

THE INFLATION HANGOVER IN PUBLIC FINANCES¹

Conference-Wrap-Up

Zusammenfassung auf Deutsch:

- Der Workshop „The Inflation Hangover in Public Finances“ zeigte, dass Inflationsschocks die öffentlichen Finanzen oft erst verzögert belasten: Einnahmen steigen rasch, während Ausgaben wie Pensionen, Transfers, Löhne, Investitionen und Zinsen später nachziehen.
- Für Österreich ist dieser Effekt besonders relevant, da viele Ausgaben preis- oder lohnindexiert sind und Inflation dadurch in künftige Budgets weiterwirkt.
- Inflation kann kurzfristig Schuldenquoten senken, ist aber keine nachhaltige Strategie zur Schuldenreduktion, da höhere Zinsen, Wachstumseinbußen und strukturelle Defizite die Entlastung wieder aufheben können.
- Fiskalische Maßnahmen sollten den „3 Ts“ folgen: timely, targeted and temporary – also rechtzeitig, zielgerichtet und vorübergehend; diskutiert wurde zudem ein viertes „T“: transformative.
- Preismaßnahmen bieten sichtbare Entlastung, können aber teuer sein und Preissignale verzerren; Zielgenaue Einkommensmaßnahmen sind fiskalisch effizienter.
- In Österreich ist eine bessere Krisenvorbereitung durch bessere Daten, administrative Kapazitäten und vorab definierte Zielmechanismen nötig.

On 22 June 2026, the Austrian Fiscal Advisory Council and the Oesterreichische Nationalbank hosted the workshop “**The Inflation Hangover in Public Finances**” in Vienna. The conference focused on how high-inflation episodes affect public finances and why the full fiscal consequences often become visible only after headline inflation has already declined.

Christoph Badelt opened the workshop by framing inflation not primarily as a price-stability issue, but as a challenge for fiscal sustainability, budget planning. The concept of an “inflation hangover” captures a key fiscal asymmetry between the timely reaction of public revenues (react faster to inflation) and public expenditures (mainly react with a longer delay). Higher nominal tax bases, higher VAT and wage-related revenues, and a mechanically lower debt-to-GDP ratio may temporarily create the appearance of fiscal space. However, delayed increases in pensions, social transfers, public wages, investment costs and interest expenditure can later reverse this initial fiscal improvement.

This mechanism is particularly relevant for Austria. Austria’s large welfare state and the importance of price- and wage-indexed expenditure mean that inflation is carried into future budgets. Indexation protects purchasing power and supports social cohesion, but it also extends the fiscal impact of inflation over time. Austrian evidence from Holler/Reiss 2023 shows that the 2021/22 inflation shock initially slightly improved the budget balance, while the fiscal position clearly deteriorates over the medium- to long-term. Overall, three key mechanisms are central to the fiscal impact of inflation: the different timing of revenue and expenditure reactions, the difference between domestic price developments and imported inflation, and the real macroeconomic losses caused by an energy-price shock.

Martin Kocher provided a macroeconomic and monetary policy framing. High-inflation episodes rarely have a single cause. Rather, they reflect the interaction of real shocks, monetary conditions, fiscal

¹ Autor: Dr. Johannes Holler (Büro des Fiskalrates). Disclaimer: Die seitens des Autors zum Ausdruck gebrachte Meinung gibt nicht notwendigerweise die Meinung des Fiskalrates wieder.

responses, wage and price setting, as well as expectations. From a central-bank perspective, the crucial question is whether a temporary relative-price shock turns into persistent inflation.

Kocher distinguished between the 2022/23 inflation episode and the current energy-price shock triggered by the war in the Middle East. The 2022/23 episode was strongly driven by energy and import prices and was closely linked to Russia's war against Ukraine, but it also contained demand-side elements: the post-pandemic reopening, supply bottlenecks, pent-up demand and shifts in global consumption patterns all contributed to broader price pressures. By contrast, the current increase in energy prices can be more clearly characterized as an external energy and terms-of-trade shock.

In addition, the fiscal starting point of the shock is different today. In 2022, many governments still had some room for maneuver, although fiscal positions had already been weakened by the pandemic. Today, higher deficits, debt levels and interest costs represent more binding constraints. The current energy-price shock has occurred at a time when fiscal space is more limited, making the design of policy measures particularly important. In this context, Kocher referred to the principle of the "three Ts": support measures should be timely, targeted and temporary. He also pointed to the potential relevance of a fourth "T": transformative. In the context of an energy-price shock, policy measures should not only compensate for losses. They should also help households, firms and public institutions adapt to the new environment and support structural adjustment. This includes preserving price signals and facilitating adaptation through greater energy efficiency, reduced dependence on fossil fuels, diversification of energy sources, investment in resilience and behavioral adjustment. In this sense, transformative measures may help economic actors respond to underlying scarcity while supporting longer-term adjustment.

The first session provided stylized facts on inflation and public finances. **Dubravko Mihaljek** showed that modern tax systems react strongly and quickly to inflation. Inflation raises nominal incomes and consumption values, thereby boosting revenues in the short run. At the same time, a large share of public expenditure also catches up with inflation, often with a lag. The main risk is therefore a misperception of fiscal strength: temporary revenue windfalls may be mistaken for structural fiscal space and used to finance permanent spending programs. The key policy implication is clear: inflation-induced revenues should not be treated as a lasting improvement in the budget position.

Clemens Jobst presented first results from a joint paper with Lukas Reiss adding a long-run Austrian perspective from 1870 to today. Their historical analysis shows that inflation has contributed to reductions in debt ratios in certain episodes, especially under exceptional circumstances such as currency reforms or periods of financial repression. However, these effects were highly context-specific and often accompanied by economic disruption, institutional constraints or rising yields. The historical lesson is therefore not that inflation is a reliable debt-reduction strategy. Rather, inflation can reduce debt burdens only under special conditions and often at significant economic and institutional cost.

The second session focused on the long-term impact of major inflation shocks on public finances. **Philipp Rother** presented the ECB perspective and emphasised that the fiscal impact of inflation depends strongly on the type and size of the shock. A demand-driven inflation episode can support fiscal positions. An imported energy-price shock is much more challenging, as it raises prices, reduces real incomes, weakens growth and often triggers fiscal support measures. Indexation plays a central role in the final fiscal impact of inflation: a significant part of public expenditure, especially pensions, follows price developments with a delay. As a result, a initial fiscal improvement can turn into a structural burden in the medium to long-run.

Nicolas Carnot presented evidence for six EU countries showing that inflation in 2022/23 contributed significantly to lower debt-to-GDP ratios, mainly through the denominator effect of higher nominal GDP. However, this does not amount to a durable improvement in fiscal sustainability. Higher interest rates, support packages, growth losses and structural deficits can offset the initial favourable effect. Moreover, only unexpected inflation can generate such short-term debt-ratio effects; expected inflation is priced into interest rates, wages and expenditure mechanisms. Inflation is therefore not a repeatable or sustainable strategy for debt reduction.

The final panel focused on the optimal fiscal-policy response to the recent inflation episode. The presentation by **Johannes Holler**, based on work by Alena Harrer-Bachleitner, contrasted price interventions with income measures. Price measures can already reduce inflation in the short run and provide visible relief, but they are often broad-based, can distort price signals and may become fiscally costly. Income measures tend to be more targetable and can better support vulnerable households while preserving relative price signals. The assessment of any measure depends on the objective: protecting purchasing power, reducing measured inflation, preventing hardship or supporting adjustment to higher energy prices. Independent of the target, the instruments must be constructed to be cost-efficient, which again translates in the 3 to 4 Ts: timely, targeted, temporary and transformative. In addition, the interaction between monetary and fiscal policy must be considered.

One of the key messages of the subsequent panel discussion with **Lilia Cavallari**, **Monika Köppl-Turyna**, **Gabriel Felbermayr** and **Christoph Badelt** were that fiscal policy should avoid amplifying inflationary pressures and should not attempt to fully offset a real terms-of-trade loss that the economy as a whole has to absorb. Instead, support measures should follow the principle of the 3Ts: they should be timely, targeted and temporary. Timely measures act quickly enough to prevent hardship and unnecessary economic damage; targeted measures focus on households and firms that are most affected and least able to absorb the shock; temporary measures secure that the measures are credibly limited, preventing emergency support from becoming a permanent fiscal burden.

The discussion also addressed a possible fourth T: transformative. In this view, optimal measures should not merely compensate for higher energy prices, but also help households, firms and the economy adapt to a changed environment. This may include supporting energy efficiency, infrastructure upgrades, diversification, behavioral adjustment and a lower dependence on imported fossil energy. However, the panel did not fully agree on this point. While some participants stressed that crisis instruments should also strengthen resilience and support adaptation, others cautioned that short-term crisis relief should not be overloaded with additional structural or policy objectives.

Implementation challenges were another central theme. Price interventions may appear attractive because they are visible and can directly affect measured inflation, but they can be costly and difficult to design, especially when a substantial effect to consumers is uncertain. Measures such as VAT reductions can involve high fiscal costs without guaranteeing that the intended, in the case of Austria also rather small, relief is fully reflected in final prices.

The panel also emphasized the importance of preparedness: effective crisis management depends not only on the choice of instruments, but also on administrative capacity. Better data on household incomes, pre-designed targeting mechanisms and, where appropriate, legally defined automatic fiscal responses could help governments deliver support more quickly and with fewer trade-offs between household protection, fiscal costs and inflation risks.