

Prolonged Iceland volcano eruption to harm the tourism industry and the oil price

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- Every week of halted air traffic would cost European tourism about EUR 4-7.5 billion in revenues
- Prolonged disruptions in air traffic to negatively affect the oil price; less impact on insurance and electricity industries
- Best-case scenario: change from volcano dust to magma spilling out would have local (limited) impact
- Worst-case scenario: eruption of nearby volcano Katla would hit Europe and the euro the most; equities to be negatively impacted, bonds would be supported

The ongoing volcanic eruptions in Iceland have caused airspace disruption in 12 European countries and airlines are collectively losing EUR 185 million per day. So far, the airline industry and closely related sectors such as tourism are most badly affected as shown by a research on the impact on the European economies which was conducted by Ceska sporitelna.

“Prolonged disruptions could have a much greater impact on the tourism industry, which currently accounts for about five per cent of world GDP, of which about one third is attributable to Europe. Estimates show that every week of halted air traffic would cost European tourism about EUR 4-7.5 billion in revenues. Furthermore, a massive decline in air traffic even has a negative impact on the oil price. Further sectors which were affected include just-in-time deliveries (e.g. electronic devices often depend on air freight) and perishable goods,” states Ľuboš Mokráš, fixed income analyst at Česká spořitelna.

The best-case scenario: Change from volcano dust to magma spilling out would have local (limited) impact

The best possible scenario is a gradual weakening of explosions and a change from the massive eruptions of volcano dust to magma spilling out (this should be supported by the melting of the glacier that covers the volcano). “In such a case, the volcano’s eruption would, in a relatively short period of time, have only a local impact and general macroeconomic consequences would not be high,” Mokráš also explains. A direct help of governments in the EU for the affected airlines can’t be ruled out, which could put further pressure on their budgets being already in great imbalance. A massive decline in air traffic has a negative impact on the price of oil.

Worst-case scenario: eruption of nearby volcano Katla would hit Europe and the euro the most; equities to be negatively impacted, bonds would be supported

Worst case scenario is the activation of the nearby volcano Katla, which could result in a substantially larger explosion. This could (depending on the extent) affect the global climate. The negative spill-over (apart from air transportation) would be mostly visible in the agricultural sector (cold weather). The current situation is mildly negative for the euro, as Europe is clearly the most affected region. Though the scenario of the activation of Katla would have a global spill over, Europe would most likely be negatively affected to a disproportionate extent. The negative impact on the euro would then be substantially stronger. The global slowdown would generally be negative for equities, while the uncertainty would support bonds in the early stage. However, in the longer term, the combination of inflation and higher rates would push yields up (negative for prices). Commodities (excluding energy) would be negatively influenced by lower economic activity, while gold would profit from increased risk aversion.

Insurance and electricity industries are less hit by current turmoil

The impact on various markets, exemplified by the following publicly traded companies:

- Vienna Int. Airport: The impact on revenues stemming from the airspace closure on Vienna Airport is estimated at some EUR 1mn for a full day without air traffic. It is still too early to assess the final impact of the volcanic ash on the European air traffic and on Vienna Airport. So far, the slightly negative sentiment towards Vienna Airport will prevail until we see a sustainable improvement of the situation.
- Vienna Insurance Group (VIG): The current situation does not have any impact on the insurance market in countries where VIG is active.
- CEZ: Short-term effects on the Czech operator of various energy sources are negligible (still a relatively small eruption with a neutral impact on the climate in the EU), as there should not be any impact on the electricity market. In the case of longer-term consequences in the form of colder weather, electricity production is positively correlated with lower temperatures (1°C ~ 1% of consumption).
- Unipetrol: A rise in the cost of crude oil and lower demand (due to overall lower economic activity) would put pressure on refining margins. Unipetrol is most exposed to petrochemicals, which would also be under pressure.

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