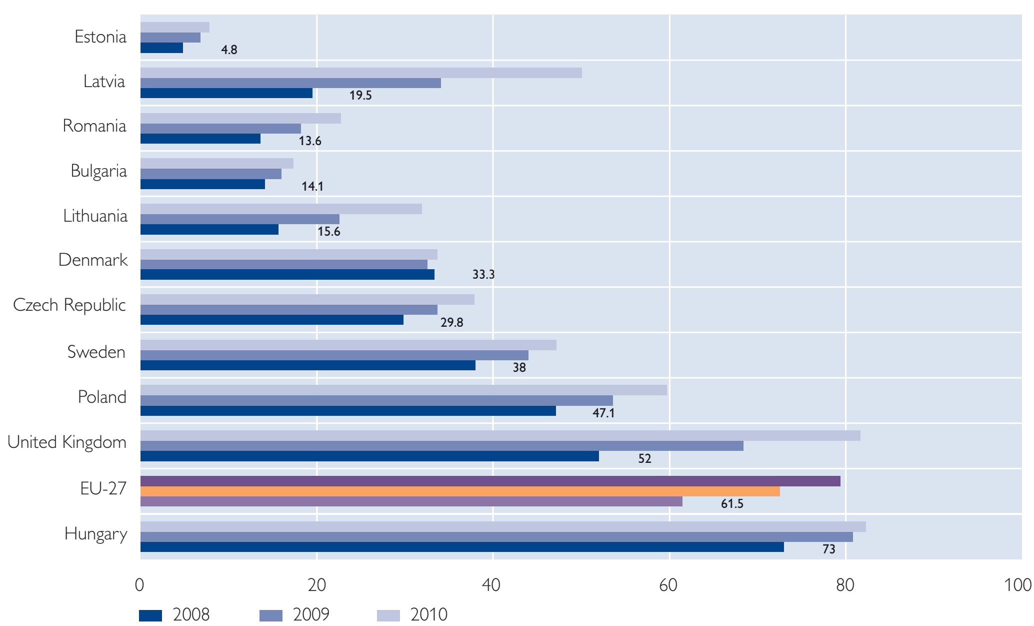


Source: OeNB.

Chart 9a

General Government: Consilidated Gross Debt

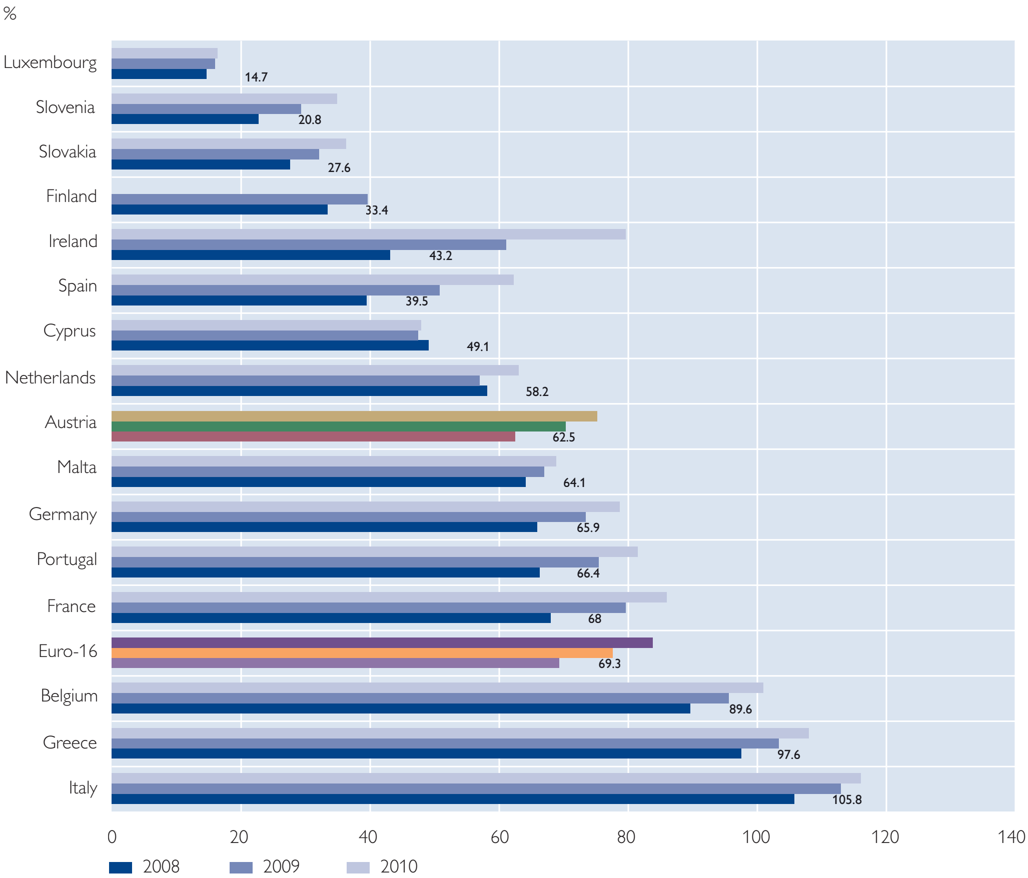
%



Source: European Commission, Spring Forecast.

Chart 9b

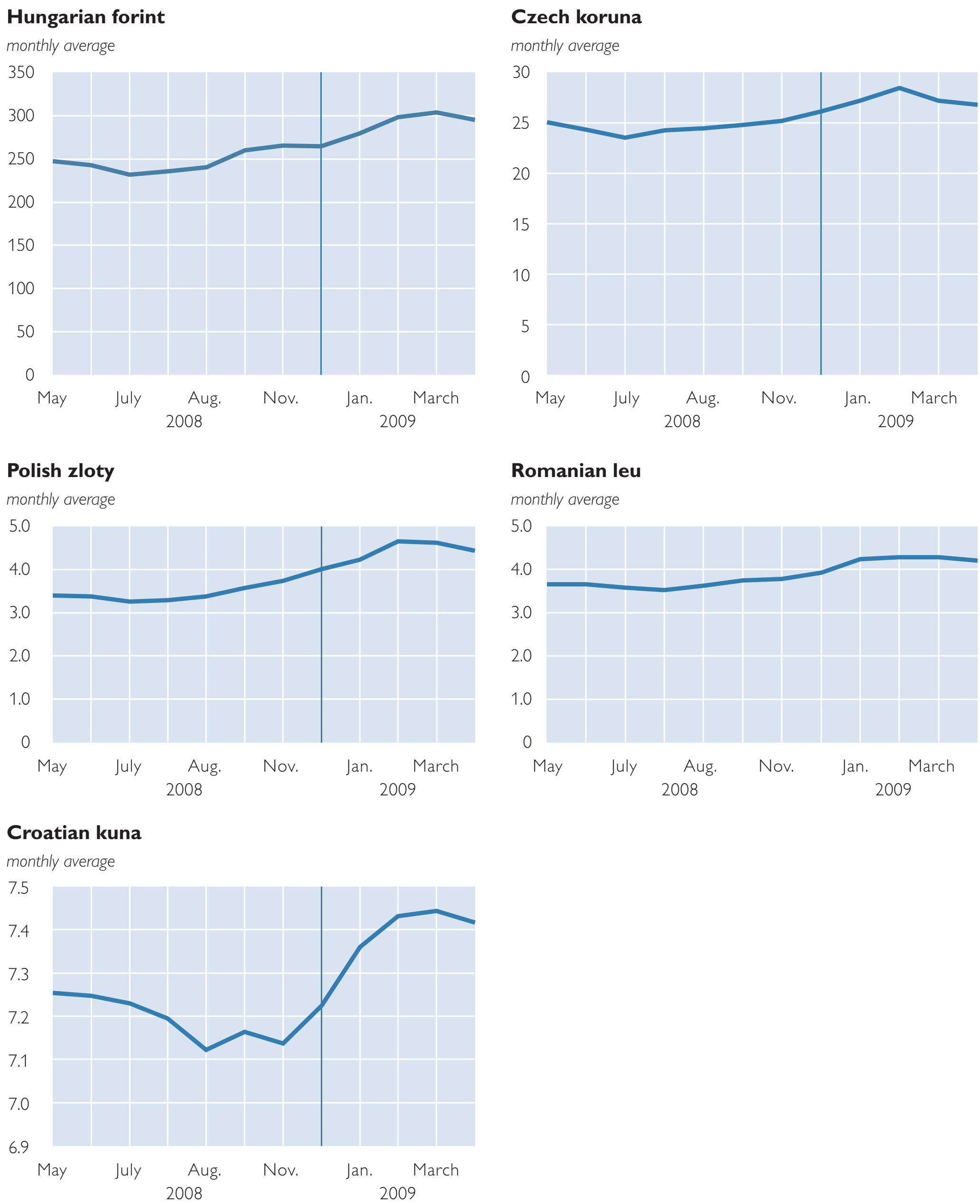
General Government: Consilidated Gross Debt



Source: European Commission, Spring Forecast.

Chart 10

National Currencies' Euro Exchange Rates



Source: Eurostat, IHS.