What's driving inflation in Austria? Energy imports, profits or wages?

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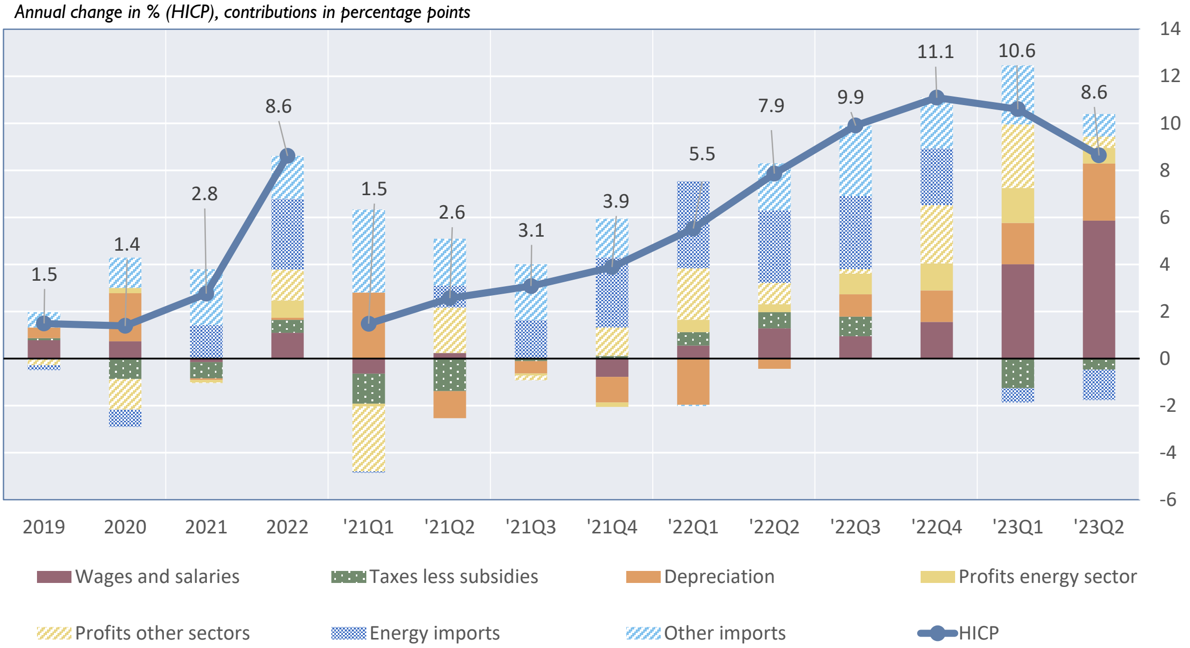
Teaser: Currently, high inflation in Austria and its causes are the subject of much debate. Is high inflation only the result of energy price increases? What has been the role of domestic profits and wages? OeNB experts shed some light on these questions.

The underlying causes driving high inflation in Austria are being hotly debated at the moment. While it is undisputed that the sharp increases in energy prices were the initial trigger, there is strong disagreement about the contribution from corporate profits and wage hikes. We shed light on the causes underlying inflation using a new method that we developed. In particular, we look at the composition of the production costs – including corporate profits – of the goods and services consumed by Austrian households, taking into account the production costs of both domestic output and imports.[1]

Following the initial import price shock, inflation has been increasingly driven by second-round effects

Contributions of cost components to consumer price inflation in Austria

Annual change in % (HICP), contributions in percentage points



Source: Statistics Austria, OeNB calculations.

Our results show that the rise in inflation observed from mid-2021 was initially triggered by a surge in import prices, especially for energy and processed goods. Since mid-2022, however, we have increasingly seen second-round effects. An expansion in corporate profits accelerated price

[1] The growth of the Harmonised Index of Consumer Prices (HICP) is explained by the growth of the individual cost components (wages and salaries, profits, depreciation of the capital stock, taxes paid on production minus subsidies and imports) per real unit of consumption. To this end, we link data from the quarterly national accounts and external trade statistics with detailed data on intermediate goods interdependencies from input-output tables. This method allows us to analyze inflation in great detail, up to the 3-digit COICOP level (45 goods and services categories).

growth, at first mostly in the energy sector, later also in other sectors. From early 2023, accelerated price growth started to cause additional second-round effects in the form of increased wage growth. In fact, wages, or, more precisely, unit labor costs, then turned out to be the main driver of inflation in the second quarter of 2023. We expect that wages will continue to contribute strongly to inflation until end-2024.

The trigger: import prices surged and drove up inflation in 2021 and 2022

The rise in inflation seen in 2021 was clearly attributable to import prices, with price hikes caused by pandemic-related international supply bottlenecks. From end-2021 onward, energy imports emerged as another major (and even bigger) driver of inflation. In 2022, inflation in Austria climbed to 8.6%; more than one-third was attributable to energy imports and another quarter to other imports. The contribution to inflation from imports decreased in the first half of 2023. Only food and processed goods imports continued to exert noticeable inflationary pressure, while energy imports had a slightly dampening effect on inflation.

Phase one of second-round effects: corporate profits fueled inflation from mid-2022

In the course of 2022, the expansion of corporate profits put additional pressure on prices. This is mainly attributable to the energy sector whose profits reflected the increases in wholesale energy prices – but with a one-year lag – which can be explained by long lock-in periods in electricity, gas and district heating supply contracts. As a result, price increases were only gradually passed on to consumers. In the fourth quarter of 2022 and the first quarter of 2023, the contribution of profits to inflation increased in other sectors, mainly for restaurants and hotels, but also for financial and insurance services. For example, profits generated by restaurants and hotels accounted for one-quarter of the increase in consumer prices in the first quarter of 2023. On average, corporate profits accounted for nearly one-quarter of annual inflation in 2022, with this share increasing in the second half of 2022. In the first quarter of 2023, the contribution of profits to inflation peaked at 40%, before declining strongly in the second quarter of 2023 due to cyclical factors.

Phase two of second-round effects: wages were main driver in the first half of 2023

Wages did not exert any notable price pressure in 2022 owing to the usually observed lagged wage adjustment process in Austria. Unit labor costs accounted for only 13% of inflation. If wages move at the same rate as the other cost components, the contribution of labor costs to inflation is about one-quarter (27%). However, as wages are only adjusted to inflation with a considerable delay, their contribution was only half as high in 2022. This changed in the first half of 2023: As negotiated wages in Austria turned out higher in Austria than in the euro area, this led to a marked rise in wage contributions. In the first quarter of 2023, the contribution of wages to inflation amounted to 38%. In the second quarter, wages were the main driver of inflation, with a contribution of more than two-thirds.

Last but not least: government support measures affect inflation

Additional price pressures in 2022 came from the end of the COVID-19 VAT cut for restaurants, hotels and cultural establishments (green bars in the chart). The reductions in energy-related taxes did not offset this upward effect in the first three quarters of 2022. Since December 2022, the electricity price cap has been dampening inflation.

And what's next for inflation? Wage negotiations will play an important role well into 2024

What can we learn about the future path of inflation from our analysis? We expect wages to continue to play a strong role for inflation in the second half of 2023 and 2024. Unsurprisingly, this is due to the lagged inflation adjustment of wages.

Wage dynamics can be tracked by looking at growth in negotiated wages, i.e. wages negotiated by trade unions with employers or employers' associations: Their growth increased significantly in the first half of 2023, at 7.2%, twice as fast as in 2022 (3.5%). Based on the wage agreements that have already been finalized, negotiated wage growth of 8.2% is expected for the second half of 2023. By historical standards, negotiated wages are also expected to be high in 2024. In addition, given the current labor shortage, many firms can be expected to hold on to their employees despite the weak business situation, further pushing up unit labor costs.

Another cost factor for firms is the fact that the cost of replacement investment needed to maintain the capital stock – depreciation – continues to increase due to high inflation. This will put pressure on profits. By contrast, import price pressures will continue to moderate owing to weak global activity, which will dampen inflation.

The exact magnitude of future price growth thus will only become clear as further second-round effects unfold. Both prudent wage negotiations and moderate profit margin developments will prove key factors for swiftly bringing down inflation.