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Austria: 2007 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Austria

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 2007 Article IV consultation with Austria, the following documents have been released and are included in this package:

- the staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 8, 2007, 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 March 27, 2007. 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;

- a staff statement of April 23, 2007 updating information on recent developments;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its April 23, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Austria.

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

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with Austria

Approved by Poul Thomsen and Michael Hadjimichael

March 27, 2007

Executive Summary

Background. The Austrian economy continues to do well. Growth has been consistently above the euro area average in recent years, inflation is low, and the external position has been strong. As economic activity has picked up, employment growth has accelerated strongly and put unemployment on a downward trend, and the fiscal deficit has come down.

Key issues and recommendations

- *Short-term outlook*. The economy gathered speed in 2004–05, and growth exceeded 3 percent in 2006, with some slowdown projected for 2007–08. Unemployment is forecast to come down, and inflation to remain below 2 percent in 2007. This positive outlook assumes continued wage moderation needed to maintain international competitiveness.

- *Fiscal policy.* The new government's objective continues to be to balance the budget over the cycle. However, the target date for reaching balance has been shifted back to 2009–10, with limited consolidation planned for 2007–08. Staff recommends a stronger focus on consolidation in good economic times. There is broad agreement that further streamlining of the functions of the various levels of government will be essential to expenditure control. Tax cuts are planned towards the end of the government period.

- *Financial sector issues.* The main challenge is to manage the rapid expansion of the activities of Austrian financial institutions abroad, including in foreign exchange lending. Supervisors will focus on the use by banks of appropriate risk management techniques, and plan to continue to increase their collaboration with host supervisors. Measures to further strengthen corporate governance need to be implemented forcefully.

- *Structural policies.* The new government's program includes an array of further structural reforms, and the authorities are advised to take advantage of the current cyclical upturn to intensify their reform efforts. In particular, further tasks remain with regard to deregulating the services sector, enhancing competition, and focusing labor market programs on encouraging participation.

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I. Introduction

1. **Austria's economy is doing well.** Economic activity has been strong in recent years, with relatively high growth and declining unemployment. This favorable economic outcome is due to a combination of stability-oriented macropolicies, a range of structural reforms, a social partnership that facilitates wage moderation thereby contributing to strong international competitiveness, and an orientation toward fast-growing economies in Central, Eastern, and Southeastern Europe (CESE). Austria's general policy direction has been supported by the Fund (Box 1).

2. **This report focuses on the macroeconomic and structural policies in the new government's program.** Parliamentary elections were held on October 1, 2006. Agreement was reached in early January between the Social-Democratic Party and the People's Party to form a grand coalition government with a large majority in Parliament. This report addresses the macroeconomic and structural policies included in the new government's program, with a special focus on fiscal and financial sector measures.

Box 1. Key Fund Policy Recommendations and Implementation

During Article IV consultations in recent years, the Executive Board commended the authorities on their success in fiscal consolidation, reducing taxes, containing public spending and launching an effective structural reform process.[1] Overall, policy implementation has been consistent with Fund policy advice.

Fiscal policy. Directors have endorsed the authorities' medium-term macroeconomic policy objectives of sustaining a balanced budget over the cycle and reducing the tax burden. They have underscored the importance of designing and setting in motion expenditure measures necessary to return to a budget balance by 2008.

Financial system. Directors have welcomed the resilience of Austria's financial sector, while emphasizing that developments in financial markets require continued close monitoring, particularly regarding the continuing growth of foreign currency loans, and the rapidly expanding activities of Austrian financial institutions in CESE. Directors have welcomed further strengthening of supervision, including through collaboration with host supervisors.

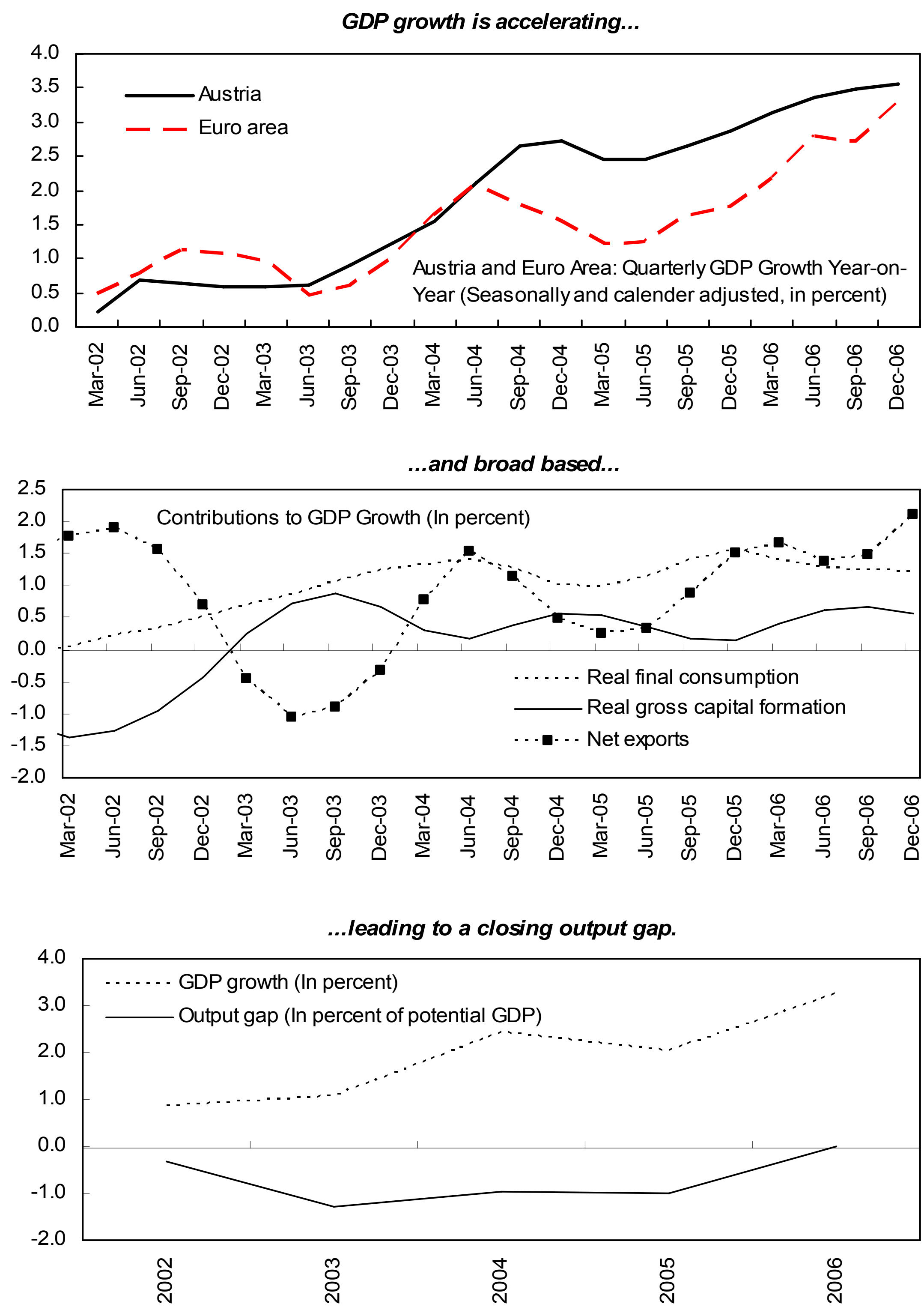
Structural policies. Directors have praised the authorities for their achievements on the structural front, including on pension reform, and encouraged them to follow through with their reform agenda.

[1]The latest Public Information Notice is available at http://www.imf.org/external/np/sec/pn/2005/pn0594.htm.

II. Recent Developments

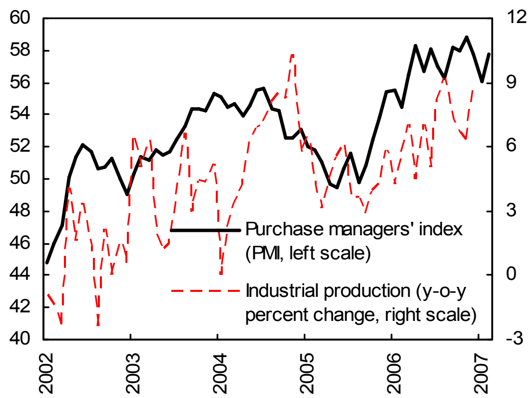
3. **After a few slow years, the economy gathered speed in 2004–05, and growth is estimated to have reached 3.2 percent in 2006 (Tables 1 and 2).** This is the highest rate since 2000 and closes the estimated output gap from previous weaker years. Growth in 2006 was broad based with strong exports, continued private consumption growth, and a considerable pickup in investment (Figure 1). Recent leading indicators, on both the production and consumption side, have been mostly positive.

Figure 1. Austria: GDP Growth, 2002-06

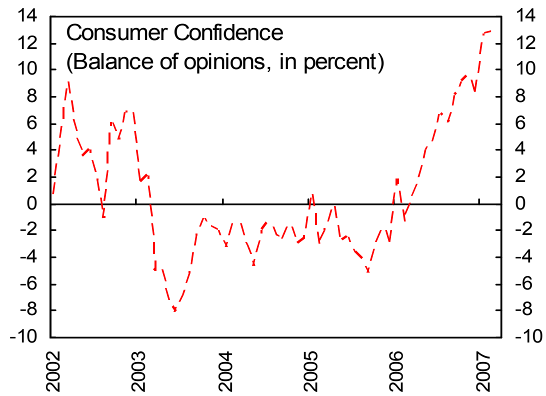


Sources: Austria Statistical Office; and IMF staff estimates.

The outlook for the industrial sector is positive...

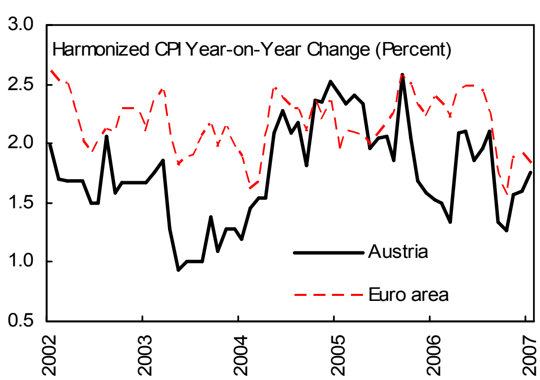


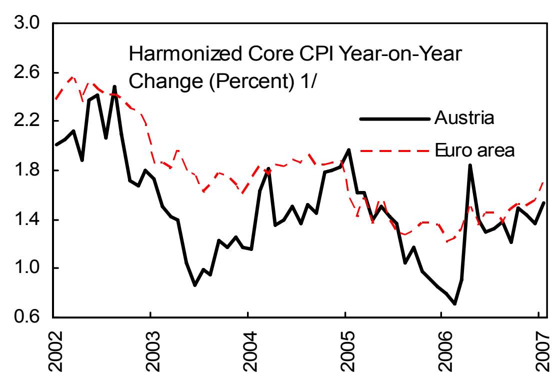
...and consumer confidence is improving.



4. **Unemployment is relatively low and declining.** At 4.4 percent in February, the unemployment rate is low compared with the euro area, although less so by Austrian standards (Figure 2). As economic activity has picked up in recent years, employment growth has accelerated and put unemployment on a downward trend, although the pace of reduction is limited due to an increase in labor supply.

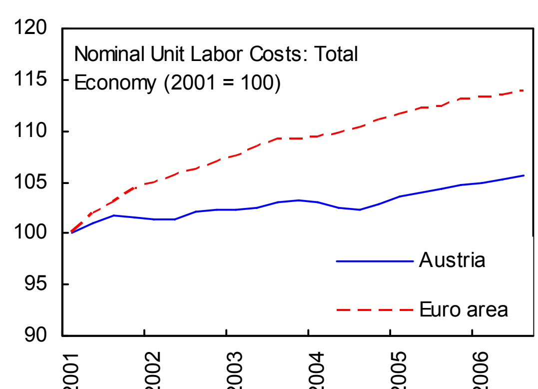
5. **Inflation, which has been around 2 percent in recent years, came down somewhat in 2006.** The oil price increases in 2005 and early 2006 occasionally pushed headline inflation above 2 percent, but, as the oil price effect tapered off, average inflation in 2006 was limited to 1.7 percent.





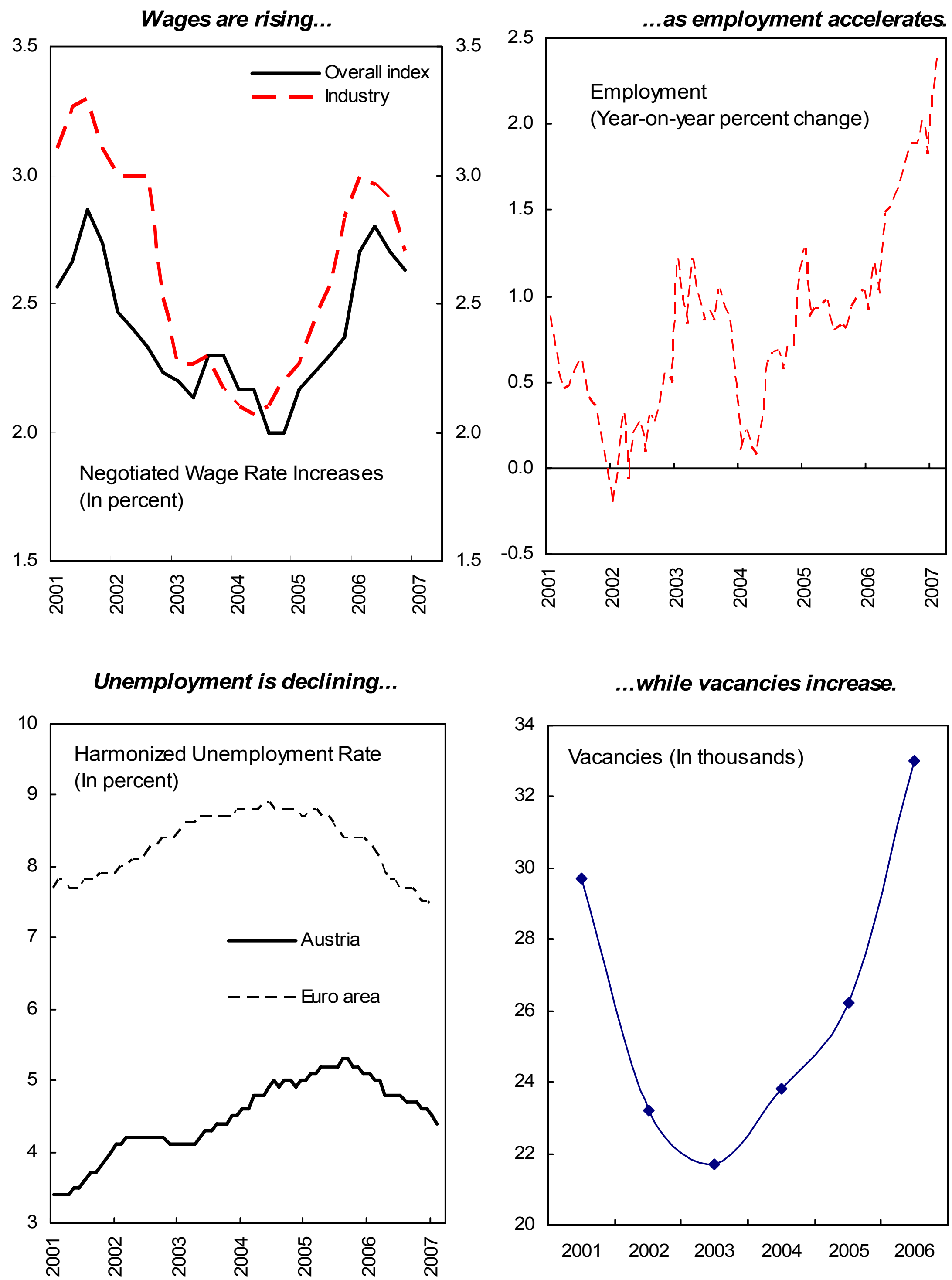
1/ Excluding energy, food, alcohol, and tobacco.

6. **Wages have been increasing modestly despite higher labor demand.** Negotiated wage increases, including for 2007, have been moderate relative to the strength of the economy. As a result, unit labor costs (ULCs) have been contained.



7. **Austria's competitiveness and external position remain strong.** The current account has been improving since the

Figure 2. Austria: Labor Markets, 2001-07



Sources: OeNB; and IMF staff calculations.

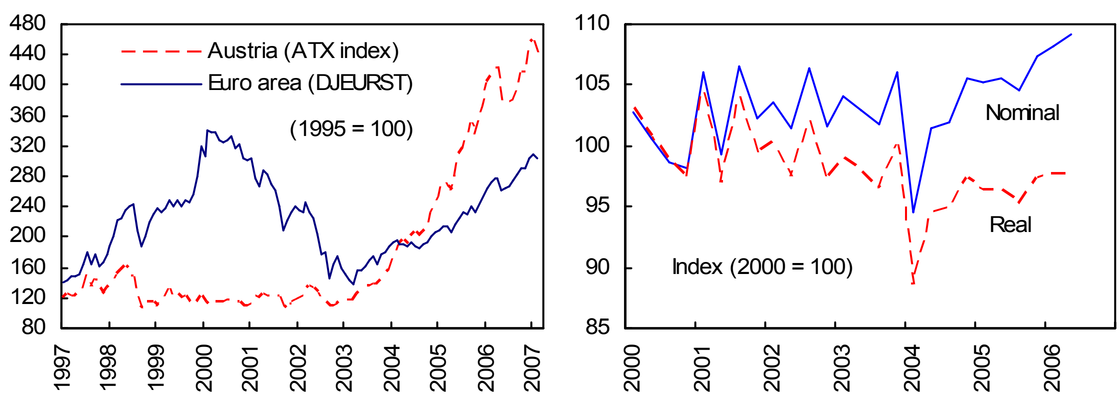
late 1990s and turned positive in 2004, on the heels of a strong trade balance (Table 3). Exports are estimated to have grown in real terms by over 8 percent annually during 2004-06. Nevertheless, Austria's world market export share has declined slightly, although in trade among the EU-15 Austria has gained market share, particularly in 2004–05. This reflects a combination of wage moderation and robust productivity growth, resulting in increased competitiveness vis-à-vis the EU-15 (Figure 3). The ULC-based real effective exchange rate stabilized after a modest appreciation earlier this decade. Model-based (CGER) calculations indicate that Austria's real exchange rate is close to its long-run equilibrium, with the various approaches showing minor deviations from equilibrium in opposite directions.[1]

8. **Aided by cyclical developments, the fiscal deficit narrowed in 2006.** Corporate income taxes performed well above expectations, and sales taxes also surprised on the upside. Initially, the 2006 deficit was projected to be 1.8 percent of GDP, but it is now estimated at 1.2 percent (Table 4; Figure 4). In contrast, the structural deficit showed a small worsening compared with previous years. The public debt ratio came down in 2006 while remaining above the Maastricht reference value of 60 percent.

9. **Monetary conditions overall remained relatively accommodative, despite recent interest rate increases (Figure 5).** Credit to nonbanks continued to grow at a moderate annual pace of around 5 percent in 2006. Loans to households increased at a similar pace. Loans in foreign exchange (mainly Swiss francs) declined slightly, but still represent about 20 percent of total domestic credit to nonbanks and 32 percent of loans to households

10. **The stock market boom of 2004–05 moderated in 2006, while real house prices remained practically flat.** The stock rally was fueled by increased company profitability and growing interest in Austrian firms' operations in CESE, and issuance of new equity covered a substantial part of companies' financing needs in 2005–06. House prices have remained practically flat in real terms in recent years, after a decline in the first half of the decade.

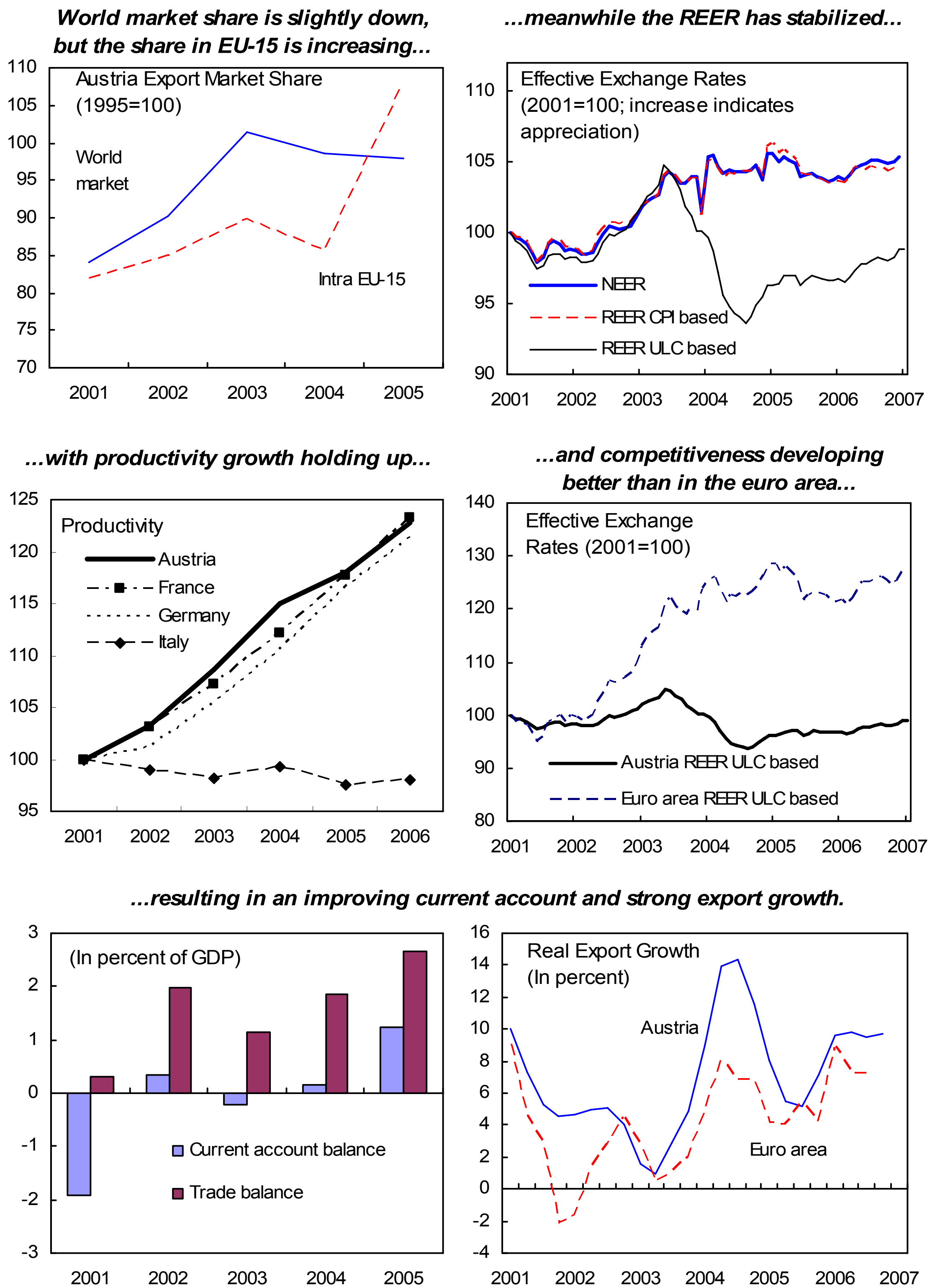
Stock market boom moderated... ***...while house prices remained almost flat.***



Sources: Bloomberg; OeNB; Austria Real Estate Exchange; Vienna University of Technology; and Institute for Urban and Regional Research.

[1] For the methodology used, see IMF policy paper, *Methodology for CGER Exchange Rate Assessments*, 2006.

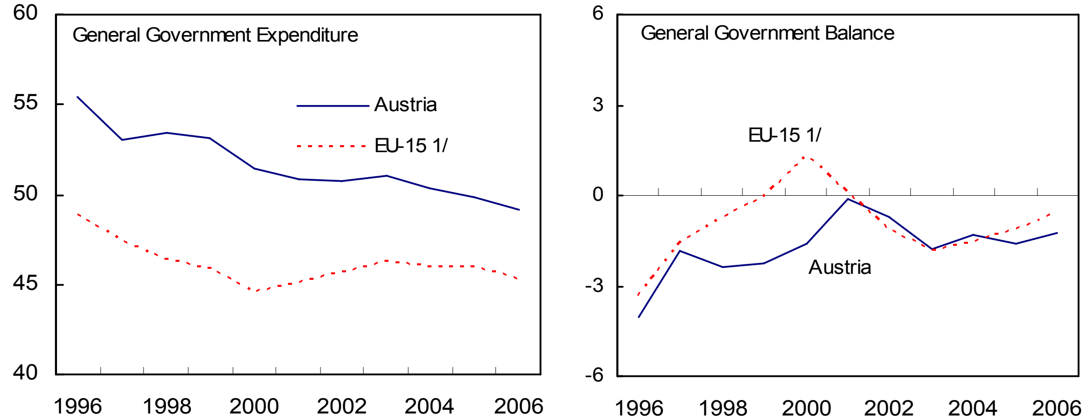
Figure 3. Austria: Competitiveness, 2001-07



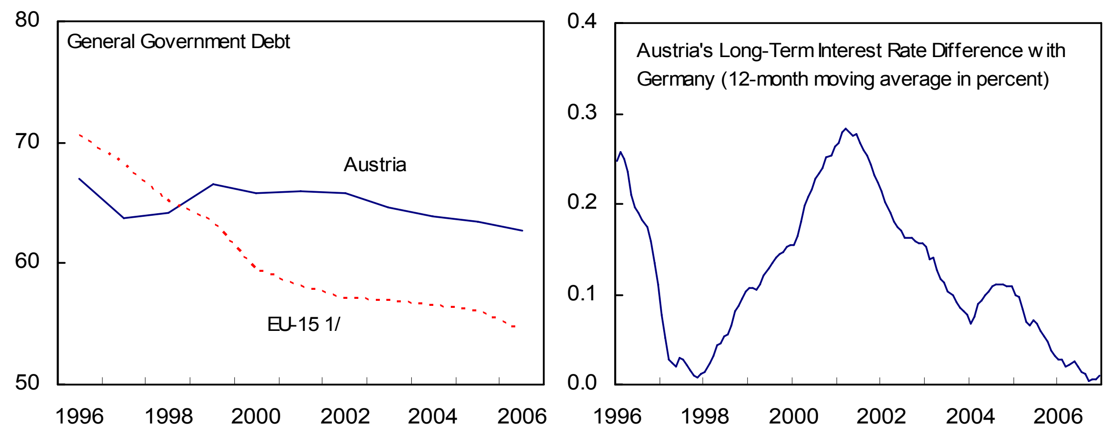
Sources: OeNB; World Integrated Trade System; Eurostat; and IMF staff calculations.

Figure 4. Austria: Fiscal Developments, 1996-2006
(In percent of GDP, unless otherwise indicated)

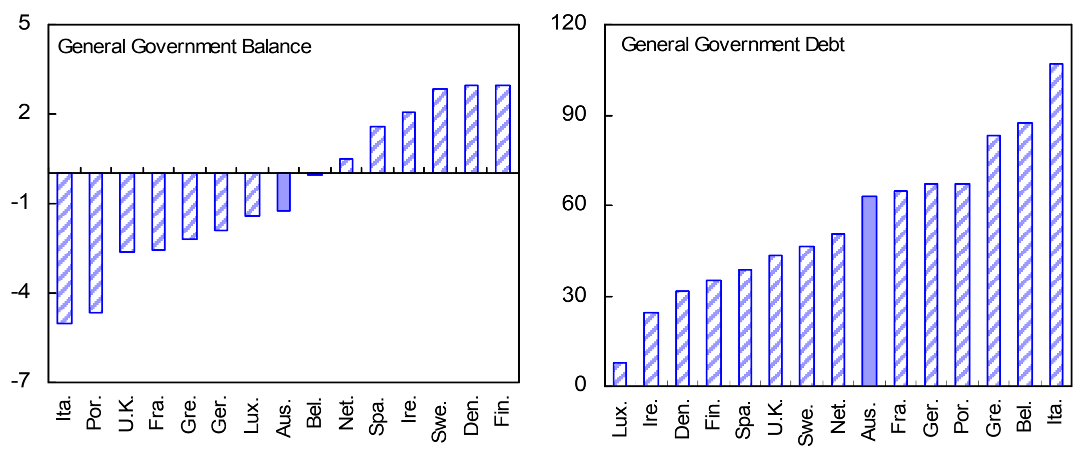
Expenditures are higher than in the EU-15, but have declined, and Austria is running a limited deficit...



...resulting in a slowly declining debt level and an elimination of the interest spread.

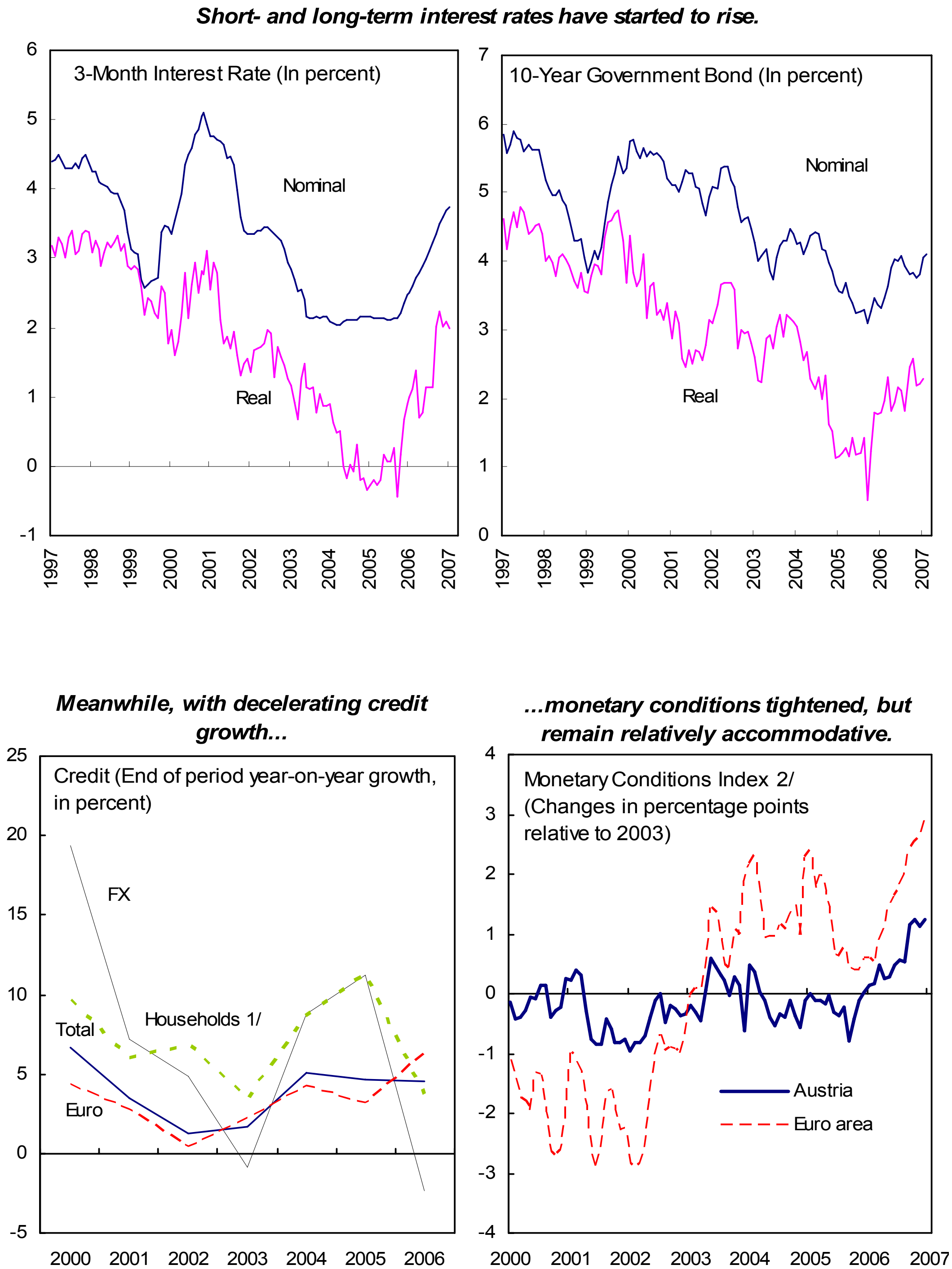


In 2006, Austria's overall fiscal position was in the middle of the EU-15 countries.



Sources: IMF, *IFS;* and *WEO*.
1/ Unweighted average.

Figure 5. Austria: Monetary Developments, 1997-2007

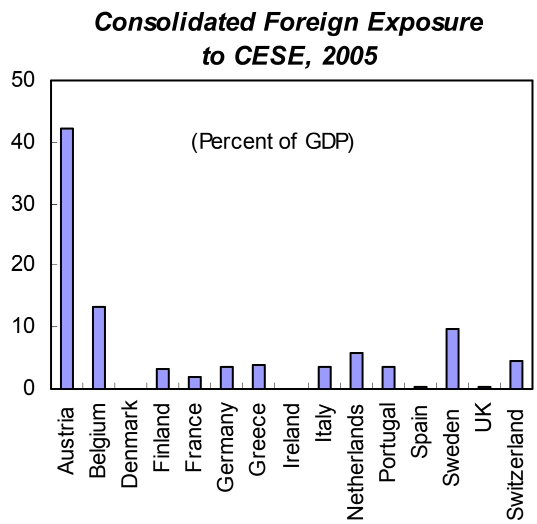


Sources: OeNB; IMF, *IFS*; ECB; and Eurostat.

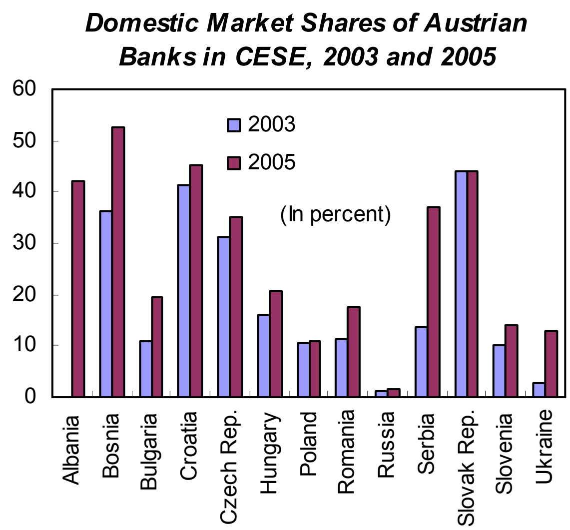
1/ The 2004 number has been corrected for a series break.

2/ Weighted average of changes in interest and exchange rates relative to their average values in a base period. An increase (decrease) indicates a monetary tightening (loosening).

11. **The Austrian banking sector plays an important role in the CESE region and continues to do well overall (Table 5).** The sector remains well capitalized and profitable, with limited nonperforming loans, and bank ratings are generally in line with those of their peers. Activities in CESE remain important, both for the region, and as an important source of profit for the banks, as the Austrian banks have increased their already large exposures to, and market shares in, this region. Lending in foreign currency has continued, both in CESE and domestically. The discovery of a fraud and a subsequent U.S. lawsuit triggered a deposit run at Bawag, Austria's fourth-largest bank in early May 2006. The authorities stemmed the run by issuing a €900 million guarantee, while convincing other banks and insurers to provide €450 million in fresh capital. The bank has now been sold, with closing expected in April–May 2007.



Sources: BIS; and BankScope.



Source: Austrian National Bank.

III. Report on the Discussions

12. **The authorities noted that there will be no fundamental change in the overall orientation of economic policies.** Four important policy objectives of the new government include: a balanced budget over the cycle; investments in research and development (R&D), infrastructure, and education; tax reform; and structural reforms in public administration, labor markets, and health (Box 2). The authorities explained that the overall direction of economic policies in Austria will remain basically unchanged, but that there will be new elements and initiatives as a reflection of the new grand coalition. The budgets for 2007–08 will be presented on March 29 and discussed in parliament during April.

A. Short-Term Outlook and Risks

13. **The authorities and mission shared a positive near-term outlook for the Austrian economy.** In line with developments elsewhere in Europe, economic growth is expected to slow somewhat in 2007, but remain strong at close to 3 percent. There was agreement that key uncertainties relate to economic developments in trading partners,

the euro-dollar exchange rate, and the oil price. The direct effect of a euro appreciation vis-à-vis the dollar would be quite small, as the share of Austria's exports to countries tied to the euro is large, but the indirect effect through weaker trading partner demand could be substantial. In this context, social partners noted that recent wage negotiations had led to relatively modest wage increases, which, paired with healthy productivity growth, would support competitiveness. With moderate wage increases, inflation is forecast to remain comfortably below 2 percent in 2007 and 2008.

Box 2. Main Economic Policy Elements of the Government Program for 2007–10

- **Growth and employment.** Promotion of economic growth and full employment by 2010 through measures to advance the international competitiveness of Austria as a business location is a key objective. Government policies in line with the Lisbon agenda, including on R&D, are expected to boost real GDP growth by about 0.1 percentage point per year during 2007–10. The quality of education at different levels will be improved, including by reducing the maximum class size to 25. Austria's infrastructure will be expanded and modernized. Competition will be enhanced, in particular in the liberal professions. Shop opening hours are to be further liberalized in 2007.

- **Fiscal policy.** The program continues to aim for balancing the budget over the cycle. The medium-term budget path in the program shows an improvement of the general government balance (in Maastricht terms) from a 1.2 percent of GDP deficit in 2006 to a 0.2 percent deficit in 2009 and a 0.4 percent surplus in 2010. There will be additional expenditures on R&D, education, and social security, while budget improvements are expected from increased social contributions, higher taxes on oil and minerals, savings on nonentitlement spending, and continued administrative reforms. A tax reform is planned aimed at creating a more efficient tax system that promotes growth and employment in Austria.

- **Social policies.** The Austrian welfare and health system will be developed further, with a view to, among others, combating poverty. Measures include a harmonization of income support by the states, accompanied by a minimum monthly wage of €1,000 (to be agreed by social partners based on a collective agreement). Reforms of the pension system are also envisaged.

- **Administrative and constitutional reform.** On the basis of the work of the Austria Convention, a constitutional reform is in preparation, including a reallocation of competences among different levels of governments. The Federal Chancellery is setting up an expert group to draft the necessary legislation, which must present its proposals by June 30, 2007, with the aim of adopting the necessary constitutional reform by end-2007.

- **Financial sector supervision and strengthening capital markets.** The functioning of the Financial Market Authority (FMA) will be evaluated to increase the effectiveness and efficiency of financial sector supervision. A working group will be established to address these and related oversight issues. The program includes various proposals to strengthen capital markets, including rotation of external auditors, measures to fight insider trading and insider abuse, separation of auditing and consulting services, and strengthening of the legal force of corporate governance standards.

Source: "Regierungsprogramm für die XXII Gesetzgebungsperiode", January 9, 2007.

B. Fiscal Near-Term

14. **The mission supported the authorities' objective of balancing the budget over the cycle, and noted that this goes beyond reaching a small surplus at the end of a high-growth period.** The current program delivers limited consolidation in the near-term—with a cumulating adjustment during 2007–08 of 1/3 percent of GDP—and the target for balancing the budget has been shifted from 2008 to 2009–10. The mission noted that given the current strength of the economy, reaching balance by 2008 would be feasible and appropriate; it would require a structural adjustment of about ½ percent of GDP per year for 2007–08. The authorities responded that in their current projections balance would be reached only one to two years later, while there could be positive surprises.

15. **The authorities and the mission agreed that adjustment should come mainly from the expenditure side as, despite recent declines, taxes in Austria are not low.** The mission noted that it is not guaranteed that the proposed measures will be sufficient for the fiscal position to reach a surplus in 2010. It expressed skepticism about the projected rapid decline in the deficits in 2009–10, which hangs on relatively optimistic assumptions. In particular, the measures are not well identified, whereas the assumed growth rates seem optimistic; this risks overestimating revenues and underestimating expenditures. The authorities described the assumptions for 2009–10 in the government program as realistic and as the result of employment-enhancing measures and strong growth perspectives in trading partners.

16. **The authorities pointed to the significant room for savings resulting from administrative reforms.** The mission agreed but stressed that there is a need for the rapid identification and implementation of concrete expenditure measures. These measures, the identification of which has been delayed already and is still incomplete in the government program, will take time to come on stream. The mission argued that it will be much easier to agree on and implement such measures in the current favorable environment than in an economic downturn, when they could have a procyclical impact.

17. **It was agreed that expenditure increases should be considered carefully.** The mission recommended a thorough discussion of such increases, in particular on R&D and labor market policies, in order to ensure their cost-effectiveness and avoid inefficiencies. It also recommended that any unexpected windfalls not be used for additional expenditures or tax cuts, but for deficit and debt reduction. The authorities agreed that additional spending had to be considered carefully to ensure its effectiveness, and that windfalls should not be used to finance additional spending.

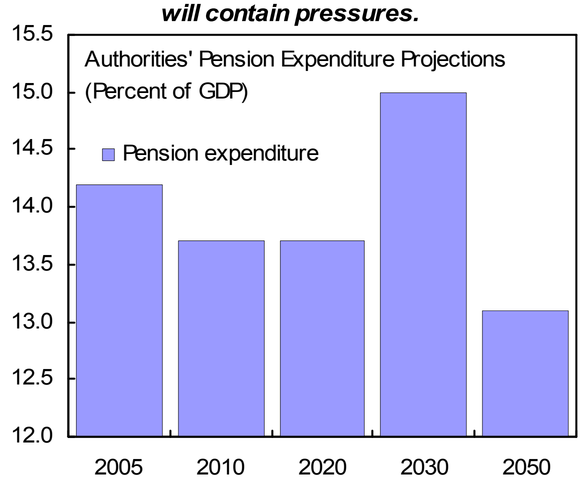
18. **The authorities noted that they see further major tax reforms largely in 2009–10.** The mission emphasized that tax cuts should follow, not precede, expenditure measures and should be consistent with achieving and maintaining budget balance. Introducing cuts in taxation now, in the absence of clearly identified and agreed-upon compensating expenditure measures, will increase the deficit at the height of the economic cycle.

C. Structural Fiscal Issues

19. **There was agreement that the grand coalition government should seize the opportunity to reform fiscal relations among the various layers of government.** A complex system for sharing revenue and allocating responsibilities across different levels of government provides limited incentives at the sub-national levels to vigorously implement expenditure control and structural reforms. As a result, it has been difficult to encourage fiscal consolidation efforts at the lower levels of government. Earlier work within the context of the Austria Convention, regrettably, did not result in substantial reforms. The mission noted that the new grand coalition government, with a more than two-thirds majority in parliament, is in a good position to agree on such a reform. The authorities agreed but pointed out that constitutional reform would nevertheless face political resistance.

20. **The authorities noted that following a series of pension reforms Austria was relatively well prepared for the implications of an aging population.** The mission agreed, but urged continued vigilance in implementing pension reforms. It is uncertain whether the recent reforms are enough to contain pension expenditure over the long run (see Appendix I for details). In particular, there are still loopholes that allow relatively easy access to early retirement, including through the disability scheme, and the population projections are subject to considerable uncertainty. Moreover, the recent plans to ease access to early retirement seem to reflect political difficulties to fully implement all aspects of the reforms over the long run. The mission urged the authorities to refrain from measures that would increase spending pressures in the pension system, ensure that the loopholes are controlled, extend reforms to the subnational government civil service pensions, and stand ready to take further measures if the development of pension spending turns out less favorable than projected.

Authorities' projections suggest recent reforms will contain pressures.



Source: Austrian Stability Program for 2005-08.

21. **Reform may even be more crucial in the health sector.** There is substantial uncertainty as to the evolution of health spending as the population ages, but a significant increase is likely. Estimates of the increase in annual public health and long-term care spending by 2050 are in the range of 2-6 percentage points of GDP. The health care infrastructure in Austria is complex, and there is room for significant improvements in efficiency in the provision of services, particularly in hospitals. The authorities noted that decision making and financing of similar activities are spread across different levels of government, which leads to duplication and inefficiencies, and complicates reform efforts.

22. **The authorities are on track to establishing a medium-term budgeting framework.** The mission reiterated that it welcomes progress in this area, as such

a framework would promote a medium-term orientation in formulating and communicating fiscal policies, and contribute to fiscal discipline and predictability.[2] The Ministry of Finance has prepared a reform of the federal budgeting system, including a medium-term expenditure framework, more performance-based budgeting, and improved accounting and information systems. The authorities explained that there is broad political support for the reforms, which could be adopted by parliament relatively soon.

D. Financial Sector

23. **The banking sector has been expanding rapidly, while remaining strong, well capitalized, and highly profitable overall.** The authorities as well as the banks pointed to domestic cost cutting, but above all the rapidly expanding activities in CESE, as the main factors behind the increases in profits.

24. **The authorities are taking action to further improve monitoring of the Austrian banks' activities in CESE, including foreign currency lending.** They mentioned more frequent on-site inspections, including follow-ups, intensified off-site analysis of systemically important banks, and the issuance of supervisory guidelines. Recent stress tests performed by the authorities covered credit and market risks, including shocks to default probabilities, interest, and exchange rates, and indicated a satisfactory shock absorption capacity of the Austrian banking system. It was, furthermore, noted that steps to educate consumers on the risks associated with foreign currency lending have been taken in Austria. The mission commended the authorities for these measures, while encouraging further progress on their implementation and emphasizing the need to ensure that banks use adequate risk management and measurement techniques.

25. **Collaboration between the Austrian and the host supervisors in CESE has intensified, improving the effective supervision of cross-border banking groups.** The authorities elaborated on how the enlargement of the EU has facilitated cross-border supervisory cooperation with the new member states. The mission welcomed, in particular, the signing of memoranda of understanding (MoUs) between home and host supervisors regarding exchange of information and cross-border supervisory cooperation with these new member states, although it noted that some gaps remain.[3] The mission further valued the authorities' preparations for joint risk assessments with their foreign peers and suggested staging, in due course, a cross-border crisis simulation exercise focused on cooperation with the authorities from CESE.

26. **Governance is being strengthened in the banking sector to avoid a repeat of recent problems.** The authorities emphasized that the problems had not affected financial stability. They have proposed various actions, which have already been partly implemented. These actions include improving banks' corporate governance through enhanced fit-and-proper tests and stricter requirements for external auditors. The mission supported these

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[2] See also Section I of the selected issues paper accompanying this staff report.

[3] For details see Section III of the selected issues paper.

steps, and argued that it would be in favor of going further, at least for the larger financial institutions, by, for example, subjecting all supervisory board members to a fit-and-proper test, making the Austrian corporate governance code mandatory, and requiring the rotation of the external audit firm at certain intervals.

27. **The authorities indicated that the functioning of supervision will be reviewed.** This includes a review of the responsibilities of the Ministry of Finance and parliamentary oversight. The mission noted that aspects of independence and accountability would benefit from a review, pointing out that some of these issues had been raised in the 2004 FSAP, although they did not lead to non-compliance with the Basel Core Principles. The authorities expressed interest in an FSAP update during the second half of 2007, in which several of the topics mentioned above could be revisited**.**

E. Structural Issues

28. **The mission noted that much progress has been made on structural reform in recent years, but more is needed**. Further deregulation of the services sector is required to foster entry and competition. More flexible shop opening hours have been legislated, but implementation by provinces has lagged. The Austrian labor market is relatively flexible, but participation of younger and older workers remains low, and active labor market programs could be more effective. The privatization agenda is not fully complete, and the investigative powers and resources of the independent Federal Competition Authority (FCA) could be enhanced. Also, competition and network access in the electricity market should be further improved to help ensure a cost-effective and stable energy supply.

29. **The authorities pointed to an array of initiatives on the regulatory front in the government program.** These include the further liberalization of the free professions, employment opportunities for foreign workers, and working and shop opening hours; the strengthening of the FCA; and a modernization of capital market regulations. The mission welcomed the renewed focus on structural reforms by the new government. The program also includes initiatives to increase spending on R&D, infrastructure, active labor market programs, and education, and reduce nonwage labor costs, which could have a significant fiscal impact. The mission stressed that these initiatives should be implemented in a manner consistent with maintaining a sound fiscal position.

IV. Staff Appraisal

30. **Austria's economy has been doing well and is expected to continue to do so in the period ahead.** Economic growth in 2006 was the highest since 2000. Unemployment is relatively low and has been declining, although the pace of reduction is more limited than the growth in employment due to an increase in the labor force. The near-term prospects for the economy are favorable, based on continued strong international competitiveness, robust underlying productivity growth, and a positive outlook for Europe. Risks to this projection arise from uncertainty regarding the euro exchange rate, the oil price, and economic developments in trading partners, among other factors.

31. **Continued wage moderation will be essential to maintain Austria's competitiveness.** Wages have been increasing modestly, despite higher labor demand, and unit labor costs have been contained. Recent agreements between social partners for 2007 show a continuation of this trend. Staff welcomes this development, given that the margins in international trade are small and significant wage increases would quickly erode Austria's current strong competitiveness.

32. **Given the strong economy, the government's fiscal program could have been more ambitious.** A balanced budget over the cycle will ensure fiscal sustainability in the face of aging related pressures on health and pension expenditures. In light of Austria's strong economic performance and outlook, one would expect to see surpluses or at least a balanced budget in the years to come, as is the case in a number of other European countries. The government's fiscal program plans only a limited decline in the deficit during a period of high growth, and the target for balancing the budget has been shifted from 2008 to 2009–10. Reaching balance sooner would reduce the debt and debt service and create more room for future tax cuts and for the automatic stabilizers to work.

33. **Spending increases should be considered carefully and windfalls saved.** Expenditure increases, in particular on R&D and labor market policies, should be evaluated in terms of their effectiveness, and considered only when offsetting measures have been clearly identified. Unexpected windfalls should not be used for additional expenditures or tax cuts, but for deficit and debt reduction. To strengthen budget discipline, efficiency, and transparency, broad-based budgeting reforms are recommended, including the adoption of a formal medium-term budgetary framework that sets explicit expenditure targets consistent with the fiscal objectives.

34. **There is a need for the rapid identification and implementation of expenditure savings.** Public administration, subsidies and transfers, pensions, and health care remain important areas for potential efficiency gains. There has been progress in streamlining public administration at the federal level, but efforts are lagging at the local levels. Better-targeted subsidies and transfers could also generate savings. Reform of the health sector is at an early stage, and duplication in the provision of health care remains significant. Harmonization of pensions has not reached the subnational level, while eligibility for disability pensions should not provide a loophole for access to early retirement.

35. **Further streamlining of the functions of the various levels of government will be essential to expenditure control**. In the past, it has appeared difficult for the federal authorities to ensure local governments' contributions to the necessary reform efforts. The parties should use the opportunity of the grand coalition to agree on a restart of the necessary constitutional reform process.

36. **Tax cuts should await the implementation of expenditure measures.** There is no need or room for tax cuts in the short-term, neither for cyclical reasons nor in light of the necessary consolidation process. Future tax cuts, which should be focused on reducing the burden on labor, should not be considered before the expenditure side is fully in order.

37. **The rapidly expanding activities of the financial sector require close monitoring and effective risk management.** The expansion into CESE has been very profitable and helped financial deepening in the host countries, but the risks involved in this process have also grown, including for the region. In particular, the rapid growth of foreign currency lending by Austrian banks requires close monitoring. In Austria, the supervisors and banks have already taken useful steps to educate consumers on risks involved in borrowing in foreign exchange, but such efforts seem less advanced in CESE. In addition, supervisors need to continue to ensure that the banks use adequate risk management techniques, also in preparation for Basel II.

38. **Good collaboration between Austrian and host supervisors in CESE is key to effective supervision of cross-border banking groups.** The enlargement of the EU has facilitated cross-border supervisory cooperation with the new member states. It will remain important to deepen cooperation with supervisors in both EU and non-EU member states in which the Austrian financial sector has a significant market share, including the negotiation of MoUs.

39. **Staff welcomes the measures taken to further strengthen corporate governance in the banking sector, as well as the authorities' interest in an FSAP update.** To avoid a repeat of recent problems at two Austrian banks, the authorities have proposed various actions, which have already been partly implemented. These actions include a higher frequency of on-site inspections, intensified off-site examinations, and measures to improve banks' corporate governance. Staff recommends the forceful implementation of these actions and consideration of further measures in this area. It welcomes the authorities' interest in an FSAP update in late 2007, which could also review issues related to the autonomy of the supervisory process.

40. **The authorities are encouraged to take advantage of the current cyclical upturn to intensify structural reform efforts.** The renewed impetus for structural reform in the government program is welcome. Despite substantial progress, reforms are still needed in a wide range of areas to foster competition and growth. Thus the initiatives for further deregulation, improved competition, and labor market reforms should be vigorously implemented, while bearing in mind the need to maintain a sound fiscal position.

41. **Staff commends Austria for its official development assistance reaching about 0.5 percent of GNP in 2006** and encourages a further increase toward the UN target of 0.7 percent of GNP.

42. It is proposed that the next Article IV consultation be conducted on the standard 12-month cycle.

Table 1. Austria: Basic Data

Total area	83,850 square kilometers
Total population (2006)	8.3 million
GDP per capita (2006)	US$ 38,961 (€ 31,029)

	2001	2002	2003	2004	2005	2006	2007	2008
						Est.	Proj.	
			(Percentage changes at constant prices)					
Demand and supply								
GDP	0.8	0.9	1.1	2.4	2.0	3.2	2.8	2.4
Total domestic demand	-0.2	-1.2	2.4	1.5	1.3	2.2	2.2	1.9
Consumption	0.4	0.5	1.3	1.8	1.8	1.6	1.7	1.9
Gross investment	-2.2	-6.8	6.6	0.5	-0.4	4.3	3.8	2.0
of which: Gross fixed investment	-1.5	-6.0	5.9	0.6	0.3	4.7	3.8	2.0
Foreign balance 1/	1.0	1.9	-1.3	0.9	0.8	1.3	0.8	0.6
Exports of goods and nonfactor services	7.2	4.0	2.0	10.0	6.4	8.5	7.3	6.7
Imports of goods and nonfactor services	5.1	0.1	5.1	8.7	5.2	6.8	6.6	6.3
Output gap (percent of potential GDP)	0.9	-0.3	-1.3	-1.0	-1.0	0.0	0.4	0.5
				(Percentage changes; period averages)				
Employment and unemployment								
Labor force 2/	0.7	1.1	1.1	0.5	1.2	1.1	1.0	0.8
Employment 3/	0.5	0.2	0.9	0.4	1.0	1.6	1.0	0.8
Unemployment rate (in percent)								
Registered 4/	6.1	6.9	7.0	7.1	7.3	6.8	6.5	6.4
Standardized 4/	3.6	4.2	4.3	4.8	5.2	4.8	4.5	4.3
				(Percentage changes; period averages)				
Prices and incomes								
GDP deflator	1.8	1.4	1.3	1.7	1.9	1.3	1.7	1.7
Consumer price index	2.3	1.7	1.3	2.0	2.1	1.7	1.6	1.7
Unit labor costs (manufacturing)	-1.0	0.8	-0.2	-9.4	0.5	0.4	1.0	1.0
				(Percent of GDP)				
General government finances 5/								
Revenue	50.7	50.0	49.3	49.0	48.3	47.9	47.6	47.4
Expenditure	50.8	50.7	51.1	50.3	49.9	49.1	48.9	48.4
Balance	-0.1	-0.7	-1.8	-1.3	-1.6	-1.2	-1.2	-1.0
Structural Balance	-1.2	-0.5	-0.8	-0.9	-1.1	-1.3	-1.4	-1.0
Gross debt (end of period)	66.0	65.8	64.6	63.8	63.4	62.0	61.0	59.9
				(Billions of euros)				
Balance of payments								
Trade balance	-1.4	3.8	1.0	2.5	2.8	6.3	8.6	10.6
Current account	-4.1	0.7	-0.5	0.4	3.0	4.6	5.0	4.6
(In percent of GDP)	-1.9	0.3	-0.2	0.2	1.2	1.8	1.9	1.6
				(Percent; period average)				
Interest rates 6/								
Three-month interbank rate	4.3	3.3	2.3	2.1	2.2	3.1	3.8	...
10-year government bond	5.1	5.0	4.2	4.2	3.4	3.8	4.1	...
				(Levels; period average)				
Exchange rates								
Euro per US $ 6/	1.12	1.06	0.88	0.80	0.80	0.80	0.77	...
Nominal effective exchange rate (2000=100)	99.8	100.5	104.0	105.5	105.3	105.5	...	...
Real effective exchange rate (1990=100)								
ULC based 6/	97.3	98.1	101.2	94.5	95.5	96.5	97.8	...
CPI based	100.1	101.0	104.2	105.6	105.7	105.4	...	...

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

1/ Contribution to GDP growth.
2/ Dependent labor force (does not include self-employed).
3/ Dependent employment.
4/ In percent of total labor force. The standardized rate is survey-based, according to EU standards.
5/ On ESA 95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition—used by the Austrian authorities differs slightly from this due to the inclusion of revenues from swaps.
6/ 2007 numbers are for February 2007.

Table 2. Austria: Staff's Medium-Term Macroeconomic Framework, 2003-12

	2003	2004	2005	Est. 2006	Projections 2007	2008	2009	2010	2011	2012
	(Percentage contribution at 2000 prices)									
National accounts										
GDP	1.1	2.4	2.0	3.2	2.8	2.4	2.2	2.2	2.2	2.2
Domestic demand	2.3	1.4	1.2	2.1	2.0	1.8	1.8	1.8	1.9	1.9
Final consumption	1.0	1.3	1.3	1.2	1.2	1.4	1.2	1.3	1.4	1.4
of which: Private consumption	0.7	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1
Gross investment	1.4	0.1	-0.1	0.9	0.8	0.4	0.6	0.5	0.5	0.5
Exports of goods and nonfactor services	1.0	5.0	3.5	4.8	4.3	4.1	3.8	3.9	4.1	4.2
Imports of goods and nonfactor services	-2.3	-4.1	-2.6	-3.5	-3.6	-3.5	-3.3	-3.5	-3.8	-4.0
	(Percentage change)									
Prices and unemployment										
CPI inflation	1.3	2.0	2.1	1.7	1.6	1.7	1.7	1.7	1.7	1.7
GDP deflator	1.3	1.7	1.9	1.3	1.7	1.7	1.7	1.7	1.7	1.7
Unemployment rate (in percent)	4.3	4.8	5.2	4.8	4.5	4.3	4.2	4.2	4.2	4.2
	(Percent of GDP)									
External accounts										
Current account balance	-0.2	0.2	1.2	1.8	1.9	1.6	1.6	1.5	1.3	1.2
Goods and services balance	1.2	1.9	2.7	3.7	3.8	3.7	3.6	3.6	3.4	3.2
General government accounts 1/										
Revenue	49.3	49.0	48.3	47.9	47.6	47.4	47.3	47.1	46.9	46.7
Expenditure	51.1	50.3	49.9	49.1	48.9	48.4	47.7	46.9	46.9	46.7
Balance	-1.8	-1.3	-1.6	-1.2	-1.2	-1.0	-0.4	0.2	0.0	0.0
Gross debt	64.6	63.8	63.4	62.0	61.0	59.9	60.0	58.7	56.5	54.4
Structural balance	-0.8	-0.9	-1.1	-1.3	-1.4	-1.0	-0.6	0.2	0.0	0.0
Memorandum items:										
Gross national saving (percent of GDP)	21.5	21.4	22.0	22.8	23.2	22.9	23.0	23.0	22.9	22.8
Gross domestic investment (percent of GDP)	21.7	21.3	20.8	21.1	21.4	21.3	21.5	21.5	21.6	21.6

Sources: Austrian authorities; IMF, *International Financial Statistics*; and IMF staff estimates and projections.

1/ On ESA 95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps. Projections are based on the government program, but may differ due to the use of a different GDP.

Table 3. Austria: Balance of Payments, 2003-12

	2003	2004	2005	Est. 2006	Projections 2007	2008	2009	2010	2011	2012
	(In percent of GDP)									
Current account	-0.2	0.2	1.2	1.8	1.9	1.6	1.6	1.5	1.3	1.2
Trade	1.2	1.9	2.7	3.7	3.8	3.7	3.6	3.6	3.4	3.2
Exports	51.8	55.0	56.0	59.6	61.6	63.4	64.8	66.4	68.1	69.7
Imports	50.7	53.1	53.3	55.9	57.8	59.7	61.2	62.9	64.7	66.5
Goods	0.4	1.1	1.1	2.5	3.2	3.8	3.8	3.8	3.7	3.7
Exports	35.0	38.2	38.5	41.9	43.7	45.4	46.7	48.3	49.8	51.4
Imports	34.6	37.2	37.3	39.4	40.4	41.6	42.9	44.4	46.1	47.8
Nonfactor services	0.7	0.8	1.5	1.2	0.6	-0.1	-0.2	-0.3	-0.4	-0.4
Exports	16.8	16.8	17.5	17.7	17.9	18.0	18.1	18.2	18.2	18.3
Imports	16.1	16.0	16.0	16.5	17.3	18.1	18.3	18.4	18.6	18.8
Balance on Factor Income	-0.5	-0.8	-0.6	-1.0	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1
Credit	6.3	6.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Debit	6.8	7.2	8.2	8.6	8.6	8.7	8.7	8.7	8.7	8.7
Current transfers, net	-0.9	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Capital and financial accounts	-0.2	0.0	-0.3	-1.8	-1.9	-1.6	-1.6	-1.5	-1.3	-1.2
Capital account, net	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
FDI, net	0.0	-1.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Portfolio investment, net	1.8	-0.3	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6	-4.6
Other	-2.5	1.3	4.2	3.0	2.9	3.1	3.2	3.3	3.4	3.6
Reserve assets	0.8	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.4	0.2	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. Austria: General Government Accounts, 2001-08

(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	Est. 2006	Proj. 1/ 2007	2008
Revenue	50.7	50.0	49.3	49.0	48.3	47.9	47.6	47.4
Taxes on production and imports	14.3	14.7	14.5	14.6	14.4	14.3	14.1	13.9
Property income	1.5	1.5	1.5	1.4	1.4	1.4	1.3	1.2
Current taxes on income, wealth, etc.	15.0	14.0	13.6	13.4	12.9	12.9	13.2	13.3
Social contributions	16.5	16.3	16.3	16.1	16.1	15.8	15.7	15.6
Other	3.5	3.6	3.4	3.6	3.6	3.5	3.4	3.4
Expenditure	50.8	50.7	51.1	50.3	49.9	49.1	48.9	48.4
Intermediate consumption	4.2	4.4	4.3	4.4	4.5	4.5	4.5	4.5
Compensation of employees	9.7	9.6	9.5	9.3	9.3	9.2	9.1	9.0
Subsidies, payable	3.0	2.9	3.2	3.1	3.0	2.9	3.0	3.0
Interest	3.6	3.3	3.1	3.0	2.9	2.8	2.7	2.7
Social benefits	18.6	19.0	19.2	18.8	18.6	18.4	18.1	18.0
Transfers	10.4	10.1	10.5	10.6	10.4	10.1	10.2	10.0
Gross capital formation	1.1	1.3	1.2	1.1	1.1	1.1	1.1	1.1
Overall balance (ESA 95 basis)	-0.1	-0.7	-1.8	-1.3	-1.6	-1.2	-1.2	-1.0
Federal government	-0.8	-1.3	-2.0	-1.5	-1.9	-1.6	-1.6	-1.4
Other levels	0.7	0.6	0.2	0.2	0.3	0.4	0.4	0.4
Structural balance (ESA 95 basis)	-1.2	-0.5	-0.8	-0.9	-1.1	-1.3	-1.4	-1.0
Fiscal impulse 2/	-2.5	-0.7	0.3	0.1	0.3	0.1	0.2	-0.4
Public debt	66.0	65.8	64.6	63.8	63.4	62.0	61.0	59.9
Memorandum item:								
Overall fiscal balance, EDP definition 3/	0.0	-0.5	-1.6	-1.2	-1.5	-1.1	-1.1	-0.9

Sources: Federal Ministry of Finance; Austrian Stability Program; and IMF staff estimates and projections.

1/ Projections based on the government program. Ratios may differ due to the use of a different GDP.
2/ Negative of the change in the structural balance.
3/ The Maastricht Excessive Deficit Procedure (EDP) definition is used by the Austrian authorities. The difference from ESA 95 is due to the inclusion of revenues from swaps.

Table 5. Austria: Indicators of Financial Vulnerability, 2001-06
(In percent)

	2001	2002	2003	2004	2005	2006 1/
Capital adequacy						
Regulatory capital to risk-weighted assets	13.7	13.3	14.5	12.4	11.8	12.8
Regulatory Tier I capital to risk-weighted assets	9.5	9.1	9.9	8.5	8.2	9.1
Capital to assets	4.7	4.7	4.9	4.9	4.8	5.2
Asset composition						
Sectoral distribution of bank credit to total gross bank credits (as percent of total bank credits)						
Nonbank financial institutions	2.6	2.9	2.9	3.0	3.6	3.7
Nonfinancial corporations	25.1	25.3	24.0	22.4	20.4	20.2
Households	17.5	19.2	18.9	19.8	20.1	19.2
of which:						
housing loans	8.5	11.0	11.4	10.3	10.0	10.2
personal loans	9.0	8.2	7.6	9.4	10.0	8.5
Public Sector	6.2	6.4	6.5	6.4	5.4	5.2
Nonresidents	11.0	11.5	11.2	11.5	12.9	13.6
Other sectors	37.7	34.6	36.6	37.1	37.6	38.1
Geographical distribution of loans to total loans						
Domestic	74.3	75.8	74.4	73.4	70.6	68.7
Cross-border	25.7	24.2	25.6	26.6	29.4	31.3
of which:						
EMU	...	8.1	8.5	8.2	10.1	9.9
CEEC	...	...	...	...	9.4	9.8
Other	...	...	...	...	9.9	11.6
Asset quality						
Nonperforming loans to total gross loans	3.0	3.0	3.0	2.7	2.6	...
Loan loss provisions (as a percentage of loans to non-banks)	3.1	3.3	3.3	3.3	3.1	2.9
Loan-loss provisions to nonperforming loans	64.6	65.8	68.0	70.8	71.5	...
Nonperforming loans net of loan-loss provisions to Tier 1 capital	21.8	22.4	19.0	15.5	15.1	...
Total foreign currency-denominated loans to total loans	29.1	26.9	24.5	24.4	25.9	25.3
Earnings and profitability						
Return on assets	0.5	0.2	0.3	0.6	0.6	0.7
Return on equity	9.7	5.2	7.0	14.8	14.8	13.6
Net interest margin (percent of interest bearing assets)	1.3	1.3	1.3	1.2	1.1	1.0
Trading income as a percentage of gross income	3.7	4.2	4.5	4.2	4.1	4.9
Noninterest expenses as a percentage of gross income	67.4	69.3	68.2	72.9	71.9	69.2
Liquidity						
Liquid assets to total assets	31.5	30.3	30.2	28.9	27.4	28.3
Liquid assets to short-term liabilities	74.5	78.7	77.9	73.8	68.0	70.8
Foreign currency-denominated liabilities to total liabilities	28.1	22.6	20.9	20.3	20.5	19.8
Deposits as a percentage of assets	69.4	67.6	67.1	66.1	65.3	64.7
Loans as a percentage of deposits	112.1	113.6	113.9	113.9	112.9	115.0

Source: Austrian National Bank.

1/ 2006 numbers are for the third quarter.

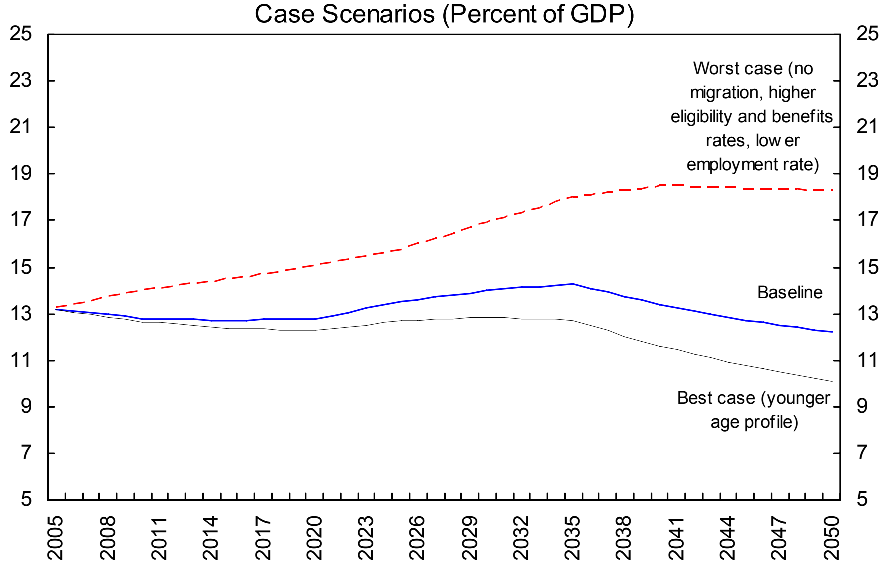
Appendix I. Austria: Debt Sustainability[1]

Like many industrial countries Austria faces an ageing challenge caused by a reduction of total fertility rates and increased life expectancy. The old-age dependency ratio is expected to increase from 24½ percent in 2006 to 53¼ percent in 2050, putting upward pressure on fiscal spending on pensions, health, and long term old age care costs.

The pension expenditure-GDP ratio can be expressed as the product of the old-age dependency ratio, benefits ratio, employment rate, and the eligibility rate for pensions.[2] For Austria, the authorities' projections indicate that the rising dependency ratio will be offset by declines in eligibility and benefits ratios (from two waves of pension reforms in 2003 and 2005), and an increase in the employment rate, by 2035. From then on pension expenditure as a percentage of GDP declines.

The projections are however subject to significant uncertainty margins. Eurostat provides several variants of the population projections, which indicate that the dependency ratio could vary between 44 percent and 66 percent by 2050. The other variables could also evolve in a manner different from the baseline assumptions. For example, the assumed substantial decline of the eligibility ratio appears optimistic, since loopholes are apparently being exploited to obtain early retirement, including through the disability pension system. Also, the recent government program backtracks to some extent from the earlier reforms by cutting the penalties for early retirement. In a worst case scenario (and assuming no policy response), staff projections suggest that pension expenditures could rise to 18 percent of GDP by 2050, compared to the authorities' projected 12¼ percent (Figure 1).

Figure 1. Austria. Pension Expenditures Under Best and Worst Case Scenarios (Percent of GDP)



Sources: DG ECFIN Special Report No 1/2006, and staff estimates.

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[1] See section II of the accompanying selected issues paper for a more in-depth discussion of the issues.

[2] The old-age dependency ratio is the ratio of the old age population to the working age population; the employment rate is the ratio of employment to working age population; the eligibility ratio is the ratio of pensioners to old age population; the benefits ratio is the ratio of average pension benefits to labor productivity.

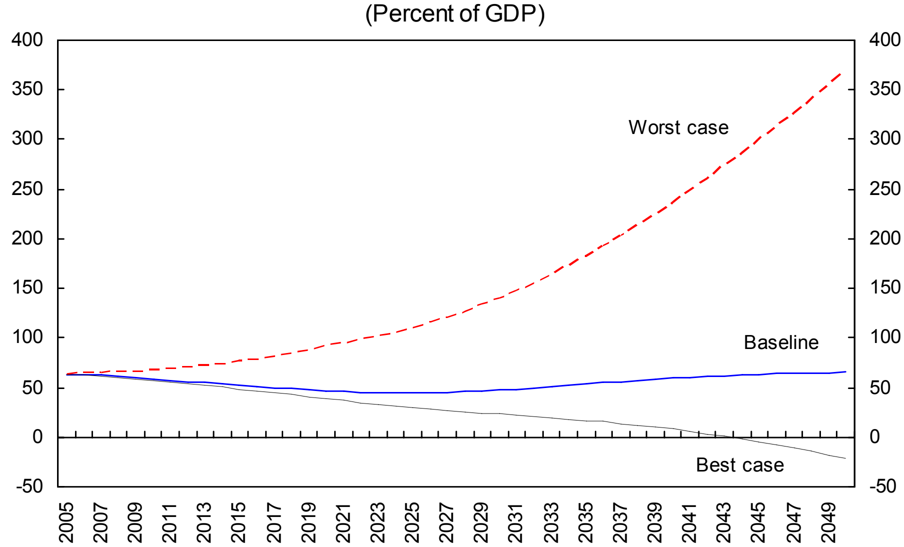
Ageing will also raise annual public health and long term care spending. Estimates of the increase are in the range of 2 to 6 percent of GDP. Reforms in the health care sector have been limited thus far, and are likely to be more difficult to address than for pensions.

Overall, the baseline projections (detailed in the 2006 ECFIN report on ageing) indicate that by 2050 ageing will raise annual fiscal expenditures by ¾ percentage point of GDP. However, there is a wide uncertainty margin; staff projections indicate that in the best case fiscal expenditures would decline by 2 percentage points of GDP, while, in the worst case, fiscal expenditures would increase by 9 percentage points.

Assuming that the fiscal stance remains unchanged from 2006 onward, under the baseline ageing scenario public debt initially declines, from 63.4 percent of GDP in 2005 to 44.6 percent of GDP by 2025, but thereafter rises steadily as ageing pressures build up, reaching 65.3 percent of GDP by 2050. However, there is a wide uncertainty margin. Under the best case scenario, where favorable demographics actually lead to an overall decline in spending, public debt falls below zero in 2044. However, under the worst case scenario public debt jumps to more than 300 percent of GDP towards 2050.

With public debt on a rising path, and higher in 2050 than in 2005 under the baseline scenario, this uncertainty implies risks for the sustainability of the fiscal position (Figure 2). Moreover, there is a possibility that the baseline could end up higher given plans to reduce penalties for early retirement. To counter these risks, fiscal consolidation is needed, which should include implementing fully the measures envisaged in the 2003 and 2005 pension reforms, while reforms in the health sector will also be key in containing fiscal pressures.

Figure 2. Austria: Public debt - Best and Worst Case Scenarios
(Percent of GDP)



Sources: DG ECFIN Special Report No 1/2006, and staff estimates.

APPENDIX II. AUSTRIA: FUND RELATIONS
(As of February 28, 2007)

Article IV Consultation:
Austria is on a 12-month consultation cycle. The last consultation was completed on July 25, 2005 (EBM/05/64). Discussions for the 2007 consultation were held in Vienna during November 30–December 11, 2006, and during a follow-up staff visit from February 6–8, 2007. The mission comprised Messrs. Hilbers (head), Kanda, Lundback (all EUR), and Tieman (MCM). Mr. Prader, Alternate Executive Director for Austria, attended the meetings. The mission met with the incoming Chancellor; the Vice-Chancellor and Minister of Finance; the Governor of the Austrian National Bank (OeNB); the Chief Executive Officers of the Financial Market Authority (FMA); and senior officials of the federal government, the OeNB, and the FMA.

Outreach:
The mission also met with the parliamentary budget committee and with representatives of economic research institutes, employers' organizations, the federation of trade unions, and the private sector. The authorities released the mission's concluding statement, which is available at http://www.imf.org/external/np/ms/2006/121106.htm and there was a press conference at the end of the mission.

Exchange System:
As of January 1, 1999, the currency of Austria is the euro. Austria has accepted the obligations of Article VIII and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. Austria maintains exchange restrictions for security reasons, in accordance with UN Security Council Resolutions and measures by the Council of the European Union, which have been notified to the Fund (see most recently, EBD/03/116, 12/17/2003) under Executive Board Decision No. 144-(52/51).

Membership Status:
(a) Joined: August 27, 1948
(b) Status: Article VIII, as from August 1, 1962

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	1,872.30	100.00
Fund holdings of currency	1,731.33	92.47
Reserve position in Fund	140.98	7.53
SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	179.05	100.00
Holdings	140.19	78.30

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):

	Forthcoming			
	2007	2008	2009	2010
Principal	--	--	--	--
Charges/Interest	1.25	1.67	1.66	1.67
Total	1.25	1.67	1.66	1.67

APPENDIX III. AUSTRIA: STATISTICAL ISSUES

Statistics are adequate for surveillance. Since September 1996, Austria has subscribed to the Fund's Special Data Dissemination Standard (SDDS), and its metadata are available on the Fund's electronic Dissemination Standards Bulletin Board:
http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=AUT
Austria is availing itself of the SDDS flexibility option on the timeliness of the industrial production index.

The transition to the new *European System of Accounts 1995 (ESA 1995)* has complicated the analysis of national accounts and fiscal data. The new national accounts do not provide information on household disposable income, except for an economy-wide aggregate, thus precluding the calculation of a household savings ratio. In addition, the reclassification of public hospitals in 1997 introduced a break in the national account series on public and private consumption. Fiscal data for 1995 onward—compiled in accordance with the *ESA 1995*—are not complete. Austria redesigned the BoP/IIP system with effect from 2005-06.

The authorities resumed reporting for inclusion in the *Government Finance Statistics Yearbook (GFSY)* the total outlays of general government according to major functional categories for 2000-04, in accordance with the methodology of the *Government Finance Statistics Manual 2001*. They also resumed reporting financing and debt data for inclusion in the *GFSY*, but without providing a breakdown between domestic and foreign debt.

Data in the 2007 Article IV staff report reflect information received by February 28, 2007.
More recent data may be obtained directly from the following sources:
Austrian Institute of Economic Research (WIFO) ....http://www.wifo.ac.at
Austrian National Bank ....http://www.oenb.at
Federal Ministry of Finance..http://www.bmf.gv.at
Institute of Advanced Studies (IHS)...............................http://www.ihs.ac.at
Statistics Austria ....http://www.statistik.at
Eurostat ....http://www.europa.eu.int/comm/eurostat
Information and documentation on Austrian economic
statistics may also be found at the Special Data
Dissemination Standard website of the IMF....................http://dsbb.imf.org

APPENDIX III. AUSTRIA: TABLE OF COMMON INDICATORS
(as of March 16, 2007)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	03/15/07	03/15/07	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jan. 2007	02/28/07	Monthly	Monthly	Monthly
Reserve/Base Money	Feb. 2007	03/14/07	Monthly	Monthly	Monthly
Broad Money	Jan. 2007	02/27/07	Monthly	Monthly	Monthly
Central Bank Balance Sheet	Feb. 2007	03/14/07	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	Jan. 2007	02/27/07	Monthly	Monthly	Monthly
Interest Rates[2]	03/15/07	03/15/07	Daily	Daily	Daily
Consumer Price Index	Feb. 2007	03/15/07	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3 2006	1/15/07	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Dec. 2006	03/16/07	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	Jan. 2007	02/21/07	Monthly	Monthly	Monthly
External Current Account Balance	Q3 2006	12/29/06	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q3 2006	12/29/06	Monthly	Monthly	Monthly
GDP/GNP	Q4 2006	2/13/07	Quarterly	Quarterly	Quarterly
Gross External Debt[5]	Q3 2006	12/29/06	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.

Statement by the IMF Staff Representative
April 23, 2007

This statement provides information that has become available since the issuance of the Staff Report for the 2007 Article IV Consultation. The new information does not change the thrust of the staff appraisal.

1. The 2007 and 2008 budget proposals were presented to Parliament on March 29. The resulting general government deficits are slightly lower for both years compared to the staff report and the January 2007 government program: -0.9 percent instead of -1.1 percent of GDP in 2007, and -0.7 percent instead of -0.9 percent of GDP in 2008 (all in Maastricht terms). The debt-to-GDP ratio in expected to drop below 60 percent in 2008. Staff has not had an opportunity to discuss the budget proposals in detail with the authorities.

2. The Austrian Stability Program for the period 2006 to 2010 has been submitted to the European Commission. The general government balances for 2007 and 2008 coincide with the presented budgets, while the targets for 2009 and 2010 remain unchanged from the government program.

Statement by Johann Prader, Alternate Executive Director for Austria
April 23, 2007

The Austrian authorities broadly agree with the staff's assessment of Austria's economic situation and its general recommendations on economic and financial policies. They appreciate the high quality of the Staff Report and the Selected Issues studies. The Staff Report again highlights Austria's good economic performance relative to its European peers in terms of GDP growth, unemployment, competitiveness and public finances.

Short-term outlook

As anticipated in the last Staff Report, Austria's economy has continued its strong growth performance, unemployment has been declining since March 2006 and is expected to drop to 4.2 percent by the end of 2007, while inflation is at 1 ¾ percent, supported by moderate wage rounds despite signs of a tightening labour supply in 2007. In 2006, the Austrian economy recorded its highest growth since 2000. Real GDP grew by 3.2 percent, making Austrian growth performance better than that of the Eurozone. At an increase of 8.5 percent in real terms, exports of goods contributed strongly to growth. With imports growing significantly slower, net exports contributed one percentage point to GDP. Austria's superior growth performance can be explained by the improvement of its external competitiveness. Since 1995, Austria's real effective exchange rate has depreciated by more than 10 percent vis-à-vis the other member states. Reflecting the significant improvement in competitiveness, the current account has swung from an average deficit of about 1 percent of GDP before 1995, the year of EU entry, into surplus in 2004 and has shown a solid surplus ever since.

The economy has started particularly well in 2007. Thanks also to the mild winter, employment expanded at more than 2 ½ percent in the first quarter, the highest rate since 1974. Growth is broad-based, and is again expected to reach 3 percent. Investment is expected to continue to grow at a brisk pace in the face of very high capacity utilization and very favorable business survey results. Also consumption is increasingly gaining strength given record employment growth and favorable disposable income developments.

Fiscal policy

The new government came into office on 11 January 2007. The broad contours of fiscal policy have been maintained, aiming at a balanced budget over the cycle. As a result of buoyant revenues and a restrictive stance on expenditures, the general government deficit in 2006 turned out to be better than expected. The latest figure puts the deficit at 1.1 percent of GDP. In 2007, the deficit is forecast to decline further to 0.9 percent. The debt to GDP ratio had declined in 2006 and in 2008, it is expected to drop below 60 percent for the first time since 1993. The promotion of investment in the field of R&D, infrastructure and education continues to be very high on the agenda, but more weight is given to social protection and poverty reduction. Thus, the focus is on achieving many of the EU-Lisbon targets.

Compared to the policy of the previous government, less emphasis is put on reducing the tax burden. By implementing structural reforms in public administration, competition policy and the labor market, savings will be achieved, which can be returned to the tax payer in the form of a tax reform, planned for 2010. The government has made it clear that tax reductions are contingent on savings on the expenditure side.

The government plans to lower administrative costs for business by 25 percent by 2010, as well as to further streamline administrative processes (e.g. one-stop-shops). Reform of public administration on both the national and regional levels will continue. Within the central government, considerable savings have been generated by implementing administrative reforms, reducing duplication of work and reduction of personnel and by implementing performance-oriented remuneration schemes. In the coming years, emphasis will be put on the lower levels of government. By mid-year, a commission is expected to make proposals for a reform of the constitution. The central government pays attention to the joint budgetary responsibility of all regional authorities within the framework of the Austrian internal stability pact. For the fiscal revenue-sharing agreement in the period after 2008 it is planned to put special emphasis on the expenditure side.

Selected Issues

Medium-Term Budgetary Framework - What can Austria Learn from other countries?

Currently, Austria has a non-binding multi-year budget program which highlights the major political aims of the government. According to current plans, the government also intends to present to Parliament this year, a proposal for a medium-term expenditure framework (MTEF).

The MTEF would cover a period of four years and is to be revised on a rolling basis each year. It will be binding both for budget decision and for budget implementation in each fiscal year. The MTEF will be an instrument for setting strategic priorities on the expenditure side of the budget. For this purpose it will be divided into five broad categories. The expenditure limits for these categories would be binding for the entire 4-year period.

The MTEF law will be accompanied by a Strategy Report to set out the political priorities and targets of the budget as well as more detailed information on economic assumptions and expected revenues during the MTEF period (estimates for tax revenue, gross national product, gross debt etc.). The authorities concur with the staff that an MTEF by itself will not deliver fiscal discipline – commitment and longer-term planning is also necessary.

Long-Run Fiscal Challenges

The staff’s long-term projections are basically those made at the EU level. The sensitivity tests, however, are based on the IMF’s own assumptions and calculations and can, therefore, be reviewed by the Austrian authorities only to a limited degree. It is to be noted that the current discussions in the government on adjustments of the pensions system would affect orders of magnitude significantly below those indicated in the Selected Issues Paper.

The staff undertakes a comprehensive analysis of risk testing of fiscal sustainability in Austria, with the focus apparently more on the downside than on the upside risks. This approach also explains why there is such a large difference in debt developments between the worst-case scenario, which is, indeed, a “worst-worst-worst”-case, and the best-case scenario. Overall, however, this staff approach centred on long-term risk analysis appears to be a good one and should also be applied to other countries in future.

Cross-border Banking Issues for Austrian Banks and their Supervisors

The activities of banks and financial institutions in the CESE have been a clear success story. This applies not only to the financial institutions concerned but also to the Austrian economy at large, as financial institutions paved the way for legal services, real estate companies, the construction sector, retail trade and green field investment in the CESE.

Notwithstanding these positive elements, the staff rightly points out the challenges ahead and the financial supervision issues, which are also being discussed as a general topic in the EU framework.

INTERNATIONAL MONETARY FUND
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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes Article IV Consultation with Austria

On April 23, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

Austria's economy is doing well. Economic activity has been strong in recent years, with relatively high growth and declining unemployment. This favorable economic outcome is due to a combination of stability-oriented macropolicies, a range of structural reforms, strong international competitiveness resulting from a social partnership that facilitates wage moderation, and an orientation towards fast-growing economies in Central, Eastern, and Southeastern Europe (CESE).

The economy gathered speed in 2004-05, and growth is estimated to have reached 3.2 percent in 2006 - the highest since 2000. Growth in 2006 has been broad based with strong exports, continued private consumption growth, and a considerable pick-up in investment. Recent leading indicators, on both the production and consumption side, have been mostly positive. In line with developments elsewhere in Europe, economic growth is expected to slow somewhat in 2007, but remain strong at close to 3 percent.

Inflation came down in 2006 and was limited to 1.7 percent and wages have been increasing modestly despite higher labor demand. As economic activity picked up in recent years, employment growth accelerated and put unemployment on a downward trend. Austria's competitiveness and external position remain strong with a positive current account balance resulting from strong export growth.

[1] 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. 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.

Aided by cyclical developments, the fiscal deficit narrowed in 2006. Corporate income taxes performed well above expectations, and sales taxes also surprised on the upside. Initially, the 2006 deficit was projected to be 1.8 percent of GDP, but it is now estimated at 1.2 percent. In contrast, the structural deficit showed a small worsening in comparison to previous years. The public debt ratio came down in 2006, while remaining above the Maastricht reference value of 60 percent.

The banking sector continues to do well overall. It remains well-capitalized and profitable, with limited nonperforming loans, and the banks' ratings are generally in line with those of their peers. Activities in CESE remain important, both for the region, and as an important source of profit for the banks, as the Austrian banks increased their already large exposures to and market shares in this region. The authorities are taking action to further improve monitoring of the Austrian banks' activities in CESE, including foreign currency lending, and are also stepping up collaboration with host supervisors.

Executive Board Assessment

Executive Directors welcomed Austria's strong economic performance, which testifies its commendable record of sound macroeconomic policies and structural reforms, and has consistently surpassed that of the euro area. Economic growth in 2006 was broad-based and the highest since 2000; unemployment has been relatively low and declining; inflation remains well contained; and the fiscal deficit has come down. Directors expected the economy to continue to do well, based on continued strong international competitiveness and a positive outlook for Europe.

Directors noted that continued wage moderation will be essential to maintain Austria's competitiveness. Wages have been increasing only modestly, keeping unit labor costs in check, despite higher labor demand. Directors welcomed the recent agreements between social partners for 2007, which suggest that this trend will continue.

Directors supported the authorities' objective of maintaining a balanced budget over the cycle, and, in this context, felt that a more ambitious fiscal consolidation would be desirable at the present juncture. They noted that the current budget proposals plan only a limited decline in the deficit during a period of high growth, and that the target date for balancing the budget has been shifted from 2008 to 2009–10. Accordingly, Directors recommended an earlier return to balance based on fiscal adjustment rather than relying largely on the automatic stabilizers. In any case, unexpected windfalls should be saved.

Directors encouraged the authorities to move expeditiously on identifying and starting to implement expenditure savings. They noted that public administration, subsidies and transfers, pensions, and health care would be important areas for efficiency gains, while supporting increased spending on research and development, infrastructure, and education. Although there has been progress in streamlining public administration at the federal level, efforts are lagging at the local levels. Further streamlining of the functions of the various levels of government will therefore be essential for expenditure control. In this regard, Directors urged the authorities to use the opportunity of the grand coalition government to restart the constitutional reform process necessary for such reforms. They welcomed the planned adoption of a formal medium-term budgetary framework that sets explicit expenditure targets consistent with the fiscal objectives.

Directors welcomed the authorities' intention to consider tax cuts only towards the end of the government period, once expenditure measures have been implemented. This will be key to safeguarding the objective of reaching a balanced budget over the cycle. Future tax cuts should be focused, in particular, on reducing the burden on labor.

Directors noted that the banking system remains well capitalized and profitable, with limited nonperforming loans. However, they emphasized that the rapidly expanding activities of the financial sector require close monitoring and effective risk management. While the expansion by Austrian banks into CESE has been very profitable and helped financial deepening in the host countries, the risks have also grown. The growth of foreign currency lending by the banks warrants special attention. Directors emphasized the importance of both domestic and cross-border supervision. They welcomed the agreements signed between Austrian and foreign supervisors regarding information exchange and cross-border cooperation, and the efforts to increase consumer awareness of the risks associated with foreign-currency borrowing. Directors urged the authorities to continue to ensure that the banks use adequate risk management techniques, including when preparing for Basel II.

Directors supported the measures taken to further strengthen corporate governance in the banking sector. They recommended the forceful implementation of actions already underway, including more frequent on-site inspections and intensified off-site examinations, and the consideration of additional measures going forward. Directors welcomed the authorities' interest in a Financial Sector Assessment Program update.

Directors supported the focus on structural reform in the government program. They encouraged early implementation of plans for further deregulation, strengthening competition, and enhancing labor participation. Directors welcomed the comprehensive and balanced pension reform that seeks to address aging-related fiscal concerns. Further efforts are however needed to close loopholes encouraging early retirement, to extend the pension reform to the sub-national level, and to reform the health sector.

Directors commended Austria for its official development assistance of about 0.5 percent of GNP in 2006, and encouraged a further increase toward the UN target.

Austria: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 proj.
Real economy						
Real GDP (change in percent)	0.9	1.1	2.4	2.0	3.2	2.8
Domestic demand (change in percent)	-0.2	-1.2	2.4	1.5	1.3	2.2
CPI (period average, percent change)	1.7	1.3	2.0	2.1	1.7	1.6
Unemployment rate (in percent)	4.2	4.3	4.8	5.2	4.8	4.5
Gross national saving (percent of GDP)	21.1	21.5	21.4	22.0	22.8	23.2
Gross domestic investment (percent of GDP)	20.7	21.7	21.3	20.8	21.1	21.4
Public finance (in percent of GDP)						
Central government balance	-1.3	-2.0	-1.5	-1.9	-1.6	-1.6
General government balance	-0.7	-1.8	-1.3	-1.6	-1.2	-1.2
General government balance (EDP definition) 1/	-0.5	-1.6	-1.2	-1.5	-1.1	-1.1
General government debt	65.8	64.6	63.8	63.4	62.0	61.0
Interest rates (in percent) 2/						
Three-month interbank rate	3.3	2.3	2.1	2.2	3.1	3.8
10-year government bond	5.0	4.2	4.2	3.4	3.8	4.1
Balance of payments (percent of GDP)						
Trade balance	1.7	0.4	1.1	1.1	2.5	3.2
Current account balance	0.3	-0.2	0.2	1.2	1.8	1.9
Fund position (as of February 28, 2007)						
Holdings of currency (percent of quota)						92.5
Holdings of SDRs (percent of allocation)						78.3
Quota (millions of SDRs)						1872.3
Exchange rates						
Exchange rate regime			EMU Member			
Euro per U.S. dollar	1.06	0.88	0.80	0.80	0.80	...
Nominal effective rate (2000=100)	100.5	104.0	105.5	105.3	105.5	...
Real effective rate (1990=100) 3/	98.1	101.2	94.5	95.5	96.5	...

Sources: Austrian National Bank; Statistics Austria; Ministry of Finance; IMF staff projections.

1/ Maastricht Excessive Deficit Procedure (EDP); includes revenues from swaps.
2/ 2007 numbers are for February 2007.
3/ Based on relative normalized unit labor cost in manufacturing.