

# Austria

## 2013 Article IV Consultation



# AUSTRIA

## 2013 ARTICLE IV CONSULTATION

September 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Austria, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 1, 2013, with the officials of Austria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 16, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Press Release** summarizing the views of the Executive Board as expressed during its September 4, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Austria.

The document listed below has been or will be separately released.

### Selected Issues Paper

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# AUSTRIA

## STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

August 16, 2013

### KEY ISSUES

**Context:** Austria remains an area of relative economic strength in the European landscape. However, the financial sector faces challenges, in particular legacy issues from its expansion to Central, Eastern and Southeastern Europe (CESEE), and a group of intervened medium-sized banks poses fiscal risks. In addition, there is scope to improve the structure of public finances.

**Growth outlook and risks:** Growth has slowed, reflecting weakness in all demand components, and expectations are for only a lackluster recovery. The main risks stem from a re-intensification of the euro area crisis and its ramifications in CESEE.

**Fiscal policy:** Full implementation of medium-term fiscal adjustment plans still requires specifying several measures, and plans will need gradual strengthening to take expected further bank restructuring cost into account. Faster winding down of non-viable intervened banks would help reduce ultimate fiscal costs.

**Structure of public finances:** The savings potential in major spending areas (pensions, health care, and subsidies) will remain considerable even after current adjustment plans are fully implemented, and meaningful fiscal federalism reforms would help realize this potential. Savings could partly be used to lower labor taxation, thus boosting labor supply and potential growth.

**Financial Stability:** Strong early bank intervention and resolution tools, a better designed deposit insurance system, and a bank-financed resolution fund would help reduce the need for budgetary support to any troubled banks in the future. Crisis prevention could be enhanced by better macroprudential tools.

Approved By  
**Ajai Chopra and  
 Tamim Bayoumi**

Discussions took place in Vienna from June 21 to July 1. The staff team comprised Ms. Detragiache (head), Messrs. Ebrahimi and Steinlein (all EUR) and Mr. Saiyid (MCM), and was assisted at headquarters by Mr. Winnekens, Ms. Moraes Rego, and Ms. Adu. Mr. Blancher (MCM) joined the final days of the mission to discuss conclusions of the 2013 Financial Sector Stability Assessment (FSAP) for Austria. Messrs. Prader and Just (OED) also participated in the discussions. The mission met with the Finance Ministry State Secretary Schieder, Governor Nowotny, Labor Minister Hundstorfer, other senior officials, parliamentarians, and representatives of the social partners, the banking sector, and think tanks.

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## INTRODUCTION

**1. Austria remains an area of relative strength in the European landscape.** The economy is affected by the regional slowdown but less so than elsewhere, and growth and employment have held up comparatively well (Figure 1). Unemployment, though on the increase, is the lowest in the EU. The 2012 fiscal outturn was favorable, and the medium-term fiscal adjustment plan accommodates currently weak economic conditions. The easing of tail risks in the euro area has sharply reduced Austrian sovereign spreads (Figure 2).

**2. Financial stability and related policies were recently evaluated under the IMF's Financial Sector Assessment Program (FSAP).** The FSAP noted that Austria's large banking system, which plays a dominant role in CESEE, appears resilient to adverse scenarios on the whole. Aggregate bank capitalization, funding and liquidity conditions have improved, and Austrian banks' foreign subsidiaries have reduced their reliance on parent bank funding. Nevertheless, bank asset quality is still deteriorating in several CESEE countries, while depressed credit demand is hurting profitability. A group of intervened medium-sized banks face uncertain prospects and pose fiscal risks.

**3. With elections to be held in September 2013, discussions focused on the policy priorities for the next government.** The current medium-term fiscal adjustment plan needs to be fully implemented in structural terms and strengthened to compensate for additional costs from intervened banks. Public spending can be made more effective, with additional expenditure savings used for reducing the high and distortionary tax burden on labor. As to financial stability, as recommended by the FSAP a comprehensive framework for early bank intervention and resolution would help reduce the need for state support in the future, as would a reform of the existing system of five private deposit insurance schemes and the creation of a separate bank resolution fund.

## RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

### *Background*

**4. Growth has stalled since early 2012, which is increasingly reflected in the labor market.** Real GDP has been flat since the second quarter of 2012, resulting in an annual growth rate of 0.9 percent for 2012, down from 2.8 percent in the year before. Both external and domestic demand components have been weak and reflected developments in main trading partners, in particular Germany and CESEE, investment uncertainty, an unwillingness of households to further reduce their savings rate from already low post-2009 crisis levels, and fiscal consolidation. While employment growth remained relatively strong in 2012, labor market conditions are now weakening in line with economic developments. As a consequence, unemployment has been gradually increasing but

remains low. Credit growth also mirrors economic activity and has decelerated since mid-2012, mainly driven by weak credit demand while tightening in credit conditions has been limited.

**5. Inflation has remained above 2 percent.** Inflation fell from its 2011 peak of 3.6 percent to 2.6 percent in 2012, with a pick-up in the second half of the year. It dropped again to 2.2 percent in June 2013. Nevertheless, both headline and core inflation remain above the level in Germany, to a large extent reflecting higher services inflation. In spite of backward-looking wage setting, gross nominal wage increases in 2012 exceeded inflation only slightly due to some negative wage drift, leading to very modest real wage growth.

**6. The current account is in a modest surplus.** The surplus has fallen considerably from its pre-crisis level of almost 5 percent of GDP in 2008 and amounted to 1.8 percent of GDP in 2012, with a deficit in goods more than offset by a surplus in services (Figure 3). The REER has appreciated somewhat in 2012 reflecting the positive inflation differential with major trading partners.

### ***Outlook and risks***

**7. Staff projects gradually accelerating economic activity.** A gradual recovery for the remainder of 2013 and 2014 would be consistent with the modest pick-up in external demand suggested by some high frequency indicators and a related recovery in investment activity, some catch-up in private consumption on the back of modest growth in real wages and disposable income, and fiscal expansion in 2013. This would lead to growth rates of 0.4 and 1.6 percent for 2013 and 2014, with the output gap bottoming out at around -1½ percent in 2013. Unemployment will rise to almost 5 percent in 2013/2014 and recede thereafter.

**8. The current account is somewhat stronger than predicted by fundamentals, but the gap has shrunk and recent trends support euro area rebalancing.** According to the IMF's external balance assessment (EBA), the current account is somewhat above the norm suggested by fundamentals, while the real effective exchange rate is broadly in line with fundamentals. The current account divergence does not reflect policy gaps included in the EBA exercise, i.e. it is an unexplained regression residual.<sup>1</sup> The surplus in the current account is evident since the early 2000s and reflects both a decline in the investment rate and an increase in the savings rate. Importantly, the current account regression residual has shrunk over time and unit labor costs relative to euro area partners are on the rise, which should contribute to rebalancing within the monetary union.

**9. The most acute risks stem from a re-intensification of the euro area crisis.** Overall, risks are tilted to the downside. They are summarized in the Risk Assessment Matrix (see text table). The main risk is that stalled or incomplete delivery of euro area policy commitments or policy slippages

<sup>1</sup> A fiscal policy "gap" in Austria's trading partners helps explain some of the Austrian current account surplus, but this is offset by a negative policy "gap" in social spending (social spending above the norm in Austria would result in a lower current account balance). A policy "gap" is the difference between the actual and desired value for the policy, normalized by the world average.

in key countries under market pressure could deal a new blow to fragile market confidence, leading to adverse aggregate demand shocks and/or a prolonged period of weak growth. Direct trade ties remain dominated by relatively stable Germany, and cyclical developments follow closely the German ones despite Austria's increased eastward integration.<sup>2</sup> Nonetheless, while direct exposures to euro area program countries are small, Austria's ties with Italy are relatively strong, as Italy is a sizable trading partner, the second largest bank in Austria is a subsidiary of an Italian bank, and cross-border exposures, at about 3 percent of GDP, are non-negligible. If a euro area recession spilled over to CESEE, this would further delay the recovery of real estate and credit markets and may result in further currency depreciation in that region, leading to higher NPLs and lower profitability for Austrian banks already burdened by the crisis legacy.<sup>3</sup>

### ***The authorities' view***

**10. Authorities' and staff forecasts and risk assessment are broadly in line.** The latest forecasts for 2013 and 2014 by the Austrian Central Bank (OeNB) and the leading Austrian research institute WIFO deviate only marginally from staff projections, while the Institute for Advanced Studies is a bit more optimistic and forecasts growth of 0.6 and 1.8 percent for 2013 and 2014. The authorities agreed on the main downside risks to recovery, but also stressed upside risks and explained that fundamentals were in place for a vigorous output response if a stronger-than-expected external demand impulse materialized.

**11. The authorities argued that the current account surplus since the early 2000s is mainly the lagged result of structural changes in the 1990s.** In the OeNB's view, the Austrian external position benefited in particular from a gradual rise in trade and FDI with CESEE, with rising exports and lagged profits from FDI being the main drivers.

<sup>2</sup> See Annex: "Austria and Germany: Have the Linkages Weakened?"

<sup>3</sup> An FSAP stress test examines the effect of an Austria and CESEE recession on banking system solvency (see below).



<b>Risk Assessment Matrix</b>		
<b>Nature/Source of Main Threats</b>	<b>Likelihood of Risk</b> (high, medium, or low)	<b>Expected Impact of Risk</b> (high, medium, or low)
Financial stress in the euro area re-emerges and bank-sovereign links re-intensify (triggered by stalled or incomplete delivery of euro area policy commitments or incomplete delivery of national policy commitments).	<b>Medium</b> Progress on key elements of the banking union, ESM direct recapitalization, or the Fiscal Compact may be very slow. Implementation of fiscal adjustment plans may falter (most euro area countries). Implementation of structural reforms could stall, or social discontent with austerity could increase, with political fallout.	<b>Medium</b> Fragile market confidence would be undermined with adverse effects on aggregate demand and growth, through macro-financial linkages and confidence effects. This would further delay economic recovery in the region and Austria as well. If the recession spilled over to CESEE, this would also delay the recovery of real estate and credit markets there, leading to higher NPLs and lower profitability for Austrian banks.
Protracted period of slower European growth.	<b>High</b> The adverse impact of public and private sector debt and deleveraging on the real economy may be larger than currently expected, potentially spurring debt-deflation dynamics. Financial market fragmentation becomes entrenched. Structural reforms are delayed and fiscal adjustment incomplete, unemployment remains high, and investment subdued, reducing potential output.	<b>Medium</b> Growth in Austria would be reduced with adverse effects on medium-term debt targets. For instance, a reduction of real GDP growth as of 2014 by a ¼ standard deviation compared to baseline would reverse the downward debt trajectory envisaged by current consolidation plans (Figure 4).
Higher-than-anticipated support to intervened bank or the realization of other fiscal risks shake market confidence in the sovereign.	<b>Medium/Low</b> Bank support outlays higher than currently envisaged by staff may call into question medium-term fiscal targets. A somewhat smaller risk is that this could be compounded by disagreement on yet-to-be specified measures in the fiscal consolidation plan (e.g. subsidies, health care) and/or by substantial non-compliance at subnational level with domestic stability pact.	<b>Medium/High</b> Fiscal discipline would be in doubt, causing sovereign spreads to climb. Funding conditions for banks would worsen. This would also threaten the banks' ability/willingness to fund some CESEE operations, with negative spillovers to the region.
Simultaneous adverse developments in individual CESEE/CIS countries.	<b>Low</b> Destabilizing policies in a number of CESEE countries to which Austrian banks are significantly exposed. Since this is an idiosyncratic country risk, the probability of a simultaneous shock is low.	<b>Medium/Low</b> Spillovers would work through trade and financial linkages, notably the loan portfolios of Austrian banks. Potential confidence effects may hurt Austrian sovereign creditworthiness with feedback on bank ratings and funding cost.
Sharp increase in global interest rates in anticipation of an exit from unconventional monetary	<b>High</b> If economic conditions strengthen in the U.S. and other advanced countries, long-term interest rates	<b>Low</b> A sharp increase in interest rates would negatively affect corporate profitability and exert pressure on

policy.	may rise sharply in anticipation of an earlier-than-expected exit from unconventional monetary policy.	household balance sheets given the high share of variable interest rate loans. This effect would be counterbalanced, however, by the positive effect of improved economic conditions on profitability and household finance. The effect on public debt dynamics would be small given long average maturity (Figure 4).  Exit from UMP may reduce external financial flows to EMs in general and CESEE in particular and cause a “sudden stop” in some countries. This might lead to higher NPLs and lower profitability for Austrian bank subsidiaries in these countries.
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## POLICY DISCUSSIONS

*The discussions focused on enhancing financial stability, more effective intervened bank restructuring, and prospects for public debt reduction, as well as a post-election agenda for more efficient public spending and stronger work incentives in particular for low-skilled workers and women.*

### A. Financial Stability

#### Background

**12. The three largest Austria-based banks have improved their capitalization, and funding and liquidity conditions are comfortable.** The banks reported Core Tier 1 ratios above 10 percent at end-2012, slightly below international peers (Figure 5) but improved relative to end-2011, reflecting a combination of earnings retention and reductions in risk-weighted assets. For two of the banks, these ratios include hybrid (participation) capital, most of it provided by the government during the crisis, which is being phased out under Basel III. At the same time, internal capital generation has been reduced by the still sizable NPL provisioning needs and falling net interest margins, while equity valuations are low even in comparison with other European banks. Nonetheless, one large bank has issued new equity and repaid all participation capital in August 2013. On the funding and liquidity side, conditions have improved markedly since last year. Deposits have been growing in Austria and in CESEE, and banks have largely repaid LTROs and are able to tap markets for term funding at favorable rates.

**13. Adverse spillovers from Austria to CESEE through deleveraging have been contained thus far.** Austrian banks continue to regard CESEE as a core market and key source of future profitability, despite rising NPLs in some countries and higher capital requirements at the group

level and locally in recent years. For the banking system as a whole, CESEE exposure has grown by 3.5 percent over 2008–12, though recently there has been a reallocation across markets, with reductions in Ukraine, Hungary, and Romania and increases in Czech Republic, Poland, Turkey, and Croatia. In general, cross-border lending and parent funding of subsidiaries have declined, and subsidiaries have become more reliant on local funding, reflecting a move away from foreign currency lending, guidance by Austrian supervisors, and strong growth in local deposits.<sup>4</sup>

**14. A group of medium-sized banks has been fully or partly nationalized and is under restructuring.** At end-2012, these banks represented about 8 percent of the banking sector and 28 percent of GDP. These banks had refocused their business models away from their traditional core (and low-profitability) domestic activities, including through a number of ill-advised acquisitions, expansion into CESEE, and exposure to euro area periphery sovereigns (Box 1).

### Box 1. Austria's Mid-Sized Intervened Banks

**Hypo Alpe Adria (HAA) was initially a regional mortgage bank based in the state of Carinthia.** It aggressively expanded into SEE in the first half of the last decade, equipped with a state guarantee. After years of weak performance, HAA received its first government support in 2008 and was nationalized in 2009, with assets of EUR 41.1 billion. Total assets at end-2012 were EUR 33.8 billion (some 3 percent of total banking sector assets or 11 percent of GDP), of which about one third had been placed in an internal wind-down portfolio, and about another third were in the SEE subsidiary network to be re-privatized. Some of the banks in this network have a sizable presence in the local market (Bosnia-Herzegovina, Serbia, Croatia).

**Kommunalkredit (“new”) had a balance sheet size of EUR 15.9 billion at end-2012.** It is the “good bank” part of Kommunalkredit (“old”) —a bank nationalized in 2008, after deviating from its low-profitability core business of public investment financing by taking on considerable bond and CDS exposure (primarily to the euro area periphery). Efforts to re-privatize this bank failed, and as of May this year, the bank does not engage in any new banking business activity. Assets of the “good bank” are mainly loans, of which nearly 70 percent were advanced in Austria, mainly to municipalities.

**KA Finanz is the “bad bank” part of Kommunalkredit (“old”) and it operates in a wind down mode, while still holding a banking license.** At end-2012, assets on its balance sheet amounted to EUR 10.9 billion, while its off-balance sheet exposure was EUR 6.2 billion. While assets on balance sheet are mainly comprised of sovereign bonds, the off-balance sheet assets are CDS positions.

**Austrian Volksbanken AG is the apex institution of one of Austria's cooperative banking groups.** Over the two last decades, it had embarked on an ill-fated acquisition and expansion strategy, including into CESEE. After a first public capital injection of EUR 1 billion in 2009, it had to be (partly) nationalized in 2012. The EC has approved a restructuring plan that envisages a reduction of the bank's balance sheet to a size commensurate with its core function as apex institution—from currently EUR 27.7 billion (end-2012) to some EUR 19 billion by 2017.

<sup>4</sup> See Box 3 of the 2012 IMF Staff Report for an analysis of the authorities' supervisory guidance on the strengthening of the sustainability of the business models of large internationally active Austrian banks.

**15. Negative feedback loops between the sovereign and the banking sector remain a risk, with potential adverse spillovers to CESEE.** The Austrian banking sector is large (with assets of over 3½ times GDP) and internationally exposed (with exposure to CESEE and CIS countries at 105 percent of GDP). At the height of the last financial crisis, the government provided capital and funding guarantees to the banking sector, and sovereign spreads became elevated for a short period of time as fears about CESEE exposures mounted. On the banks' side, while banks' holding of sovereign debt is limited, funding conditions for the larger banks benefit from market perceptions that the fiscally sound sovereign will step in, as reflected in the considerable support credit rating uplift. If sovereign creditworthiness was called into question, the resulting worsened bank funding conditions might cause negative spillovers to CESEE through reduced supply of credit by Austrian banks in the region.

### ***Policy issues***

**16. Large, internationally active banks should continue to strengthen their capital position.** With market expectations of capital levels well ahead of current regulatory minimum requirements, still volatile global financial markets, and uncertainty about asset quality in CESEE, focus on strengthening capital buffers should continue, as emphasized by the FSAP. Against this background, supervisors should continue to monitor the size and quality of capital buffers at large banks closely, and stand ready to take action if needed (e.g. by restricting dividend payouts), including with a view to the forthcoming balance sheet assessment exercise in the context of the transition to the new single supervisory mechanism in the euro area.

**17. Faster medium-sized bank restructuring will assist in containing final fiscal cost.** Restructuring strategies should focus on minimizing the ultimate fiscal cost regardless of any short-term effects on fiscal headline figures. While the downsizing of Austrian Volksbanken AG (OeVAG) appears on track and the approach to operate Kommunalkredit in a "no-new-business" mode until assets run off seems workable, the strategy to sell off the SEE operations of nationalized bank Hypo Alpe Adria (HAA) as a going-concern to private investors *en bloc* has not succeeded so far. To speed up disposal, a further bad asset carve-out is necessary. The carved-out assets, together with HAA's already existing internal wind-down portfolio, should be transferred to a defeasance structure without banking license and disposed of within a clearly limited timeframe. In addition, a rapid sale of remaining viable units individually or even in parts should follow to limit further asset deterioration.<sup>5</sup> An asset quality review conducted by external experts may facilitate this process. As the bank is restructured, efforts should be made to minimize adverse spillovers to HAA's SEE markets and the broader CESEE region. In a similar vein, it would be useful to withdraw the banking license from "bad bank" KA Finanz to prevent asset disposal from being held back by lack of loss-

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<sup>5</sup> The authorities might also consider further "market tests" to determine the interest of potential buyers for the viable entities before carrying out the restructuring.

absorbing capital. The restructuring of intervened banks should be used as an opportunity to reduce capacity and improve cost efficiency in the Austrian market.<sup>6</sup>

**18. Stronger financial oversight to promote better risk management and governance practices in the small and medium-sized bank segment would help prevent a recurrence of past problems.** According to the FSAP, the Financial Market Authority (FMA) and Austrian National Bank (OeNB) collaborate effectively in performing banking supervision, including on a cross-border basis. Nonetheless, they could usefully step up the use of supervisory tools and powers for corrective action and the promotion of stronger risk management and governance standards, especially among small and medium-sized banks.

**19. As recommended by the FSAP, early intervention and resolution powers and the deposit insurance system should be bolstered to reduce the likelihood of future government bailouts.** A recent amendment to the Banking Act covers early intervention, but falls short of FSAP recommendations in some areas, while no initiative is in the works for resolution yet.<sup>7</sup> In addition, given the significant size of Austrian banks' cross border operations, it would be important to better define cross-border resolution arrangements with host country supervisors, for instance by expanding cross-border stability groups. As to deposit insurance, among the reasons why the authorities supported some banks in recent years might have been concerns about depositor panic and possible domino effects from the activation of sectoral deposit guarantees. To reduce the need for future bailouts, allow for different modes of bank resolution, and ensure rapid payouts, the FSAP recommends the unification of the five existing private deposit insurance schemes to a publicly-administered pre-funded scheme.

**20. Future crisis management would benefit from the creation of a bank resolution fund.** Such a fund, which would be used to facilitate resolution rather than finance bailouts, could be financed through the existing financial stability tax currently levied on banks and could be rapidly deployed to support bank intervention in a crisis situation. Austrian banks are broadly supportive of the financial stability tax being allocated to a resolution fund rather than to the general budget. The existing tax, which yields about 0.2 percent of GDP per year, could, in 3-4 years time, grow large enough to provide temporary capital support to a large institution in case of difficulties.

### ***Authorities' view***

**21. The authorities highlighted progress in a number of areas aimed at enhancing financial stability.** They welcomed the FSAP's findings about the resilience of the overall banking system to various solvency shocks, while emphasizing the need for some individual banks to

<sup>6</sup> For a discussion of overcapacity in the Austrian banking market, see the staff report for the 2012 Article IV Consultation.

<sup>7</sup> The areas are: specific triggers for intervention, broader powers to appoint a special administrator, replace management, and impose restriction on dividends; issuance of convertible bonds or unsecured long-term debt that can be bailed-in, and ring-fencing of subsidiaries or related entities.

continue strengthening capital buffers. They also noted that policy measures taken to reduce CESEE-related spillovers, including encouragement of greater reliance of Austrian banks' subsidiaries on local funding, have helped reduce systemic vulnerability, and have not resulted in large-scale deleveraging in the CESEE region. They indicated that developments with regards to bank resolution frameworks and deposit guarantee schemes would have to wait until decisions are finalized at the EU level, while at the national level, discussion of early intervention triggers on capital and liquidity has been initiated. On intervened bank restructuring, the authorities emphasized concerns about the immediate debt implications of creating defeasance structures located within general government, and informed that external consultants had been hired to explore alternative design options.

## B. Balance Sheets and Housing Market Developments

### *Background*

**22. Households have relatively low debt, but carry a sizable share of Swiss franc denominated debt and are exposed to a rising interest rate environment.** Households have assets of nearly 3 times net disposable income while gross liabilities are less than one-third of assets. Only about 36 percent of households have any debt, more than half of it mortgage credit mainly at variable interest rate. While total mortgage indebtedness is low, the high share of Swiss-franc denominated debt (23 percent of the total)—much of it mortgages with bullet maturity and tied to an investment vehicle—presents some risk. The overall funding gap of repayment vehicle loans, the difference between the loan principal and the amount accumulated in an investment vehicle, was assessed by the FSAP at EUR 5.5 billion, 18 percent of loan principal, in September 2012.

**23. The housing market has experienced strong price growth but from low levels.** In nominal terms at end-2012, house prices rose 14.9 percent y-o-y in Vienna compared with 11.5 percent y-o-y for Austria overall. In real terms and from a medium-term perspective, the price increase appears more modest: a cumulative 40 percent over 10 years in Vienna and about 5 percent in the rest of Austria. Housing market activity seems to be driven largely by non-resident buyers and domestic investors seeking an alternative to low fixed-income returns, though continued immigration also likely supported demand for housing in urban areas. Mortgage credit has exhibited slow growth, suggesting the prevalence of equity buyers.

**24. Aggregate corporate debt is around the euro area median.** Over the past two decades, corporates have increasingly substituted bank loans with debt issued in the markets, which has risen to 19 percent of total corporate debt at Q2 2012 compared with just 7 percent in 1995. This long-term trend accelerated in recent months reflecting rising risk appetite among global investors and falling yields. Only 8 percent of corporate debt is in foreign currency,  $\frac{3}{4}$  of which in Swiss francs. Thus, vulnerability to adverse exchange rate movements appears limited in the aggregate. After falling for two years, bankruptcies in the corporate sector picked up in 2012 as macro-economic conditions slowed. The recent high profile failure of one large construction company has raised some concerns about the operating environment for the construction sector.

**Policy issues**

**25. Risks from Swiss franc-denominated mortgages are manageable.** The FSAP stress test suggests that the funding gap would increase substantially in the face of a 200 bp interest rate shock and 5 percent Swiss franc appreciation shock at maturity. However, given the long residual maturity of these loans, the impact of such a shock could be absorbed with a relatively modest increase in provisioning. Furthermore, banks no longer offer foreign-currency loans domestically (with very limited exceptions).

**26. While there are no major immediate domestic imbalances, the work to put in place a full-fledged macroprudential policy framework should start now.** As recommended by the FSAP, the authorities should consider strengthening the macroprudential framework with the OeNB in a leading role in the envisaged committee. This would ensure that decisions are based primarily on its economic and risk expertise, as recommended by the European Systemic Risk Board. Going forward the committee should consider a broad set of macroprudential tools, including for instance maximum loan-to-value and debt-service-to-income ratios, and should promote the construction of the statistical database needed to use these tools.<sup>8</sup>

**Authorities' view**

**27. The authorities agree with the need to strengthen the macroprudential framework and have already taken steps in this direction.** A Financial Market Stability Committee will be instituted at the beginning of 2014. It would be comprised of senior officials from the MoF, the Fiscal Council, the FMA and the OeNB and chaired by a MoF representative, and it would be tasked with making recommendations to the FMA on the activation of macroprudential policies. At present, it would have the ability to implement changes in the macroprudential tools proposed under CRD / CRR IV, namely the countercyclical buffer and the systemic risk surcharge, but other tools could be considered at a later date.

## C. Reducing Public Debt While Absorbing Further Bank Restructuring Costs

**Background**

**28. The authorities' consolidation plans remain largely unchanged.** On the back of broad-based underspending (including on interest cost) and overperforming labor taxes, the headline and structural deficit in 2012 amounted to respectively 2.5 and 1.3 percent of GDP, about ½ percentage point better than targeted a year ago (Figure 5). The 2014–17 update of the authorities' budgetary framework broadly confirms earlier deficit targets. Given last year's favorable outcome, the 2013

<sup>8</sup> Data availability on corporate subsectors and real estate price developments (including commercial real estate) is relatively poor, while data on loan-to-value and debt service-to-income ratios are unavailable.

budget now implies a structural expansion, notched up by a recently-approved stimulus package with minor deficit effects in 2013 and 2014.<sup>9 10</sup> Gradual adjustment is resumed in 2014, and a structural deficit of 0.45 percent is targeted by 2016, in compliance with Austria's new fiscal rule framework.

**29. However, implementation gaps and uncertainties remain.** As regards health care expenditure, although stakeholders have agreed to reduce its growth rate from 4.3 percent in 2013 to the projected medium-term nominal GDP rate of 3.6 percent by 2016, the underlying measures still need to be further specified, and the new decision-making framework created for this purpose is complex.<sup>11</sup> In a similar vein, the planned savings volume on subsidies has not yet been underpinned by specific cuts. Furthermore, there are uncertainties on the revenue side, mainly from the envisaged EU financial transaction tax (FTT, budgeted as of 2014), and proceeds from the treaties with Switzerland and Liechtenstein on the taxation of interest earned by Austrian residents on assets held in the two countries

Staff Baseline and Authorities' Adjustment Scenario  
(percent of GDP unless indicated otherwise)

	2012	2013	2014	2015	2016	2017	2018
Staff Baseline Scenario							
Headline balance	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Structural balance 1/	-1.3	-1.7	-1.7	-1.5	-1.4	-1.4	-1.4
Debt	74.1	74.3	74.7	74.3	73.8	72.8	72.0
Output gap	-0.7	-1.6	-1.3	-0.8	-0.4	-0.2	0.0
Real GDP (percentage change)	0.9	0.4	1.6	1.8	1.7	1.5	1.4
<i>structural adjustment</i>		-0.5	0.0	0.2	0.1	0.0	0.0
Authorities' Adjustment Scenario 2/							
Headline balance	-2.5	-2.3	-1.5	-0.6	0.0	0.2	
Structural balance 1/	-1.4	-1.8	-1.3	-0.8	-0.5	-0.4	
Debt	73.4	73.6	73.0	71.3	69.3	67.0	
Output gap	-0.7	-0.9	-0.4	0.4	0.9	1.4	
Real GDP (percentage change)	0.8	1.0	1.8	2.0	1.8	1.9	
<i>structural adjustment</i>		-0.4	0.5	0.5	0.3	0.1	

Sources: Austrian Stability Program 2012–17; IMF staff projections.

1/ The structural balance excludes revenue from the 2012 tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following bank restructuring cost (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; budgeted 0.4 in 2013;

2/ Based on the January 2013 medium-term projections of the Austrian research institute Wifo.

<sup>9</sup> The authorities' and staff's structural balance calculations exclude revenue from a tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following capital transfers to restructuring banks (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; and an already budgeted 0.4 in 2013.

<sup>10</sup> The announced size of the package is EUR 1.6 billion (0.5 percent of GDP), with the main spending occurring in 2014. Over ¼ of it consists of loans and loan guarantees for enterprises hit by the recent floods, while the remaining measures focus on residential and non-residential construction and provision of child and elderly care facilities. To a large extent, spending is advanced from later years and/or by public enterprises outside general government.

<sup>11</sup> This view is also shared by the Austrian Court of Auditors (see position of March 13, 2013 on the draft health reform law 2013).



(budgeted in 2013, or projected in 2014). Unspecified expenditure measures and revenue from the FTT are not taken into account in the staff's baseline projections.<sup>12</sup>

**30. In addition, further costs from the restructuring of nationalized mid-sized banks are imminent.** Until 2012, these banks have received about 1.7 percent of GDP in capital transfers, in addition to government guarantees. An additional capital transfer of 0.4 percent of GDP is already budgeted for 2013. However, further significant bank restructuring costs will emerge as these banks are downsized more decisively than in the past and medium-term fiscal planning does not yet cater for these costs.

**31. Furthermore, there are contingent liabilities from non-financial public enterprises and guarantees.**

Public enterprise debt amounted to around EUR 43 billion at end-2012, of which about EUR 11 billion are already included into general government debt.

Another part will likely need to be included when revised ESA national accounting rules come into effect in 2014, with the debt effect expected by the authorities at 2 to 3 percent of GDP. Most of public enterprise debt is covered by explicit federal or subnational guarantees. Other guarantees relate mainly to export promotion, and the financial sector.

Financial sector guarantees are not only crisis-related but comprise also state guarantees to regional banks that are slated to expire in 2017 under EU rules.

Public Enterprise Debt 2006–2012 1/  
(In billion euro unless indicated otherwise)

	2006	2011	2012 2/
<b>Federal</b>			
Federal Railways	7.1	16.9	17.3
o/w: Infrastructure	6.1	14.4	14.7
Federal Real Estate Company	3.3	3.3	3.6
Federal Highway Agency	8.6	8.7	8.3
<b>States</b>			
Hospitals	0.8	2.9	2.9
<b>Municipalities</b>			
Associations of Municipalities 3/	2.2	...	...
Utilities, Housing and Other	9.9	10.5	10.6
Vienna Hospital Association	...	0.3	0.4
<b>Total</b>	<b>32.3</b>	<b>42.9</b>	<b>43.1</b>
<i>(in percent of GDP)</i>	<i>12.5</i>	<i>14.3</i>	<i>14.1</i>
<i>Of which: already in general government debt</i>	<i>4.3</i>	<i>10.3</i>	<i>10.8</i>
<i>(in percent of GDP)</i>	<i>1.7</i>	<i>3.4</i>	<i>3.5</i>

Source: Federal Ministry of Finance.

1/ Non-financial public enterprises

2/ Preliminary results

3/ Data no longer available since 2009.

### Policy issues

**32. The authorities' adjustment plans already accommodate currently weak economic conditions.** In particular, the structural expansion implied by the 2013 budget is appropriate, given currently sub-par growth.<sup>13</sup> On the other hand, additional discretionary fiscal stimulus would not seem to be warranted under current growth projections, given the moderate output gap and low unemployment and medium-term consolidation needs. From this perspective, the recently passed stimulus package or other new spending initiatives should be financed within the existing budgetary

<sup>12</sup> If the authorities' plans are fully implemented, their fiscal deficit targets would be achieved under staff's baseline macroeconomic scenario.

<sup>13</sup> The authorities' headline deficit target of 2.3 percent of GDP for 2013 is not in violation of the headline deficit target of the Austrian domestic stability pact of 2.14 percent of GDP as it includes a budgeted 0.4 percent of GDP bank restructuring costs, which are exempt from the fiscal rule.

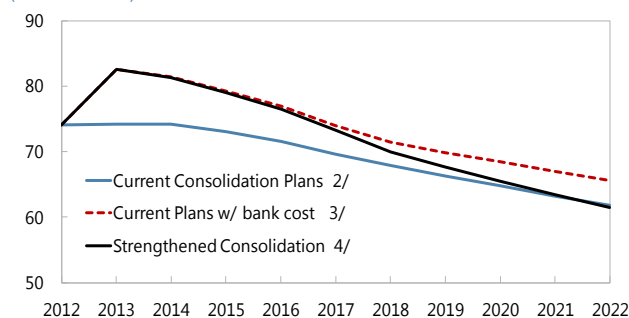
envelope. The swift further specification of measures to underpin the planned savings in health care and subsidies should gain center stage.

**33. Further bank restructuring cost will not preclude debt reduction to pre-crisis levels around end-decade if fiscal adjustment is gradually strengthened.** While the final impact on

government debt from the on-going restructuring of medium-sized banks is difficult to gauge at present, staff assesses costs as manageable.<sup>14</sup> Specifically, reducing public debt to the pre-crisis level of close to 60 percent of GDP in the first years of the next decade should be achievable. To this end, however, structural fiscal adjustment will need to be strengthened gradually in the next budget and medium-term fiscal planning exercises (covering the years 2014–18), with a moderate temporary overperformance on

Austria's fiscal rule in the outer years. Bringing debt back to pre-crisis levels around the end of the decade is advisable in light of contingent and implicit public liabilities, including from population aging, and tail risks from the continued foreign activities of large banks.

Debt Dynamics: Planned Consolidation and Illustrative Bank Restructuring Cost 1/  
(Percent of GDP)



1/ With staff macroeconomic projections.

2/ Authorities' consolidation plans fully implemented.

3/ As in footnote 2, but with illustrative bank restructuring cost scenario.

4/ Strengthened consolidation in reaction to illustrative bank restructuring cost.

Sources: National authorities; and IMF staff calculations.

**Authorities' view**

**34. The authorities stressed that planned consolidation measures are on track.** Newly created coordination bodies had been tasked to map health care expenditure ceilings into multi-annual agreements among stakeholders, first at the federal level and then in each individual state. Subsequently, these agreements were to be further broken down into annual implementation plans. Similarly, although specific measures to save on subsidies had not been decided yet, efforts to create a subsidy "transparency database" as decision-making tool were progressing as planned. The authorities were confident in their revenue estimates, and informed that the recent "stimulus package" would only have marginal effects on the deficit, which could indeed potentially be compensated within the existing budgetary envelope. The authorities acknowledged that significant further costs from bank restructuring were to be expected and were open to the idea of building buffers for bank restructuring costs into the next vintage of their medium-term fiscal framework.

<sup>14</sup> The text chart shows an illustrative bank restructuring scenario with a debt shock reflecting the creation of a defecance structure ("bad bank") within general government in 2013 and subsequent asset recoveries.

## D. Restructuring Public Finances and Strengthening Work Incentives

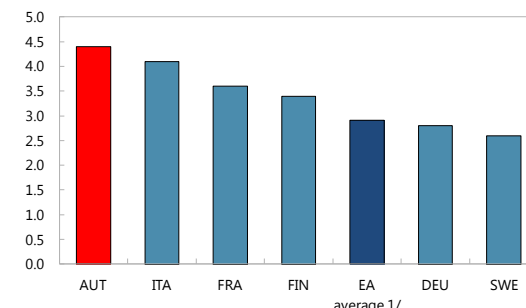
### Background

**35. Gaps in expenditure efficiency remain considerable.**<sup>15</sup> Even after the current consolidation plans are fully implemented, the room for reductions in health care, subsidies, and pension expenditures will be large: (1) As regards health care, the room for further savings without diminishing health care outcomes has been estimated by the OECD at 2 percent of GDP, with particular rationalization potential in the hospital area (*see text chart*).<sup>16</sup> (2) As for subsidies and capital transfers, Austria spends about 3¾ percent of GDP more than the euro area average. Even abstracting from subsidies to hospitals and capital transfers to banks, the currently targeted cuts of less than 0.2 percent of GDP would not exploit all possibilities; (3) pension expenditures are high, especially given a relatively favorable age dependency ratio (*see text chart*), and will continue to rise despite recent reforms.<sup>17</sup> As pointed out in previous staff reports, accelerating plans to align the low female statutory retirement age of 60 with the male retirement age of 65 and introducing automatic adjusters for the retirement age to life expectancy would generate savings. In most of these and other areas, decision making is fragmented across and within government levels and spending powers are not coupled with financing responsibilities.

**36. Austria's tax burden is high and labor is taxed heavily.**<sup>18</sup> Austria ranks among the high tax countries in the euro area and has the highest labor tax share in total taxation (*see text chart*). Social contributions and payroll taxes amount to almost 50 percent of gross wages, and statutory marginal

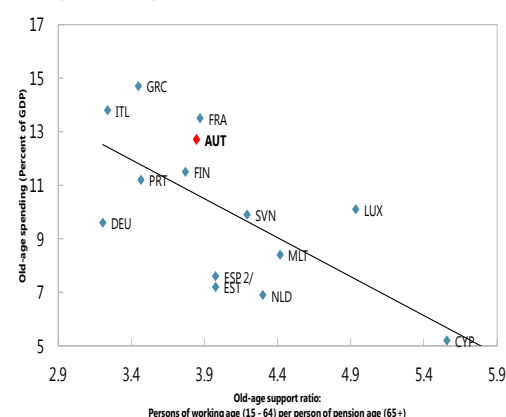
Spending on Hospital Services, 2011

(Percent of GDP)



1/ Excluding Belgium, Spain and Slovak Republic due to missing data.  
Source: Eurostat.

Old-age Spending and Support Ratio in the Euro Area, 2011 1/

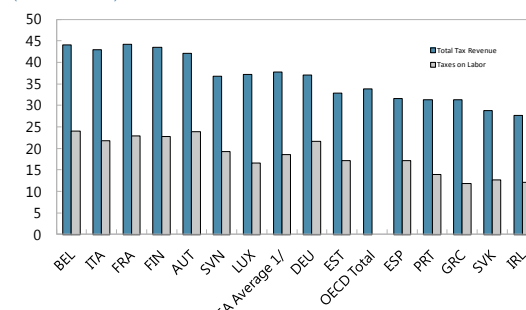


1/ excluding Belgium and Slovakia due to missing old-age spending data.  
2/ 2010 Data

Sources: Eurostat; and IMF staff calculations.

Total Tax Revenue and Taxes on Labor

(Percent of GDP)



1/ Euro area average includes only OECD members.  
Sources: OECD and Eurostat.

<sup>15</sup> See Annex 4 to the 2011 IMF Staff Report.

<sup>16</sup> See 2011 OECD Economic Survey for Austria.

<sup>17</sup> For future aging cost, see 2012 IMF Staff Report.

<sup>18</sup> See Selected Issues Paper "Making Work Pay."

income tax rates range from 36.5 to 50 percent.<sup>19</sup> Negative work incentives from such high labor taxes in Austria seem to be particularly sharp for low-skilled workers and secondary earners, as evidenced by a relatively low employment rate in the former case and the high share of part-time work among women in the latter. Negative incentive effects may be aggravated by interactions with the benefit system, i.e. too rapid social benefit withdrawals as work income increases, and the additional childcare cost incurred by mothers working full-time.

### Policy issues

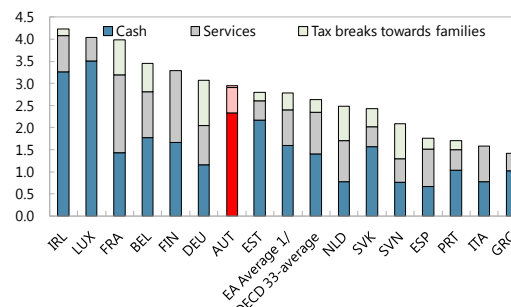
#### 37. A bolder approach to expenditure and fiscal federalism reform should be a priority.

Specific decisions on further expenditure reforms should be embedded into the next medium-term fiscal framework for 2015–18. In the context of the renewal of the financial equalization law expiring at end-2014, this should be combined with a reform of inter-governmental fiscal relations to streamline and connect more closely spending powers and financing responsibilities across government levels. Furthermore, efforts to strengthen the fiscal governance toolkit of states in areas such as budgeting, medium-term fiscal planning, accounting and financial management should continue. At the federal level, the full independence of the fiscal council, which is being created in the context of the fiscal governance reforms in the euro area, should be ensured to maximize its effectiveness.

#### 38. Expenditure savings could assist in financing a comprehensive reform of the tax-benefit-system, including family benefits, in a deficit-neutral way.

As recommended in previous staff reports, work incentives and job creation for low-skilled workers should be strengthened by selectively lowering social security contributions and payroll taxes. In addition, income tax rates should be reduced, in particular for the first income bracket, while higher in-work benefits would mitigate negative interactions with the social benefit system. These reforms should be coupled with a simplification and redesign of the complex and relatively costly family benefit system to strengthen work incentives for women (*text chart*). The current system is tilted heavily toward monetary transfers that are neither conditional on the working status of the parents nor means-tested. A reallocation of funds from monetary transfers to the provision of high-quality and affordable childcare facilities and after-school programs would offer more women the choice to work longer hours. Monetary transfers could also be subjected to some means-testing to save budgetary resources or to in-work conditionality for both parents to further leverage work incentives.

Public Spending on Family Benefits, 2009  
(Percent of GDP)



1/ Euro area average includes only OECD members.  
Sources: OECD; and IMF staff calculations.

<sup>19</sup> The effective rates are somewhat lower due to standard tax relief, in particular a lower taxation of leave and Christmas bonuses customary in Austria.

**Authorities' view**

**39. There are currently no agreed plans for additional expenditure reforms or a reconfiguration of the tax-benefit system.** As regards expenditures, the current focus is on the implementation of the already agreed reforms also after the elections. In the pension area, efforts are concentrated on aligning actual and statutory retirement ages, while changes in statutory parameters are not under consideration. While there was general agreement that a reduction of the high tax burden on labor would be desirable, views among the two coalition partners differed on the specific parameters to be changed, and there had still not been any consensus on how to finance such changes.

**40. The authorities were also not prepared for a more fundamental redesign of family benefits.** The authorities generally agreed that Austria's family benefit system was too complex as regards the number and features of programs and would benefit from simplification. They had taken small steps to simplify child allowances, but there were no plans at the moment for a more comprehensive reallocation and reform of monetary benefits. In contrast, the authorities favored very much the provision of additional childcare facilities and had just agreed on more federal transfers to states for this purpose.

## STAFF APPRAISAL

**41. While Austria's macroeconomic fundamentals are relatively healthy, growth has stalled and the forecast is for a slow recovery.** After a swift post-crisis rebound, real GDP has been flat since early 2012 with weakness in both domestic and foreign demand. Economic activity should start to recover in the second part of this year, mainly driven by an expected gradual strengthening in the international environment. Risks from the still difficult situation in the euro area, an emerging market slowdown, and volatile global financial markets could delay the recovery.

**42. The medium-term fiscal plan's accommodation of currently weak economic conditions is welcome.** The 2013 budget envisages a structural expansion, which is appropriate given the current sub-par growth performance. Going forward, it will be essential to focus on the further specification of measures necessary to implement the already envisaged fiscal adjustment, particularly related to health care and subsidies. Efforts should be made to finance the recently-announced new stimulus measures within the existing budgetary envelope.

**43. Further significant but manageable fiscal costs from medium-sized banks under restructuring should be compensated with additional gradual fiscal adjustment.** To contain these costs, faster disposal of troubled assets and downsizing of non-viable entities than in the past is necessary, and the authorities are moving in this direction. Correspondingly, structural fiscal adjustment should be strengthened gradually in the fiscal planning for 2014–18 to absorb bank restructuring costs in the medium term, with a view to bringing public debt down to its pre-crisis level in the first years of the next decade.

**44. While measures are being implemented to rein in early retirement, further reforms to make public spending more efficient would be desirable.** As noted in earlier consultations, there is considerable scope for reducing spending in pensions, health care, and subsidies. An earlier equalization of male and female statutory retirement ages and automatic longevity adjustors would be welcome. A better targeting of subsidies towards more clearly defined long-term objectives is desirable. Further efficiency improvements in the health care area should be encouraged, even if the currently envisaged expenditure containment path is fully implemented. As pointed out in previous IMF staff reports, better aligning spending powers and financing responsibilities in the federal system, and strengthening the latter by introducing meaningful tax autonomy for states, would facilitate expenditure rationalization.

**45. Expenditure savings could be used to finance a comprehensive reform of labor taxation and social and family benefits to foster labor supply and potential growth.** Austria has a relatively high tax burden on labor which hampers work incentives in particular for the low-skilled and women. As pointed out in previous IMF staff reports, an income tax reform and the selective lowering of social security contributions, taking interactions with social benefits into account, could help to remedy the situation. In addition, a simplification and redesign of the complex and costly family benefit system could strengthen work incentives for women. In particular, a reallocation of funds from unconditional monetary transfers to the provision of high-quality and affordable childcare facilities would offer more women the choice to work longer hours.

**46. A comprehensive framework for bank resolution would help reduce the need for state intervention in the future.** While a common EU framework is the ultimate goal, in the interim the Austrian authorities should put in place a bank resolution regime consistent with international best practices and already-agreed elements of the forthcoming EU directive. This would complement the current legislative package, which covers early intervention tools and the preparation of recovery and resolution plans by banks.

**47. As part of this new framework, the deposit insurance system should be unified and a bank resolution fund created.** A unified and privately pre-funded scheme administered by the government would make it easier to close down failing banks without incurring excessive public liabilities. The forthcoming EU DGS Directive is an opportunity to move along this path. Future crisis management would also benefit from the creation of a bank resolution fund, which could eventually be integrated into a newly-created EU resolution fund. Proceeds from the existing bank financial stability contributions could be used for this fund.

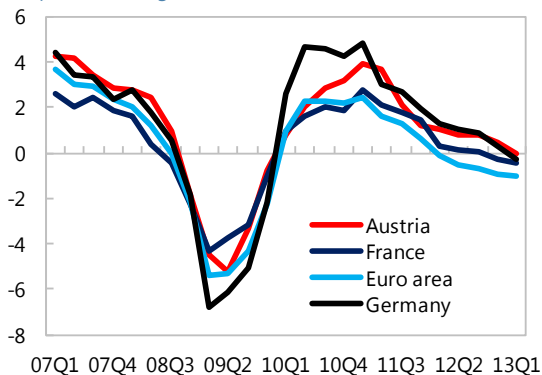
**48. Recent progress in strengthening the macroprudential framework is welcome and the OeNB should be given a leading role.** The OeNB should be given a decisive role in the new macroprudential committee, in line with recommendations by the European Systemic Risk Board. Going forward the committee should consider a broad set of macroprudential tools, including for instance maximum loan-to-value and debt-service-to-income ratios, and the availability of related statistical information to diagnose emerging imbalances should be improved.

**49.** It is recommended that the next Article IV consultation with Austria be held on the standard 12-month cycle.

**Figure 1. Austria: Recent Economic Developments**

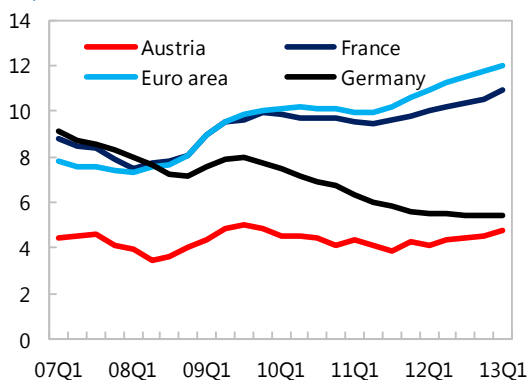
Growth has slowed down again ...

**Real GDP Growth**  
(YOY, percent change)



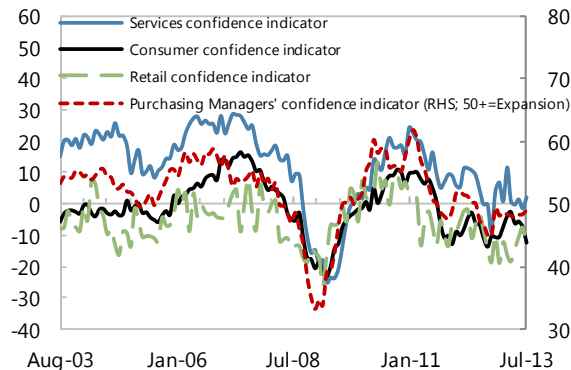
...but unemployment has remained low.

**Harmonized Unemployment Rate**  
(In percent)

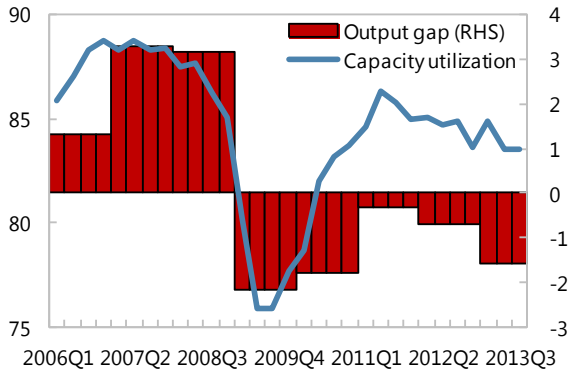


Indicators suggest a modest upswing, at best.

**Confidence Indicators and PMI**

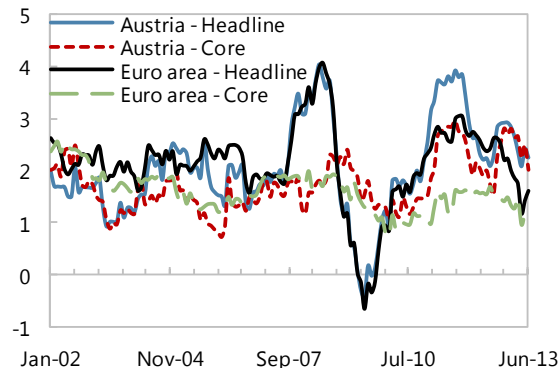


**Capacity Utilization**  
(In percent, SA)



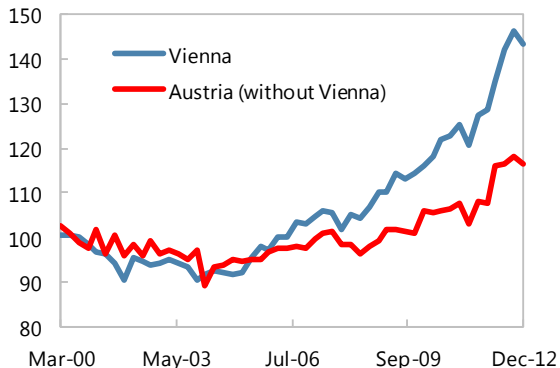
Inflation follows euro area downward trends...

**Harmonized CPI**  
(Annual percentage change)



...and real estate price increases seem to have paused.

**Real Property Prices**  
(2000=100)



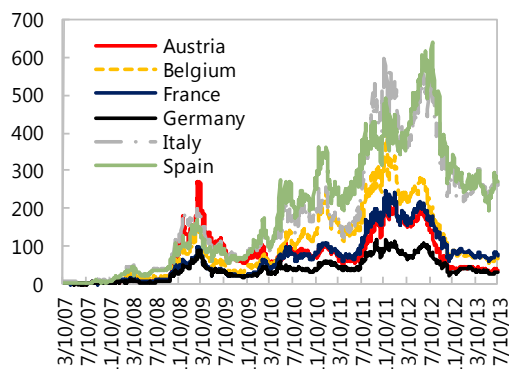
Sources: Austrian authorities; WIFO; Eurostat; Haver; WEO; and IMF staff calculations.



**Figure 2. Austria: Financial Market Indicators**

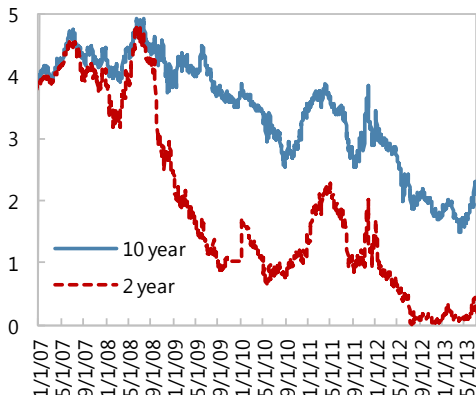
The market perception of sovereign creditworthiness has improved since late 2012

**Sovereign CDS, 5-year**  
(Basis points)



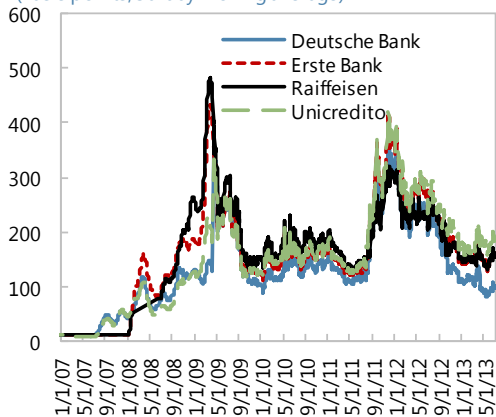
...while interest rates are at historic lows

**Government Interest Rates**  
(Percent)



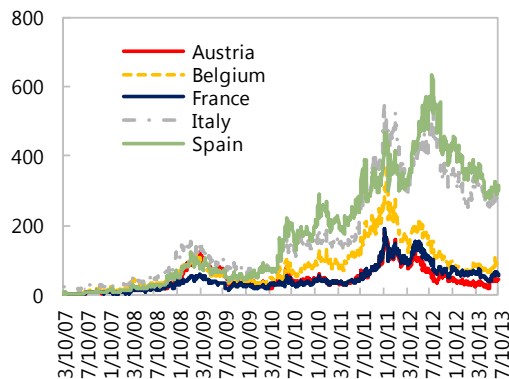
...and so have those of default risk...

**Credit Default Swaps, 5-year**  
(Basis points, 30-day moving average)



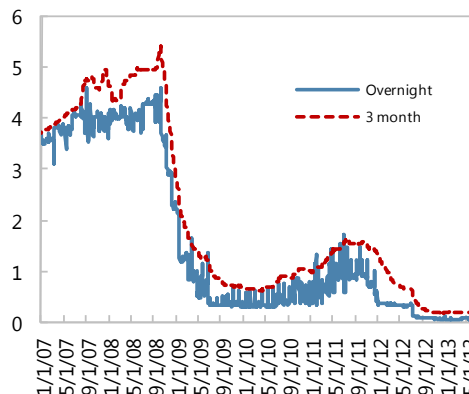
...but is not yet at pre-crisis levels

**10-year Sovereign Spread with German Bund**  
(Basis Points)



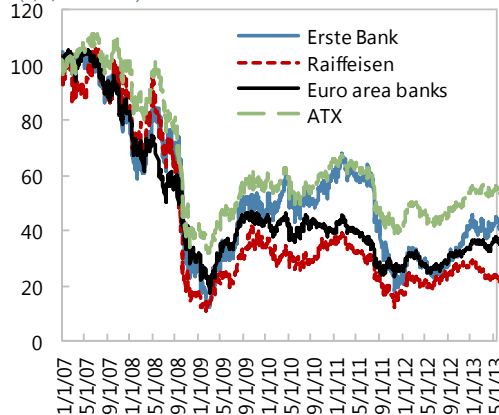
Perceptions of bank counterparty risks have declined

**Interbank Money Rates**  
(Percent)



...while banks' equities are trailing the broad market index.

**Equities**  
(1/3/07 = 100)

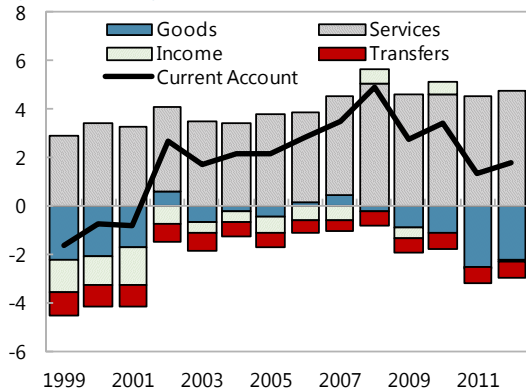


Sources: Thomson Financial/DataStream and Bloomberg.

**Figure 3. Austria: External Sector**

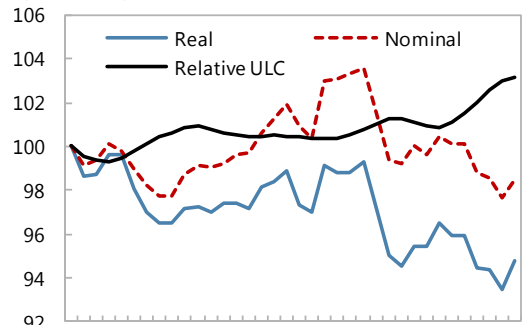
The CA registers a small surplus thanks to services...

**Current Account Components**  
(Percent of GDP)



...while unit labor costs are rising relative to the EA.

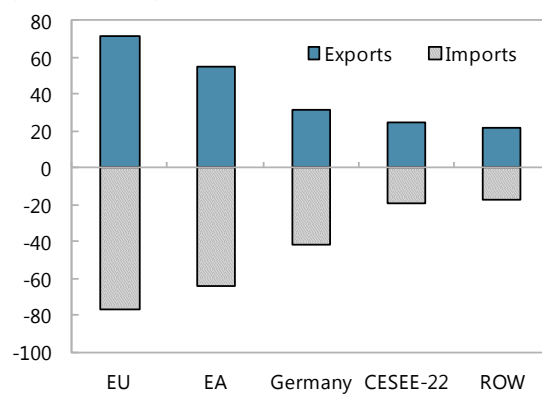
**Austria's Effective Exchange Rate**  
(2004 = 100)



REER CPI-based; NEER and REER relative to broad group of 40 advanced and emerging market partners; ULC relative to the rest of the euro area

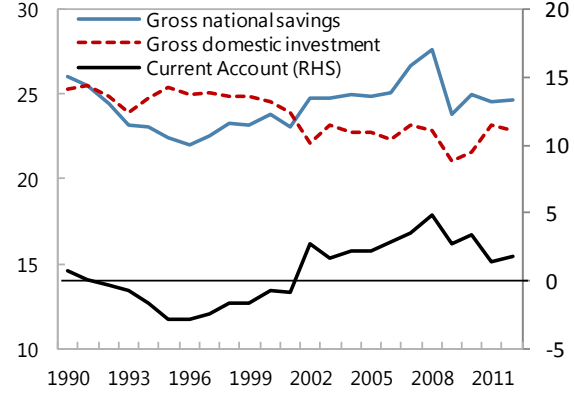
Trade with Germany is dominant.

**Geographic Composition of Trade in Goods and Services, 2012**  
(Percent of Total)



Lower investment and higher savings pushed up the CA...

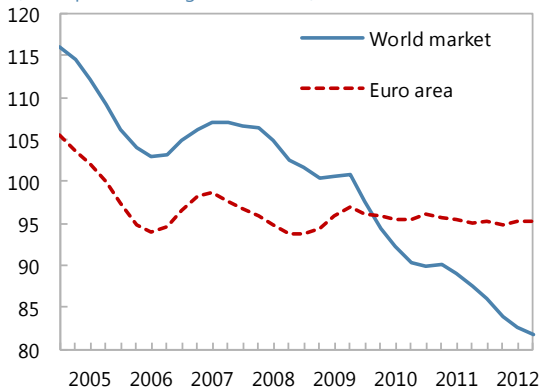
**Savings, Investment, Current Account**  
(Percent of GDP)



...while market share in EA has been stable.

**Export Market Shares**

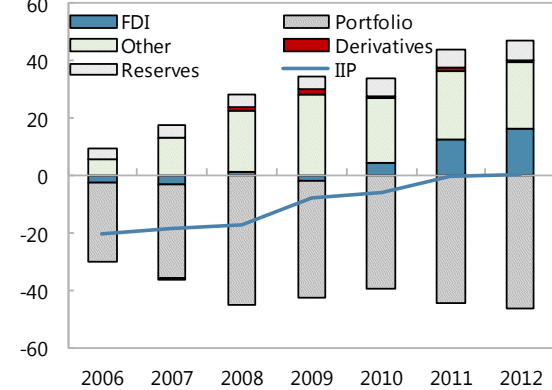
(Four-quarter average; 2001 = 100)



The IIP is in balance for the first time.

**International Investment Position**

(Percent of GDP)



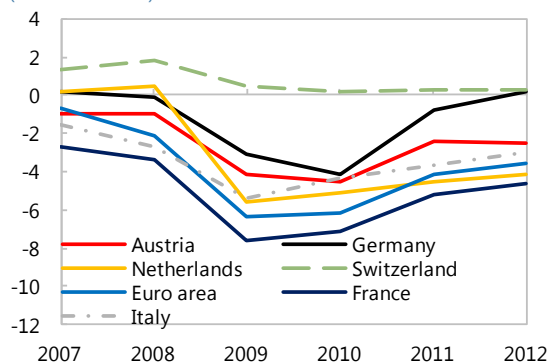
Sources: Austrian National Bank; Eurostat; Haver; and IMF staff calculations.

**Figure 4. Austria: Fiscal Developments and Outlook**

The fiscal deficit has fallen...

**Fiscal Balances**

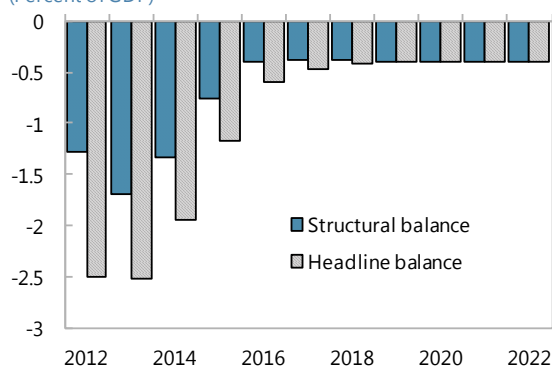
(Percent of GDP)



Assuming no further bank restructuring cost, full implementation of the authorities' consolidation plans...

**Headline and Structural Balance 1/ 2/**

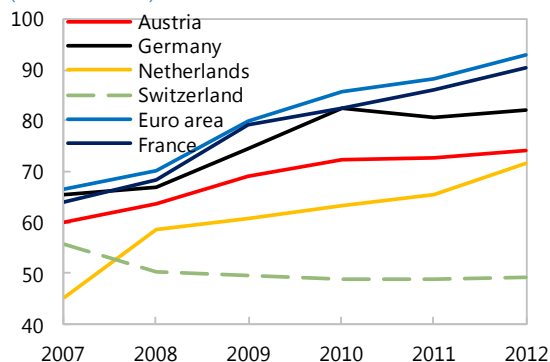
(Percent of GDP)



...but debt has not yet peaked.

**General Government Debt**

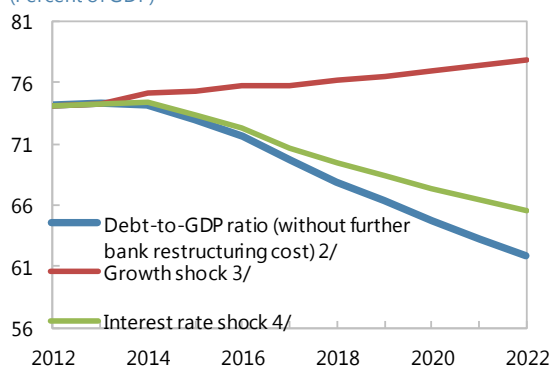
(Percent of GDP)



...would bring debt on a downward trajectory unless there is a protracted period of low growth.

**Debt dynamics**

(Percent of GDP)



Sources: Austrian authorities; WEO; and IMF staff calculations and projections.

1/ The structural balance excludes revenue from the 2012 tax treaty with Switzerland and the following bank restructuring cost (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; budgeted 0.4 in 2013.

2/ Authorities' consolidation plans fully implemented; with staff macroeconomic baseline projections.

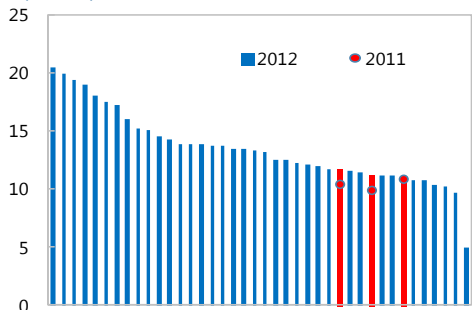
3/ Authorities' consolidation plans fully implemented; compared to staff baseline projections, 1/4 ten-year standard deviation lower real GDP growth (and 1/4 pp lower inflation) from 2014 onwards.

4/ Authorities' consolidation plans fully implemented; compared to staff baseline projections, 200 bps higher sovereign interest rate from 2014 onwards.

**Figure 5. Austria: Banking Sector**

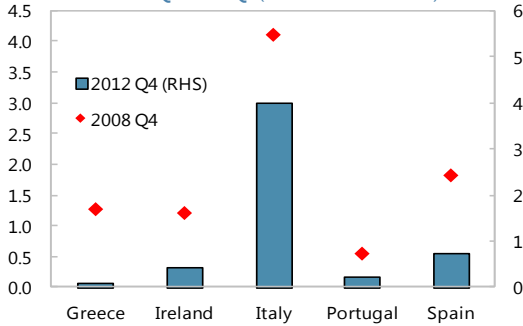
Bank capital ratios are improving...

**Selected Large European Banks: Tier I Ratio 2011-2012**  
(Percent) 1/



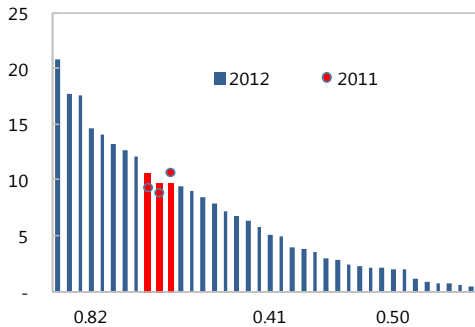
Banks have little exposure to euro area sovereigns under market pressure...

**Austria: Banks' Foreign Claims on Selected Euro Area Countries 2011:Q4-2012:Q4**  
(Percent of 2012 GDP)



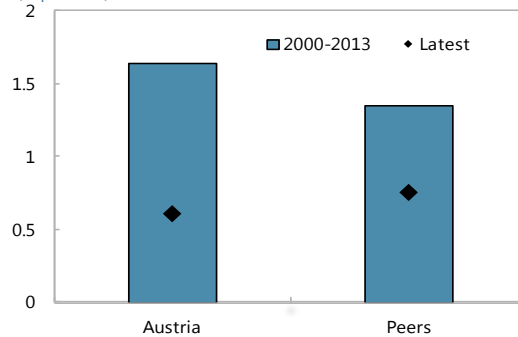
...contributing to a pickup in consolidated NPLs...

**Selected Large European Banks: Nonperforming loans ratio, 2011-2012** (Percent) 1/



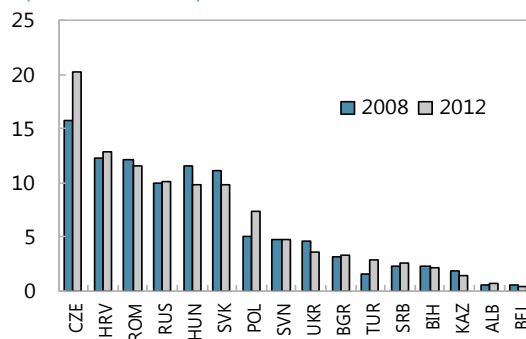
...but market valuations have fallen relative to peers.

**Price to book ratio of Austrian Banks**  
(In percent)



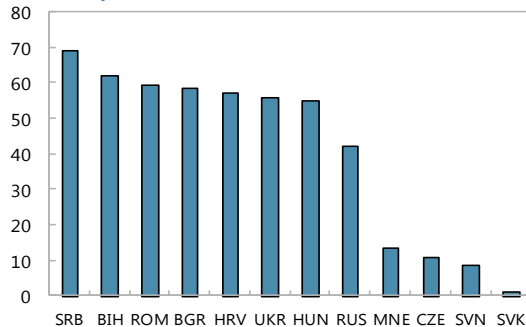
...but carry significant exposure to CESEE and CIS countries...

**CESEE Exposures**  
(Percent of 2012 GDP)



...in part, due to legacy foreign currency lending.

**Proportion of Foreign Currency Loans on Austrian Banks' CESEE Exposure**



Sources: OeNB; Bloomberg; SNL Financial; BIS consolidated banking statistics; and IMF staff calculations.  
1/ Austrian banks are shown in red and non-Austrian banks are shown in blue. The set of "large European banks" includes 2 Belgian banks, 1 Danish bank, 5 French banks, 5 German banks, 5 Italian banks, 2 Dutch banks, 1 Norwegian bank, 5 Spanish banks, 4 Swedish banks, 2 Swiss banks, and 5 British banks.

**Table 1. Austria: Selected Economic Indicators, 2007–14**

Total area	83,850 square kilometers							
Total population (2012)	8.5 million							
GDP per capita (2012)	US\$ 46,642 (36,264 Euro)							
	2007	2008	2009	2010	2011	2012	2013	2014
	Projections							
	(change in percent unless indicated otherwise)							
Demand and supply								
GDP	3.7	1.4	-3.8	1.8	2.8	0.9	0.4	1.6
Total domestic demand	2.5	0.7	-2.0	1.4	3.2	0.1	0.2	1.5
Consumption	1.2	1.6	0.9	1.5	0.7	0.4	0.5	1.1
Gross fixed capital formation	3.6	0.7	-7.8	-1.4	8.5	1.6	-0.3	2.5
Net exports (growth contribution in pp)	1.4	0.8	-2.2	0.6	-0.1	0.9	0.2	0.2
Exports of goods and nonfactor services	8.9	1.4	-15.6	9.4	6.6	1.2	1.9	4.5
Imports of goods and nonfactor services	7.1	0.0	-13.6	9.1	7.6	-0.3	1.6	4.7
Output gap (percent of potential GDP)	3.3	3.2	-2.1	-1.8	-0.3	-0.7	-1.6	-1.3
Unemployment (in percent; Eurostat definition)	4.4	3.8	4.8	4.4	4.2	4.3	4.9	4.8
Prices								
Consumer price index (period average)	2.2	3.2	0.4	1.7	3.6	2.6	2.1	1.8
General government finances (percent of GDP)								
Revenue	47.6	48.3	48.5	48.3	48.3	49.1	49.1	48.7
Expenditure	48.6	49.3	52.6	52.8	50.7	51.7	51.7	51.1
Balance (EDP-definition)	-0.9	-0.9	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4
Structural Balance <sup>1/</sup>	-2.5	-2.4	-3.0	-3.0	-2.1	-1.3	-1.7	-1.7
Gross debt (end of period)	60.2	63.8	69.2	72.3	72.8	74.1	74.3	74.7
Balance of payments								
Current account (percent of GDP)	3.5	4.9	2.7	3.4	1.4	1.8	2.2	2.2

1/ The structural balance excludes revenue from the 2012 tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following capital transfers to banks (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; and budgeted 0.4 in 2013.

Sources: Austrian authorities; and IMF staff estimates and projections.

Table 2. Austria: Medium-Term Macroeconomic Framework, 2007–18

	(in percent of GDP unless indicated otherwise)											
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Projections											
National accounts												
GDP (growth in percent)	3.7	1.4	-3.8	1.8	2.8	0.9	0.4	1.6	1.8	1.7	1.5	1.4
Total domestic demand	2.5	0.7	-2.0	1.4	3.2	0.1	0.2	1.5	1.7	1.6	1.4	1.2
Consumption	1.2	1.6	0.9	1.5	0.7	0.4	0.5	1.1	1.2	1.2	1.2	1.2
<i>of which</i> : Private consumption	0.9	0.7	0.9	2.0	0.8	0.5	0.3	1.1	1.2	1.1	1.1	1.1
Gross fixed capital formation	3.6	0.7	-7.8	-1.4	8.5	1.6	-0.3	2.5	3.2	2.9	2.1	1.7
Exports of goods and nonfactor services	8.9	1.4	-15.6	9.4	6.6	1.2	1.9	4.5	4.8	5.2	5.5	5.9
Imports of goods and nonfactor services	7.1	0.0	-13.6	9.1	7.6	-0.3	1.6	4.7	5.1	5.3	5.8	6.1
Growth contributions (percentage points)												
Final domestic demand	1.6	1.2	-1.0	0.8	2.2	0.7	0.3	1.3	1.6	1.5	1.3	1.2
Net exports	1.4	0.8	-2.2	0.6	-0.1	0.9	0.2	0.2	0.2	0.3	0.2	0.3
Inventories and statistical discrepancies	0.7	-0.6	-0.6	0.3	0.8	-0.7	-0.1	0.1	0.0	0.0	0.0	0.0
Prices and unemployment												
CPI inflation (pa; annual percent change)	2.2	3.2	0.4	1.7	3.6	2.6	2.1	1.8	1.8	1.8	1.8	1.8
Unemployment rate (percent)	4.4	3.8	4.8	4.4	4.2	4.3	4.9	4.8	4.6	4.4	4.2	4.2
Current account balance												
Goods and services balance	4.5	4.8	3.7	3.5	2.1	2.5	2.9	3.0	3.1	3.1	3.1	3.1
General government accounts												
Revenue	47.6	48.3	48.5	48.3	48.3	49.1	49.1	48.7	48.7	48.7	48.7	48.7
Expenditure	48.6	49.3	52.6	52.8	50.7	51.7	51.7	51.1	50.6	50.3	50.1	50.1
Balance	-1.0	-1.0	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Gross debt	60.2	63.8	69.2	72.3	72.8	74.1	74.3	74.7	74.3	73.8	72.8	72.0
Structural balance <sup>1/</sup>	-2.5	-2.4	-3.0	-3.0	-2.1	-1.3	-1.7	-1.7	-1.5	-1.4	-1.4	-1.4
Memorandum items:												
Overall balance (EDP-definition)	-0.9	-0.9	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Gross national saving	26.6	27.7	23.7	24.5	24.4	24.5	24.6	25.0	25.3	25.6	25.8	25.9
Gross domestic investment	23.1	22.8	21.0	21.1	23.0	22.7	22.4	22.7	23.0	23.3	23.5	23.5
Potential output (growth in percent)	1.7	1.6	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Output gap (in percent of potential output)	3.3	3.2	-2.1	-1.8	-0.3	-0.7	-1.6	-1.3	-0.8	-0.4	-0.2	0.0
GDP (current prices, in billion euro)	274.0	282.7	276.2	285.2	299.2	307.0	315.5	326.2	338.0	349.6	360.9	372.2

Sources: Austrian authorities; and IMF staff estimates and projections.

<sup>1/</sup> The structural balance excludes revenue from the 2012 tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following capital transfers to banks (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; and budgeted 0.4 in 2013.

**Table 3. Austria: Balance of Payments, 2007–18**

(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
							Projections					
Current account	3.5	4.9	2.7	3.4	1.4	1.8	2.2	2.2	2.3	2.4	2.3	2.4
Trade	4.5	4.8	3.7	3.5	2.1	2.5	2.9	3.0	3.1	3.1	3.1	3.1
Exports	57.8	58.3	49.3	53.5	56.3	56.5	56.6	57.6	58.7	60.1	62.0	64.3
Imports	53.2	53.5	45.6	50.0	54.2	54.0	53.7	54.6	55.6	57.0	58.9	61.2
Goods	0.5	-0.2	-0.9	-1.1	-2.5	-2.3	-2.1	-2.0	-2.0	-2.1	-2.3	-2.4
Exports	43.3	43.0	35.1	39.1	41.6	41.0	40.6	41.4	42.5	43.6	45.1	47.0
Imports	42.9	43.2	36.0	40.2	44.1	43.2	42.7	43.5	44.4	45.7	47.3	49.3
Nonfactor services	4.1	5.0	4.6	4.6	4.6	4.8	5.0	5.0	5.0	5.3	5.4	5.5
Exports	14.5	15.3	14.2	14.4	14.7	15.6	16.0	16.1	16.2	16.5	16.9	17.4
Imports	10.4	10.3	9.6	9.8	10.1	10.8	11.0	11.1	11.2	11.3	11.5	11.9
Balance on factor income	-0.6	0.6	-0.4	0.6	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Current transfers, net	-0.4	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Capital and financial accounts	-4.1	-5.3	-3.6	-1.1	-1.4	-1.8	-2.2	-2.2	-2.3	-2.4	-2.3	-2.4
Capital account, net	0.1	0.0	0.0	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
FDI, net	-2.0	-5.4	0.0	-2.6	-3.6	-3.1	-3.0	-2.9	-2.8	-2.8	-2.8	-2.8
Portfolio investment, net	8.3	9.4	-2.5	-2.4	5.4	1.9	2.4	2.4	2.4	2.4	2.4	2.4
Financial derivatives	-0.3	0.1	0.2	-0.1	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Other	-9.5	-9.5	-2.1	4.3	-3.1	-0.4	-1.5	-1.7	-1.9	-1.9	-1.9	-1.9
Reserve assets	-0.7	0.2	0.9	-0.4	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.6	0.4	0.9	-2.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Austrian National Bank; WIFO; and IMF staff projections.

**Table 4. Austria: General Government Operations, 2007–18**

(In percent of GDP, unless indicated otherwise)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Projections											
Revenue	47.6	48.3	48.5	48.3	48.3	49.1	49.1	48.7	48.7	48.7	48.7	48.7
Taxes	27.3	28.1	27.3	27.3	27.4	28.0	28.2	27.9	28.0	28.1	28.1	28.1
Indirect taxes	13.9	14.1	14.6	14.5	14.4	14.6	14.5	14.3	14.3	14.3	14.3	14.3
Direct taxes	13.3	14.0	12.7	12.8	13.0	13.4	13.8	13.6	13.7	13.8	13.8	13.8
Social contributions	15.7	15.9	16.5	16.3	16.3	16.6	16.4	16.4	16.4	16.4	16.4	16.3
Other current revenue	4.7	4.4	4.6	4.7	4.6	4.6	4.5	4.4	4.3	4.3	4.2	4.3
Expense	48.7	49.4	52.7	52.9	50.7	51.7	51.7	51.1	50.6	50.3	50.1	50.1
Compensation of employees	9.0	9.2	9.8	9.8	9.5	9.5	9.4	9.3	9.2	9.2	9.2	9.2
Goods and services	4.2	4.5	4.7	4.5	4.3	4.3	4.3	4.3	4.2	4.2	4.1	4.1
Interest	2.9	2.7	2.8	2.7	2.6	2.6	2.4	2.4	2.4	2.4	2.4	2.3
Subsidies	3.3	3.5	3.5	3.5	3.4	3.5	3.6	3.6	3.5	3.4	3.3	3.3
Social benefits	23.2	23.6	25.4	25.5	24.7	25.0	25.3	25.4	25.3	25.2	25.2	25.2
Other expense	6.1	6.0	6.5	7.1	6.2	6.7	6.7	6.2	6.0	6.0	6.0	6.0
Net operating balance	-1.1	-1.1	-4.2	-4.6	-2.5	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Net acquisition of non-financial assets	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / Net borrowing	-1.0	-1.0	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Net acquisition of financial assets	0.7	4.1	-0.6	0.6	1.6	1.1	...	...	...	...	...	...
Net incurrence of liabilities	1.9	5.3	3.9	5.4	4.1	3.5	...	...	...	...	...	...
Statistical Discrepancy	0.1	0.2	0.4	0.3	0.1	-0.1	...	...	...	...	...	...
Memorandum item:												
Overall balance (EDP-definition)	-0.9	-0.9	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4	-2.0	-1.6	-1.5	-1.5
Primary balance	1.9	1.7	-1.3	-1.8	0.2	0.1	-0.2	0.0	0.4	0.8	0.9	0.8
Structural balance <sup>1/</sup>	-2.5	-2.4	-3.0	-3.0	-2.1	-1.3	-1.7	-1.7	-1.5	-1.4	-1.4	-1.4
Change in structural balance	-0.1	0.1	-0.6	0.0	1.0	0.8	-0.5	0.0	0.2	0.1	0.0	0.0
Public debt	60.2	63.8	69.2	72.3	72.8	74.1	74.3	74.7	74.3	73.8	72.8	72.0

Sources: Authorities, Eurostat, and IMF staff projections.

<sup>1/</sup> The structural balance excludes revenue from the 2012 tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following capital transfers to banks (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; and budgeted 0.4 in 2013.



**Table 5. Austria: General Government Balance Sheet, 2007–12**

(In billions of Euro)

	2007	2008	2009	2010	2011	2012
Net worth	...	...	...	...	...	...
Nonfinancial assets	...	...	...	...	...	...
Net financial worth	-86	-98	-111	-126	-139	-157
Financial assets	88	95	93	98	102	105
Currency & deposits	12	21	12	12	15	14
Securities other than shares	7	7	8	8	8	8
Loans	23	24	24	24	26	30
Shares and other equity	38	37	42	46	44	46
Insurance technical reserves	0	0	0	0	0	0
Financial derivatives	3	0	1	1	1	0
Other accounts receivable	6	6	6	7	7	8
Liabilities 1/	174	193	204	224	240	263
Securities other than shares	141	161	169	186	197	217
Loans	27	26	30	34	39	42
Shares and other equity	0	0	0	0	0	0
Insurance technical reserves	0	0	0	0	0	0
Financial derivatives	3	3	3	2	1	1
Other accounts payable	2	2	2	2	3	3

Sources: Statistical Office of Austria and Eurostat.

1/ At market value

**Table 6. Austria: Financial Soundness Indicators, 2008–12**

	(Percent)				
	2008	2009	2010	2011	2012
<b>Capital adequacy</b>					
Regulatory capital to risk-weighted assets 1/	12.9	15.0	15.4	15.8	17.0
Regulatory Tier I capital to risk-weighted assets 1/	9.3	11.1	11.7	12.0	12.9
Capital to assets (percent) 2/	6.3	7.0	7.5	7.2	7.8
Large exposures to capital 2/	67.6	55.5	64.8	62.9	59.1
Nonperforming loans net of loan-loss provisions to capital 2/	8.6	6.3	8.2	8.0	6.9
<b>Asset quality</b>					
Nonperforming loans to total gross loans 2/	1.9	2.3	2.8	2.7	2.8
Sectoral distribution of loans to total loans 3/					
Residents	67.4	68.7	70.0	70.0	70.5
Deposit-takers	28.1	27.7	25.2	25.4	23.6
Central bank	1.0	1.4	1.4	2.0	2.6
Other financial corporations	3.2	3.2	3.2	2.9	2.8
General government	3.1	3.4	3.8	4.0	4.0
Nonfinancial corporations	16.6	16.9	18.4	18.1	18.9
Other domestic sectors	15.4	16.2	18.1	17.7	18.6
Nonresidents	32.6	31.3	30.0	30.0	29.5
<b>Geographical distribution of loans to total loans 2,3/</b>					
Domestic economy	67.4	68.7	70.0	70.0	70.5
Advanced economies, excluding China	12.1	15.4	13.7	14.5	14.6
Emerging market and developing countries, including China	20.5	15.9	16.3	15.6	14.9
Africa	0.1	0.1	0.1	0.1	0.1
of which: Sub-Saharan Africa	0.0	0.1	0.1	0.1	0.1
Central and Eastern Europe	16.3	13.0	13.2	12.6	12.2
Commonwealth of Independent States and Mongolia	3.2	2.0	2.1	2.0	1.9
Developing Asia, including China	0.2	0.4	0.4	0.4	0.5
Middle East	0.4	0.4	0.4	0.3	0.1
Western Hemisphere	0.3	0.1	0.1	0.1	0.1
<b>Earnings and profitability 1/</b>					
Return on assets	0.1	0.1	0.5	0.1	0.3
Return on equity	2.6	1.5	7.9	1.4	5.5
Net interest income to gross income	64.6	69.7	67.4	63.3	59.3
Noninterest expenses as a percentage of gross income	90.4	86.0	83.0	87.4	84.4
<b>Liquidity 2/</b>					
Liquid assets to total assets	26.8	26.1	23.5	25.4	24.8
Liquid assets to short-term liabilities	69.7	76.2	68.0	71.6	73.4
Net open position in foreign exchange to capital	1.6	0.6	0.3	0.1	0.4
<b>Other FSIs 2/</b>					
Gross asset position in derivatives as a percentage of tier 1 capital	n.a.	n.a.	n.a.	n.a.	n.a.
Gross liability position in derivatives as a percentage of tier 1 capital	n.a.	n.a.	n.a.	n.a.	n.a.
Trading income as a percentage of gross income	-4.0	2.8	3.4	1.7	3.3
Personnel expenses as a percentage of noninterest expenses	50.6	51.4	50.2	51.2	51.2
Spread between reference lending and deposit rates (basis points)	232.0	191.0	197.0	208.0	180.0
Spread between highest and lowest interbank rates (basis points)	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign currency-denominated loans to total loans	25.6	22.4	22.1	21.4	19.7
Foreign currency-denominated liabilities to total liabilities	19.4	14.4	11.3	12.0	10.6
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: OeNB; and fsi.imf.org.  
1/ Domestically controlled, cross-border and cross sector consolidation basis  
2/ Domestic consolidation basis  
3/ Total loans include loans to financial institutions

<b>Table 7. Austria: Authorities' Response to Past IMF Policy Recommendations</b> (Scale—fully consistent, broadly consistent, or marginally consistent)	
<b>IMF 2012 Article IV Recommendations</b>	<b>Authorities' Response</b>
<p><b>Fiscal policy I</b></p> <p>Strictly implement fiscal consolidation plan in structural terms by further specifying measures for savings in health care and subsidies; and develop contingency plans for revenue risks and potential new outlays, in particular from bank restructuring.</p>	<p><b>Broadly consistent</b></p> <p>Favorable budgetary outcome in 2012, but specification of some medium-term savings still work in progress. Expected further bank restructuring cost not yet taken into account in medium-term budgetary planning.</p>
<p><b>Fiscal policy II</b></p> <p>Decide on further expenditure reforms to anchor sustainability in the medium and long run.</p>	<p><b>Marginally consistent</b></p> <p>No further reform plans at the moment.</p>
<p><b>Fiscal policy III</b></p> <p>Streamline intergovernmental fiscal relations and create stronger nexus between spending and financing responsibilities at the subnational level.</p>	<p><b>Marginally consistent</b></p> <p>No substantial progress.</p>
<p><b>Financial sector policy I</b></p> <p>Dispose more efficiently of legacy assets in restructuring banks to minimize final fiscal cost.</p>	<p><b>Marginally consistent</b></p> <p>Pertinent strategy still outstanding for main problem bank; one bad bank still has banking license; some progress in the troubled apex institution of one banking group.</p>
<p><b>Financial sector policy II</b></p> <p>Implement macroprudential measures to address risks posed by systemically important banks.</p>	<p><b>Fully consistent</b></p> <p>New macroprudential guidelines for internationally active banks are being implemented, and capital strengthening is actively encouraged.</p>
<p><b>Financial sector policy III</b></p> <p>Put a new early intervention and bank resolution framework in place.</p>	<p><b>Broadly consistent</b></p> <p>Recent legislation covers early intervention, but falls short of FSAP recommendations in a number of areas, while no initiative is in the works for resolution yet.</p>
<p><b>Structural reforms I</b></p> <p>Increase the employment of older worker through robust implementation of already decided reforms and further reform steps.</p>	<p><b>Broadly consistent</b></p> <p>Already decided reforms are gradually being implemented but there are no new reform plans, such as for an advanced increase of the female retirement age.</p>
<p><b>Structural reforms II</b></p> <p>Reduce tax burden on labor in a budget-neutral way.</p>	<p><b>Marginally consistent</b></p> <p>Tax and social security contribution wedges still to be addressed.</p>

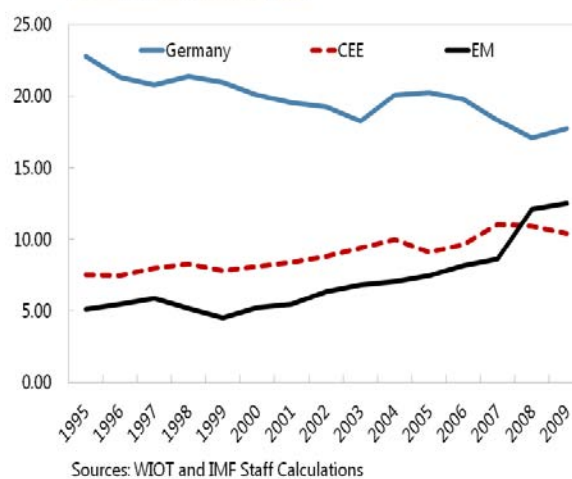
## Annex I. Austria and Germany: Have the Linkages Weakened?<sup>1</sup>

The Austrian economy has traditionally had close ties with Germany, fostered by geographical proximity and a common language. After the fall of the Berlin wall both countries have increasingly looked east for economic growth opportunities through trade and foreign investment. Austria, in particular, was especially well positioned to take advantage of these new opportunities because of its location at the center of Europe, its historic connections to Central and Eastern Europe (CEE), and its commercial ties with neighboring Eastern countries during the Cold War.

In this paper, we examine whether closer integration with CEE has weakened the connection between the Austrian and German economies as measured by business cycle co-movement.<sup>2</sup> This may not necessarily be the case, as the growth of the CEE as a trading partner may have occurred at the expense of trading partners other than Germany, CEE countries themselves may have become more integrated with Germany, or global shocks may have become more dominant and thus economies have become more synchronized in general.

Germany is by far Austria's largest trading partner, accounting for more than 30 percent of Austria's exports and over 40 percent of Austria's imports. To better gauge how Germany-specific shocks may affect Austrian GDP it is preferable to consider exports by final consumption rather than total exports. This measures the share of Austrian exports that go to satisfy German demand rather than demand in third countries through further processing and re-export. This share has actually decreased somewhat over time, and stood below 20 percent in 2009. On the other hand, the share of exports by final consumption to CEE countries has increased over time, reaching around 10 percent in 2009.

**Share of Austria Exports by Final Consumption**  
(Percent of total Austrian exports)



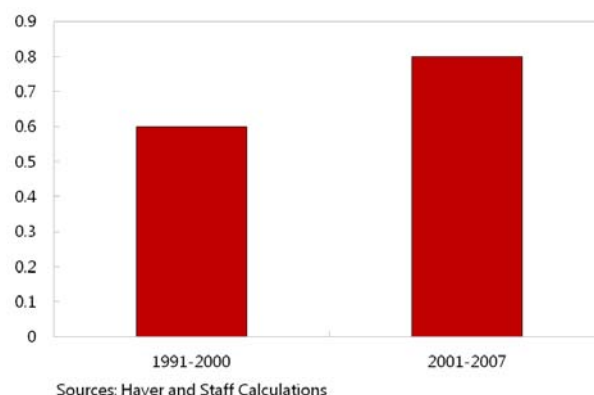
<sup>1</sup> Prepared by Ehsan Ebrahimi

<sup>2</sup> Countries included in the CEE sample in the Annex are the following: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Romania, Poland, Slovakia, and Slovenia. Lack of quarterly GDP data precludes the inclusion of additional Southeastern European countries.

Turning to business cycle synchronization, the degree of co-movement between Austria and Germany is high and has increased significantly over time, from 60 percent in the 1990s to 80 percent in the following decade.<sup>3</sup> Therefore, even though exports by final demand to Germany have become somewhat less important, business cycle synchronization has increased substantially.

Several explanations may be considered to reconcile the two seemingly contradictory facts above. One possibility is that higher synchronization was the result of the introduction of the euro in 1999. However, the Austrian currency was pegged to the German one for many years before the euro was introduced, so this explanation is not convincing. Another possibility is the increased importance of regional or global shocks in driving the Austrian business cycle. If this is the case, then we would expect to see a similar increase in correlation between Austria's GDP and that of other large advanced European countries, which are also presumably affected by regional or global shocks. However, this is not evident from the data.

Business Cycle Correlation: Austria and Germany



Cyclical Correlation	1991-2000	2001-2007
Austria - Germany	0.60	0.80
Austria - Italy	0.51	0.80
Austria - France	0.90	0.77
Austria - U.K.	0.18	-0.22
Austria - U.S.	0.66	0.00
Austria - Japan	-0.20	0.10
Austria - Netherland	0.78	0.82
Austria - Spain	0.83	0.74

Another possibility is that the change reflects a German idiosyncratic element, for instance the economic effects of German reunification in the early 1990s, which might have temporarily moved Germany "off cycle" in the 1990s. If this was the case, then we would expect to see an increase in business cycle synchronization between Germany and other advanced European countries, not just between Germany and Austria. Again, this is not evident from the data.

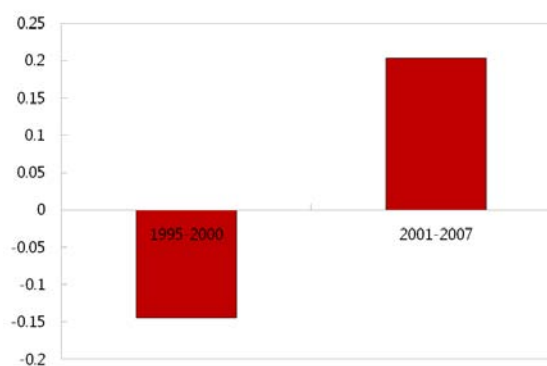
<sup>3</sup> The correlation is measured using HP-filtered quarterly GDP data. Results are the same if we extend the period to include the crisis years of 2008-2013. In fact the correlations appear stronger in the crisis time due to strong global shocks.

Cyclical Correlation	1991-2000	2001-2007
Germany - Austria	0.60	0.80
Germany - Italy	0.73	0.84
Germany - France	0.74	0.76
Germany - U.K.	0.42	-0.16
Germany - U.S.	0.43	-0.25
Germany - Japan	0.20	0.03
Germany - Netherland	0.65	0.88
Germany - Spain	0.67	0.79

Yet another possibility is that German cyclical movements are transmitted to Austria through third countries such as the CEE. In fact, the business cycle correlation of Germany and CEE countries has increased significantly after 2000, though it remains much lower than with Austria.

More generally, it may also be that being part of the same supply chain results in higher business cycle synchronization between the two countries, despite the falling share of exports by final consumption. In fact, the recent IMF study of the German supply chain finds that business cycle synchronization with Germany is an increasing function of the share of German value added in total exports, a measure of supply chain integration.<sup>4</sup> This share for Austria was 8.6 percent in 2009, the second highest after the Czech Republic.

Business Cycle Correlation: Germany and CEE



Sources: Haver and Staff Calculations

In conclusion, the evidence suggests that Austria's ties with Germany have strengthened over time. This has happened despite the growing linkages between Austria and CEE countries. As the German economy has been relatively stable during the recent crisis years, this close connection has likely been a stabilizing factor for Austria.

<sup>4</sup> See German-Central European Supply Chain Cluster Report, by B. Augustyniak, C. Ebeke, N. Klein and H. Zhao (IMF, EUR Department), July 2013.



# AUSTRIA

August 16, 2013

## STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

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## FUND RELATIONS

(As of June 30, 2013)

**Mission:** Consultation discussions were held in Vienna from June 21 to July 1, 2013. The authorities released the mission's concluding statement, which is available at:

<http://www.imf.org/external/np/ms/2013/070113.htm>

**Staff team:** Ms. Detragiache (head), Messrs. Ebrahimi and Steinlein (all EUR) and Mr. Saiyid (MCM). Mr. Prader, Executive Director for Austria, and Mr. Just (OED) attended the meetings.

**Country interlocutors:** Central Bank Governor Nowotny, Minister of Labor Hundstorfer, State Secretary for Finance Schieder, members of Parliament, and representatives of the social partners, the financial sector, and economic research institutes.

**Fund relations:** Austria is on a 12-month consultation cycle. The last consultations were held June 22-July 2, 2012, and the staff report is available at:

<http://www.imf.org/external/pubs/cat/longres.aspx?sk=26223.0>

**Membership Status:** Joined: August 27, 1948; Article VIII, as of August 1, 1962

<b>General Resources Account:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Quota	2,113.90	100.00
Fund holdings of currency	1,495.53	70.75
Reserve position in Fund	618.40	29.25
Lending to the Fund:		
New Arrangements to Borrow	485.10	

<b>SDR Department:</b>	<b>SDR Million</b>	<b>Percent Allocation</b>
Net cumulative allocation	1,736.31	100.00
Holdings	1,607.82	92.60

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:** None



**Projected Payments to Fund:**

(SDR Million; based on existing use of resources and present holdings of SDRs):

	<b><u>Forthcoming</u></b>				
	<b><u>2013</u></b>	<b><u>2014</u></b>	<b><u>2015</u></b>	<b><u>2016</u></b>	<b><u>2017</u></b>
Principal	--	--	--	--	--
Charges/Interest	0.05	0.11	0.11	0.11	0.11
Total	<u>0.05</u>	<u>0.11</u>	<u>0.11</u>	<u>0.11</u>	<u>0.11</u>

**Implementation of HIPC Initiative:** Not Applicable

**Exchange System:**

As of January 1, 1999, the currency of Austria is the euro, which floats freely and independently against other currencies. Austria's exchange system is free of restrictions on the making of payments and transfers for current international transactions, with the exception of restrictions notified to the Fund in accordance with decision No.144-(52/51) resulting from UN Security Council Resolutions and EU Council Regulations.

## STATISTICAL ISSUES

- 1. Macroeconomic statistics are adequate for surveillance.** Austria subscribed to the Fund's Special Data Dissemination Standard (SDDS) in 1996, and its metadata are available on the Fund's electronic Dissemination Standards Bulletin Board. Austria is availing itself of the SDDS flexibility option on the timeliness of the industrial production index and the merchandise trade data.
- 2. The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB.** The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the IFS and IFS Supplement.

## Austria: Table of Common Indicators

(as of July 30, 2013)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	07/29/13	07/30/13	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	June 2013	07/20/13	Monthly	Monthly	Monthly
Reserve/Base Money	June 2013	07/30/13	Monthly	Monthly	Monthly
Broad Money	June 2013	07/30/13	Monthly	Monthly	Monthly
Central Bank Balance Sheet	June 2013	07/15/13	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	June 2013	07/30/13	Monthly	Monthly	Monthly
Interest Rates <sup>2</sup>	07/29/13	07/30/13	Daily	Daily	Daily
Consumer Price Index	June 2013	07/14/13	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2013:Q1	06/30/13	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	June 2013	07/30/13	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	June 2013	07/30/13	Monthly	Monthly	Monthly
External Current Account Balance	2013:Q1	06/30/13	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	2013:Q1	06/30/13	Quarterly	Quarterly	Quarterly
GDP/GNP	2013:Q1	06/11/13	Quarterly	Quarterly	Quarterly
Gross External Debt <sup>5</sup>	2013:Q1	06/30/13	Quarterly	Quarterly	Quarterly
International Investment Position	2013:Q1	06/30/13	Quarterly	Quarterly	Quarterly

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.



INTERNATIONAL MONETARY FUND



Press Release No.13/331  
FOR IMMEDIATE RELEASE  
September 10, 2013

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Concludes 2013 Article IV Consultation with Austria**

On September 4, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.<sup>1</sup>

Austria remains an area of relative strength in the European landscape, but the economy is being affected by the regional slowdown, with growth in 2012 falling to 0.9 percent, from 2.8 percent in 2011. Both external and domestic demand components have been weak, reflecting developments in main trading partners, investment uncertainty, an unwillingness of households to further reduce their savings rate, and fiscal consolidation. While employment growth remained relatively strong in 2012, labor market conditions are now weakening. As a consequence, unemployment has gradually increased, but remains low. Inflation fell from its 2011 peak of 3.6 percent to 2.6 percent in 2012 and stood at 2.2 percent in June 2013, with comparatively high price growth in the services sector. Wage increases in 2012 exceeded inflation only slightly, leading to modest real wage growth.

The current account is showing a modest surplus, which has fallen considerably from its pre-crisis level of almost 5 percent of GDP in 2008 and amounted to 1.8 percent of GDP in 2012, with a deficit in goods more than offset by a surplus in services. The real effective exchange rate has appreciated somewhat in 2012, reflecting the positive inflation differential with major trading partners.

Prospects are for a gradual recovery for the remainder of 2013 and 2014, consistent with the modest pick-up in external demand suggested by some high frequency indicators, a subsequent recovery in investment activity, some catching-up of private consumption on the back of modest growth in real wages and disposable income, and fiscal expansion in 2013.

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<sup>1</sup>Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

On the back of broad-based underspending (including on interest cost) and overperforming labor taxes, the headline and structural deficit amounted to respectively 2.5 and 1.3 percent of GDP in 2012. Given last year's favorable outcome, the 2013 budget now implies a structural expansion. Gradual adjustment is planned to resume in 2014, and a structural deficit of 0.45 percent is targeted for 2016, in compliance with Austria's new fiscal rule framework. Gaps in expenditure efficiency remain considerable, and the fiscal burden on labor is heavy.

Financial stability and related policies were recently evaluated under the IMF's Financial Sector Assessment Program (FSAP). The FSAP noted that Austria's large banking system, which plays a dominant role in Central, Eastern and South-Eastern Europe (CESEE), appears resilient to adverse scenarios on the whole. Aggregate bank capitalization, funding and liquidity conditions have improved, and Austrian banks' foreign subsidiaries have reduced their reliance on parent bank funding. Nevertheless, bank asset quality is still deteriorating in several CESEE countries, while depressed credit demand is hurting profitability. Adverse spillovers from Austria to the CESEE through deleveraging have been contained thus far. A group of intervened medium-sized banks face uncertain prospects and pose significant but manageable fiscal risks.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors commended the authorities for their prudent macroeconomic management, which has helped maintain healthy macroeconomic fundamentals in a challenging global environment, and welcomed prospects of a gradual economic recovery. Directors noted the risks arising from volatile global financial markets, lingering uncertainties in the euro area, and vulnerabilities in CESEE countries where Austrian banks have large exposures. Against this background, Directors concurred that the post-election agenda should focus on further enhancing financial sector resilience, strengthening public finances, and boosting potential growth.

Directors welcomed the strong fiscal performance in 2012 and considered the mildly expansionary stance envisaged in the 2013 budget as appropriate. They stressed, however, that the recently-announced stimulus package should be financed within the existing envelope and encouraged the authorities to identify specific measures needed to achieve the consolidation planned for the medium term.

Directors noted that bank restructuring will have further significant, though manageable, fiscal costs. They recommended compensating for these costs by gradually strengthening

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<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

medium-term fiscal adjustment. Directors agreed that a faster downsizing of non-viable entities and disposal of troubled assets would help contain bank restructuring costs.

Directors underscored that further reforms remain necessary to make public spending more efficient, especially in the areas of pensions, health care, and subsidies. In addition, they emphasized that better aligned spending powers and financing responsibilities in the federal system would facilitate expenditure rationalization. Directors noted that expenditure savings could be used to address low work incentives, particularly for women and low-skilled workers, which are hampered by high labor taxes and social security contributions as well as a complex and costly family benefit system. Some Directors stressed the need for a comprehensive approach to this issue.

Directors welcomed the overall results of the FSAP. Notwithstanding the overall system resilience to shocks, they recommended that large internationally active banks be encouraged to strengthen their capital buffers. Directors stressed the need to reinforce financial oversight and promote better risk management and governance practices, especially in the small- and medium-sized bank segment, to prevent a recurrence of past problems.

To further reduce the potential for adverse feedbacks between bank and sovereign risk and possible associated spillovers, Directors advised comprehensive reforms, including a strengthened framework for early intervention and resolution, a bank resolution fund, and a unified, publicly administered, and pre-funded deposit insurance scheme. While many Directors underscored the urgency of new legislation on these topics, a number drew attention to the need for consistency with the forthcoming EU directives. Directors welcomed recent progress in strengthening the macroprudential framework.

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### Austria: Selected Economic Indicators, 2007–14

Total area	83,850 square kilometers								
Total population (2012)	8.5 million								
GDP per capita (2012)	US\$ 46,642 (36,264 Euro)								
	2007	2008	2009	2010	2011	2012	2013	2014	
								Projections	
	(change in percent unless indicated otherwise)								
Demand and supply									
GDP	3.7	1.4	-3.8	1.8	2.8	0.9	0.4	1.6	
Total domestic demand	2.5	0.7	-2.0	1.4	3.2	0.1	0.2	1.5	
Consumption	1.2	1.6	0.9	1.5	0.7	0.4	0.5	1.1	
Gross fixed capital formation	3.6	0.7	-7.8	-1.4	8.5	1.6	-0.3	2.5	
Net exports (growth contribution in pp)	1.4	0.8	-2.2	0.6	-0.1	0.9	0.2	0.2	
Exports of goods and nonfactor services	8.9	1.4	-15.6	9.4	6.6	1.2	1.9	4.5	
Imports of goods and nonfactor services	7.1	0.0	-13.6	9.1	7.6	-0.3	1.6	4.7	
Output gap (percent of potential GDP)	3.3	3.2	-2.1	-1.8	-0.3	-0.7	-1.6	-1.3	
Unemployment (in percent; Eurostat definition)	4.4	3.8	4.8	4.4	4.2	4.3	4.9	4.8	
Prices									
Consumer price index (period average)	2.2	3.2	0.4	1.7	3.6	2.6	2.1	1.8	
General government finances (percent of GDP)									
Revenue	47.6	48.3	48.5	48.3	48.3	49.1	49.1	48.7	
Expenditure	48.6	49.3	52.6	52.8	50.7	51.7	51.7	51.1	
Balance (EDP-definition)	-0.9	-0.9	-4.1	-4.5	-2.5	-2.5	-2.6	-2.4	
Structural Balance 1/	-2.5	-2.4	-3.0	-3.0	-2.1	-1.3	-1.7	-1.7	
Gross debt (end of period)	60.2	63.8	69.2	72.3	72.8	74.1	74.3	74.7	
Balance of payments									
Current account (percent of GDP)	3.5	4.9	2.7	3.4	1.4	1.8	2.2	2.2	

1/ The structural balance excludes revenue from the 2012 tax treaty with Switzerland (estimated at 0.3 percent of GDP in 2013) and the following capital transfers to banks (in percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; and budgeted 0.4 in 2013.

Sources: Austrian authorities; and IMF staff estimates and projections.

**Statement by Johann Prader, Executive Director for Austria and  
Christian Just, Advisor to the Executive Director  
September 4, 2013**

The Austrian authorities welcome the consultations with the Fund and thank staff for the high-quality report. They broadly agree with the assessment of Austria's economic and financial situation and the recommendations on economic and financial policies. As this consultation took place before the upcoming general elections (end of September), it provides timely input for the next legislative term.

The staff report gives credit to the relative strength of the Austrian economy in Europe. Most recent indicators seem to confirm that the phase of modest growth since mid-2012 might soon come to an end. Austria now ranks second in terms of GDP per capita in the EU. At 4.6 percent in June 2013, Austria's unemployment rate is the lowest in the EU. But keeping Austria among the best performers in the EU will require additional efforts. Austria's fiscal position so far has been rather good. This will allow Austria to cope with potential costs of the financial sector. The Austrian authorities broadly agree with the challenges ahead as regards strengthening the long-term growth potential and improving the resilience of the financial sector.

### **Macroeconomic outlook**

We concur with staff's forecast of a moderate upswing in the coming months. Exports and investment of enterprises will be driven by external demand, while domestic demand shows little room for a strengthening and the housing cycle is coming to an end. The recent stimulus package will show its effect later next year. Employment growth will continue to be driven by the increase in labor supply due to the opening of the labor market to new EU member states. Supply pressures also explain why the unemployment rate will remain relatively high by Austrian standards.

The authorities concur with staff that the main risks to the outlook are external and are related to a further intensification of the debt crisis in the euro area and possible spillovers to important trade and financial partners in CESEE. They see, however, no risk that a period of slow growth would delay or reduce the planned fiscal consolidation. Actually, past experience shows that fiscal consolidation in Austria weakens in upswings, rather than in downswings. They also point to the new EU fiscal framework, which should anchor expectations and ensure effective action.

The staff report points to the need to strengthen work incentives, especially for women. Indeed, this has been one of the political priorities in the last decade and the female employment rate at 70.3 percent in 2012 is 8 percentage points higher than the EU average and has risen 6.9 percentage points since 2001. As the report rightly points out, there are many factors driving the female participation rate. Thus, a comprehensive approach is needed. As the concept of marginal tax wedge does not include benefits in kind (such as available or free kindergartens), it might not be the appropriate comprehensive indicator to track work incentives. The authorities continue to monitor developments very closely and will continue to give priority to the issue in the formulation of medium-term economic and fiscal policies.

## **Fiscal policy**

The government has put in place a “debt brake” similar to the German model, restricting the general government structural deficit to 0.45 percent of GDP from 2017. Its implementation was accompanied by a comprehensive consolidation package, aimed at reducing the structural deficit to 0.4 percent of GDP by 2016 and putting the debt ratio on a strictly downward path from 2013 onwards. The package was implemented on top of the measures already implemented in early 2011.

Traditionally, Austrian budgeting is based on conservative and reliable revenue estimates and the execution of the budget is strict. Still, budget execution in 2012 surprised positively, with the general government deficit at 2.5 percent of GDP being 0.5 percentage point lower than targeted. As regards public expenditure savings from 2014, the authorities remain fully committed to implement the necessary reforms in the areas of health care and subsidies, as planned in cooperation with sub-national governments.

While the cost of restructuring of nationalised banks has offset part of the fiscal consolidation efforts, it should also be pointed out that the recent repayment of state aid by one of the three major banks reduces the debt ratio by about 0.4 percent of GDP.

Recently, parliament adopted a law on the establishment of an independent fiscal council. It will start its operation in November this year. Its members are fully independent with terms beyond the legislative period. The council has a broad mandate, including monitoring budget compliance with EU fiscal rules. This should contribute to a further strengthening of fiscal discipline in Austria.

## **FSAP**

The FSSA provides a balanced view of the state of the Austrian financial system. It rightly points at some key challenges and risk factors such as the restructuring of problem banks, foreign currency loans, and asset quality in the CESEE region, but also highlights the strengths of Austrian banks such as the stable macroeconomic environment in Austria or the strong local funding base.

Even though the Austrian financial system has weathered the European crisis relatively well thus far, there is no room for complacency, as the FSSA rightly notes. While capital ratios have already been increased significantly in recent years, they continue to be lower than those of peer groups. Leverage indicators, however, are more favorable than in many European peers and the FSAP stress tests have shown the Austrian banking system to be overall resilient to adverse shocks. The pressure on Austrian banks to further strengthen their loss absorption capacity in the years ahead should be maintained. From a broader perspective, the greatest impact on fostering financial stability would be associated with higher capital ratios of large, internationally active Austrian banks with significant CESEE activities. The authorities concur with the staff’s view in this respect and welcome the recent capital increase and repayment of government participation capital by the largest Austrian banks as a first important step in that direction.

As in many other European countries, asset quality is an important risk factor for Austrian banks. This is particularly the case for Austrian banks with significant international activities in the CESEE



region, as domestic credit quality has remained fairly stable in recent years. However, as regards data shortcomings on asset quality on CESEE exposures, which are pointed out in the FSSA, it should be mentioned that this is a relevant caveat for all internationally active banks, in particular in Europe, and Austrian banks should not be singled out in this respect.

In view of the difficult economic environment and new regulatory measures, there have been concerns that banks might restrict lending to the real economy, in the case of Austrian banks most prominently with regard to the CESEE region. However, concerns about a widespread deleveraging did not materialize, as stated in the FSSA. On the contrary, local funding has improved in line with supervisory expectations, and with the exception of a few countries, total credit to the real economy has increased. Moreover, a gradual reduction in leverage is a welcome development from the perspective of financial stability. This ongoing process is an important component of adapting banks' balance sheets to a post-crisis environment and – if implemented carefully – should result in positive externalities. Clearly, both its scale and pace require close monitoring, particularly given its potential impact on the supply of credit to the real economy.