

Austria: 2010 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 2010 Article IV consultation with Austria, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 30, 2010, 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 July 29, 2010. 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 August 30, 2010 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 30, 2010 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Austria.

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AUSTRIA

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with Austria

Approved by Juha Kähkönen and Tamim Bayoumi

July 29, 2010

Executive Summary

- **Focus:** As Austria is emerging from the recession with worsened public finances, vulnerabilities in the banking sector, and weaker medium-term growth prospects, this consultation focused on ways to restore public finances, ensure financial stability, and enhance sources of future growth.
- **Background and outlook:** The government intervened heavily—through fiscal stimulus and financial sector support packages, including the nationalization of some smaller banks. With global demand picking up, the recovery is now underway, but external uncertainties are significant.
- **The policy challenges are three-fold:**
 - Fiscal consolidation should start, as planned, in 2011, to bring debt on a declining path after 2013. While the government currently plans a 60/40 split between expenditure and revenue measures, a mostly expenditure-based consolidation with participation of all levels of government would help minimize the effects on growth and enhance sustainability.
 - Financial stability needs further strengthening. While capital positions have strengthened, remaining weaknesses in a number of banks need to be addressed. Despite welcome improvements to the supervisory framework, some important gaps in supervisory and resolution powers still need to be filled.
 - Structural reforms are crucial to strengthen potential growth in view of lower growth prospects in some Central, Eastern and South Eastern European countries and population ageing. The authorities were considering measures to raise the effective retirement age.

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I. THE CONTEXT

1. **The Austrian economy is recovering from a sharp decline in real GDP in 2009.**

This 3.9 percent decline was between those experienced by its neighbors Germany and Switzerland, with which Austria shares a number of features—limited indebtedness of corporate and households, and strong contributions of trade to growth in the last decade.

2. **Austria is dependent on foreign developments, but is also important for many Central, Eastern, and South Eastern European (CESEE) countries.**¹

Exports represent more than 50 percent of GDP, with Germany and CESEE countries respectively taking up one third and one fifth of total. Foreign bank claims amount to 140 percent of GDP, half of which are to the CESEE. About 13 percent of the labor force in Austria is foreign-born.

3. **The legacy of the crisis is apparent on three fronts:**

- The fiscal deficit and debt of the general government are expected to reach respectively 4¾ percent and 70 percent of GDP in 2010. In addition to the workings of automatic stabilizers, these increases largely reflect permanent tax cuts decided in 2008 and 2009.
- The financial sector, weakened by the bursting of credit bubbles in some CESEE countries, still faces rising nonperforming loans and will be affected by regulatory changes, while public support schemes are to gradually unwind.
- Potential growth will be affected in the context of less dynamism in some CESEE countries and an ageing population.

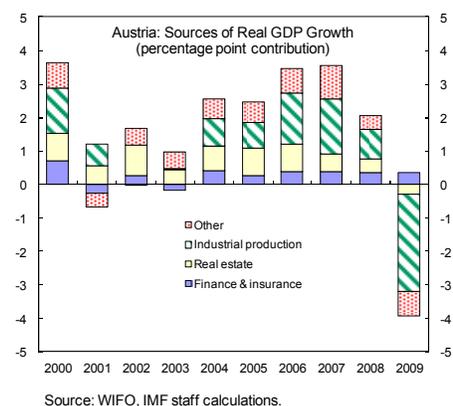
II. RECENT DEVELOPMENTS AND OUTLOOK

A. The Crisis

4. **GDP contracted by 3.9 percent in 2009, mainly as a result of a trade shock (Figure 1).**

Industrial production shrunk by about 12 percent in 2009.

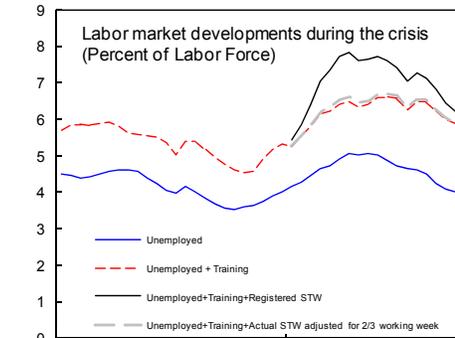
5. **On the demand side, both net exports and investment fell sharply.** Net trade contributed about half of the decline in GDP in 2009, while machinery investment contracted by around 14 percent.



¹ CESEE refers to Hungary, Poland, Slovakia, Slovenia, Czech Republic, Romania, Bulgaria, Albania, Bosnia & Herzegovina, FYRM, Serbia, Montenegro, Croatia, Ukraine.

Credit conditions tightened and larger firms increased their recourse to bond financing (Figure 5). However, the increase in loan spreads to SMEs was in line with past recessions, the drop in credit followed activity, and surveys suggest that investment reacted more to depressed demand than to tighter financing conditions. The authorities, too, saw little evidence of a credit crunch.

6. **Consumption held up thanks to relatively comfortable balance sheets, limited wealth effects,² and still dynamic labor incomes.** Part-time and training schemes are estimated to have reduced the increase in unemployment, from 3.8 percent mid-2008 to 5.1 percent mid-2009, by about 1 percentage point.³ The authorities also pointed to the concentration of the shock on capital-intensive industries.



Source: OeNB and Haver.
Note: STW=Short-term working week. Data on monthly STW before 2009 is unavailable.

B. Recovery and Uncertainties

7. **Austria is well equipped to benefit from the pick-up in trade.** Wage agreements in Austria are traditionally moderate, and CGER approaches do not point to a misalignment of the real exchange rate (Figure 3). As trade recovers, GDP growth is expected to reach about 1.5 percent in 2010 and 2011. Given the slack in the economy, inflationary pressures should remain limited, in spite of the depreciation of the euro. The authorities broadly shared this view.

8. **However, the outlook is fragile.** Given its trade and financial openness, Austria is particularly exposed to growth and financial shocks, notably in the euro area and CESEE. While direct financial exposure to Southern euro area countries and Ireland is moderate, renewed tensions in some CESEE countries could bear on funding costs and profitability of Austrian banks, with possible implications for domestic credit supply and growth.

C. Medium-Term Perspectives

9. **In the medium run, potential growth is unlikely to return to pre-crisis levels.** It will be affected by ongoing weak investment, including as a result of an ageing population and lower growth in some CESEE countries (Box 1, Figure 4). While migration is a mitigating factor, the working age population is slowing down and is expected to start

² Fenz and Fessler, "Wealth Effects on Consumption in Austria," *Monetary Policy & The Economy*, Q4/08, Österreichische Nationalbank.

³ Taking into account actual short-term work and adjusting by one third to take account of the effective reduction in working time.

contracting from 2020 onwards. Overall, potential growth is estimated to have diminished from around 2 percent in the years preceding the crisis to 1.7 percent by 2014.

Box 1. 'Boom-Bust' in CESEE and Implications for Austria⁴

In the decade preceding the crisis, Austria was able to seize the opportunities arising from opening up and catching up of CESEE economies. According to empirical studies, EU enlargement increased Austrian GDP growth by 0.4 percentage points each year, with also positive effects on employment.⁵ (Net) exports, FDI to CESEE, and returns from these investments, including in the financial sector, increased substantially to reach considerable shares of the corresponding aggregates.

Financial and Real Linkages Austria-CESEE

	Stock of FDI in CESEE (2007)	Exports to CESEE (2004-2008)	Imports from CESEE (2004-2008)	Net trade with CESEE (2004-2008)	Total gross investment income from CESEE (average 2004-2008)	Financial sector profits from CESEE (2004-2009)
Billion euro	51.1	28	21.9	5.9	6.9	2.3
% of total	49.9	19.3	16.4	55	30	46
% of GDP	18.7	10.9	8.4	2.2	2.7	0.9

Source: OeNB, WIIW and staff calculations.

Note: In the case of CESEE, gross investment income is a good proxy for net investment income.

However, in some CESEE countries, the convergence process degenerated into a credit boom which burst in the context of the global financial crisis. Domestic demand in these countries is anticipated to be well below levels and pace before the crisis, in contrast to the more balanced economies of the region. GDP is also expected to be affected, though to a lesser extent as countries reorient to more export-oriented activities. As a result, Austrian exports and returns on investments could be more subdued than in the past. GDP growth could be lower by about 0.1 to 0.2 percentage points and the current account balance reduced by 0.3–0.5 percent of GDP over the projection period.

10. **Staff viewed a better utilization of labor resources a priority.** While Austria fares well in research and development, use of labor market resources could be improved in certain segments of the population (Box 2). The authorities saw the gradual introduction of the 2003 pension reforms and measures to improve the health of workers as ways to increase the effective retirement age. While welcoming these reforms, staff noted that their introduction was very gradual and that recent measures have tended to lower participation rates of older workers. Authorities also pointed to the gradual introduction of compulsory and free pre-school education for 5-year olds as a way to improve employment conditions for women and the socially disadvantaged.

⁴ See Annex.

⁵ F. Breuss, "Oesterreich, 15 Jahre EU-Mitglied", *WIFO-Monatsberichte* (2/2010).

Box 2. The Austrian Labor Market: Issues and Challenges

With moderate growth in unit labor costs, high employment and low unemployment rates, overall, the Austrian labor market compares favorably with its European peers (Figure 3). Apart from 2008–09, past collective bargaining agreements have resulted in wage increases comparable with the German ones, and unemployment is well below the EU average.

However, there are significant differences in employment outcomes across subsets of the population. Employment rates are low for older workers (41 percent of workers aged 55–64 employed, while the EU average is 46), and also to some degree for low skilled (below 50 percent relative to 60–65 percent in some other European countries). Unemployment is high for foreign-born workers. An above average share of female employment is part-time.

Policies have a role to play. The effective retirement age is well below legal age due to early and partial retirement schemes, and disability benefits (entered by about a third of the work force, at an average age of 51). The introduction of the 2003 pension reform—which increases incentives for later retirement and extends the accounting period for the pension base—is very gradual. And some recent measures have resulted in opposite effects and have been misused for early retirement—such as those in support of old age part-time work and the extension of a pension scheme for the long-term insured (“Hacklerreglung”). High effective labor tax rates weigh on employment of the low-skilled. Also, education may be relying excessively on family support, resulting in one of the largest achievement gap among OECD countries for children with migrant origins. Finally, the gender wage gap is high and more effective female participation is hampered by a variety of factors, including the absence of full-day pre-school child care and schools.

Legal Retirement Age and Effective Age of Exit for the Active Population, 2002-07

	Men		Women	
	Effective Age	Legal Age	Effective Age	Legal Age
Austria	58.9	65	57.9	60
Belgium	59.8	65	58.3	65
Canada	63.3	65	61.9	65
France	58.7	60	59.5	60
Germany	62.1	65	61	65
Italy	60.8	65	60.8	60
Japan	63.5	64	66.5	62
Luxembourg	59.2	65	60.3	65
Spain	61.4	65	63.1	65
Sweden	65.7	65	62.9	65
Switzerland	65.2	65	64.1	64
United Kingdom	63.2	65	61.9	60
United States	64.8	65.8	63.9	65.8
OECD-30	63.5	64.4	62.3	63.1
EU-19	61.7	64.3	60.5	62.7

Source: OECD estimates derived from national surveys and the European workforce.

11. **A strong implementation of EU directives is also needed to boost competition in services.** OECD indicators suggested restrictions in some utilities sectors as well as in liberal professions. The authorities pointed at a planned strengthening of the Federal Competition Authority, measures to decrease administrative burdens for businesses, and several ongoing regulatory changes. The law on postal markets will enter into force in January 2011, implying the removal of the remaining monopoly on letters weighting less than 50 grams, while transposition of the EU Services directive is in process. Transposition of the EU directive on nondiscriminatory network access in energy markets should be effective by 2011–12.

III. FISCAL POLICY: FROM STIMULUS TO CONSOLIDATION

12. **While deficit and debt levels do not compare unfavorably with the average of the euro area, Austria's fiscal position has weakened significantly (Figure 6).** The general government deficit and debt are set to rise to respectively 4.8 and 70 percent of GDP in 2010, from 0.5 percent and 59 percent in 2007. Discretionary stimulus measures, which totaled almost 2 percent of GDP in cumulative terms in 2010, were mostly designed to be permanent, thus complicating consolidation efforts.

Fiscal implications of stimulus packages 2008-13
(Cumulative effect on deficit, in percent of GDP)

	2008	2009	2010	2011	2012	2013
Decisions of Parliament of 24th Sept 2008 1/	0.2	0.4	0.4	0.5	0.5	0.6
Growth Programme I 2/	0.0	0.0	0.0	0.0	0.0	0.0
Growth Programme II 3/	0.0	0.1	0.2	0.2	0.1	0.0
Tax reform 2009 4/	0.0	0.8	1.1	1.1	1.0	1.0
Other 5/	0.1	0.2	0.2	0.1	0.1	0.1
Total	0.3	1.5	1.9	1.8	1.8	1.7

Source: Authorities.

1/ Mainly related to pension and family benefits and VAT exemption for pharmaceuticals.

2/ Measures with a focus on business environment and SMEs.

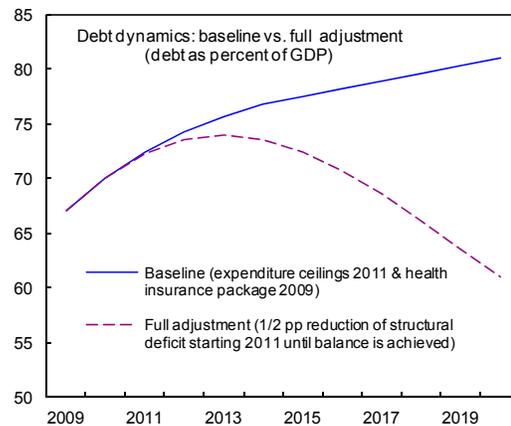
3/ Investment and R&D incentives; mandatory kindergarden year.

4/ Predominantly related to income tax (including family components).

5/ Short-time work package, reduction of unemployment insurance contributions, car scrapping premium, etc.

13. **Reducing the deficit to below 3 percent of GDP by 2013 and continuing consolidation in 2014 and beyond would put the debt-to-GDP ratio on a declining path from 2014 onwards.** Staff supported the continued fiscal stimulus in 2010 given the fragility of the recovery and lack of evident imbalances.

Looking forward, the authorities have planned to reduce the deficit from 2011 onwards and designed a consolidation path until 2014, with annual structural steps of about ½ percent of GDP. Under this scenario, general government debt would increase to around 75 percent of GDP by 2013 before decreasing. Noting that current policies were unsustainable staff saw the planned consolidation path as appropriate, but stressed the need to identify early the measures to achieve consolidation. Moreover, as market pressures had been observed when banks came under stress connected to instability in some CESEE countries, the authorities were advised to stand ready to take additional measures if needed to guarantee achievements of targets, or in case of market pressures.



Source: Staff calculations.

14. **The authorities have decided a 60/40 percent split between expenditure and revenue measures.** At the central government level, Parliament has approved new medium-term expenditure ceilings, 4 percent lower than previous year's ceilings, binding for each ministry in 2011. Performance-based budgeting is to be introduced by 2013. While welcoming these actions, staff noted that the envisaged expenditure reductions will need to be underpinned by structural measures to be sustainable. The authorities agreed, indicating that these would be included in the 2011 budget to be transmitted to Parliament in December 2010. In addition, public health insurance companies are expected to save a total of 1.7 billion euro over 2010–13 on medical and related fees, leading to a potential cumulative deficit-reducing impact of some 0.2 percent of GDP. Other measures are yet to be defined, including a bank levy, expected to yield 500 million euro (close to 0.2 percent of GDP).

Austria: Fiscal Developments 2007-15

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Staff Baseline Scenario 1/	percent of GDP (unless otherwise indicated)								
Overall balance	-0.5	-0.5	-3.5	-4.8	-4.1	-3.9	-3.7	-3.7	-3.6
Gross debt	59.2	62.4	67.1	70.1	72.5	74.2	75.8	76.8	77.6
Real GDP growth	3.7	2.2	-3.9	1.5	1.6	1.7	1.8	1.8	1.8
Authorities' Adjustment Scenario	percent of GDP (unless otherwise indicated)								
Overall balance	-0.5	-0.5	-3.5	-4.7	-4.0	-3.3	-2.7	-2.3	-
Gross debt	59.2	62.4	67.1	70.2	72.6	73.8	74.3	74.2	-
Real GDP growth 2/	3.7	2.2	-3.9	1.5	1.5	1.9	2.0	-	-

Source: Eurostat (until 2009); authorities and staff projections.

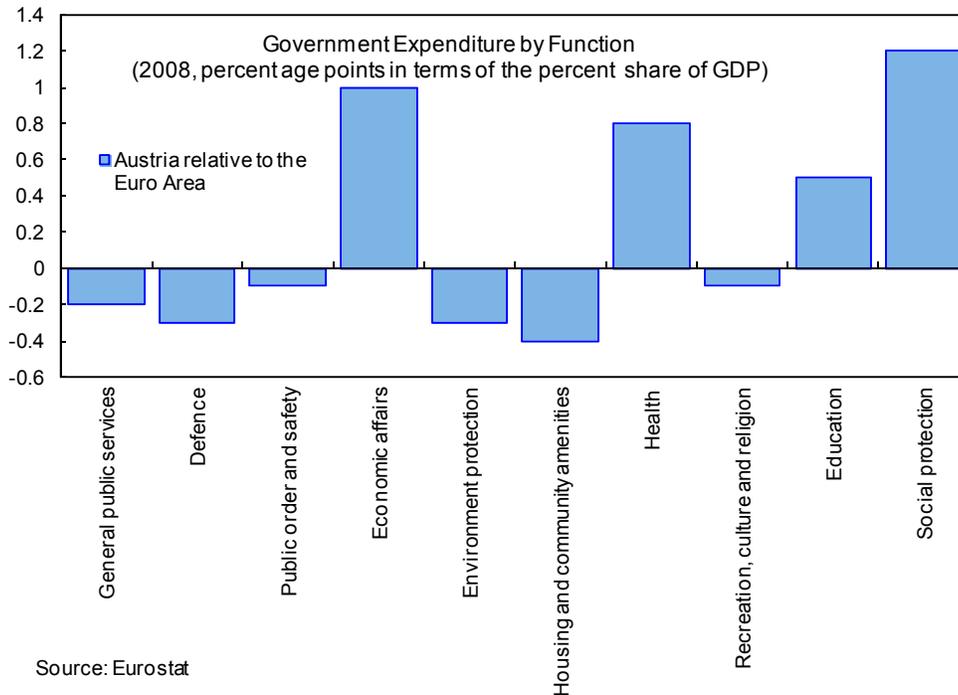
1/ Assumes implementation of expenditure ceilings at the federal level in 2011.

2/ Stability Programme Jan 2010.

15. **Staff recommended a mainly expenditure-based consolidation at all levels of government, noting room for rationalization.** Evidence suggests that expenditure based consolidations are more sustainable. Moreover, expenditure levels are elevated in international comparison in Austria, with outcomes not always commensurate to spending (Box 3). In several areas with savings potential, such as health care, responsibilities overlap across government levels. More broadly, the current federal framework suffers from a number of shortcomings (Box 4). Working groups on administrative reforms have been put in place but have not resulted in any decision. An overhaul of fiscal federal arrangements would be desirable to disentangle responsibilities and better align taxing with spending powers. Staff also recommended revisiting Austria's internal stability pact, to reduce its procyclicality—including by adopting expenditure ceilings also at the *Laender* level—and to improve compliance through binding sanctions. Finally, as some local governments have been issuing guarantees in excess of their financial abilities, the mission advised setting ceilings. The authorities indicated that discussion between government levels would take place in the fall.

Box 3. Fiscal Spending and Outcomes

An analysis of current levels of spending and outcome indicators suggests some possible areas for savings and/or efficiency gains.



- Subsidies:** Subsidies exceed the average, with more than half going to public enterprises (notably railways and hospitals) and the rest being spread on various private recipients. The authorities' efforts to improve their administration and increase transparency should help identify possible savings.
- Health:** While health spending is higher than the euro area average, life expectancy and healthy-life years are around average. Hospital spending has a particular high share, as Austria ranks among the top two in the EU in terms of hospital beds and hospital visits per inhabitant. Rationalization, which would require increased coordination across *Laender*, could help reap scale benefits, see OECD Economic Surveys (2005, 2009) and WIFO "*Optionen zur Konsolidierung der oeffentlichen Haushalte in Oesterreich*" (2010).
- Social protection:** Spending adds up to some 20 percent of GDP. The share of pensions is relatively high (around 2/3 against an average of 60 percent), even though the old-age dependency ratio is close to average.
- Education:** Education spending is roughly in line with the average. However, this is due to low enrollment rates at the tertiary level, while spending per student is consistently higher than average across attainment levels. Results are mixed (evidenced by PISA scores, for example) and efficiency could be increased, see OECD (2009).

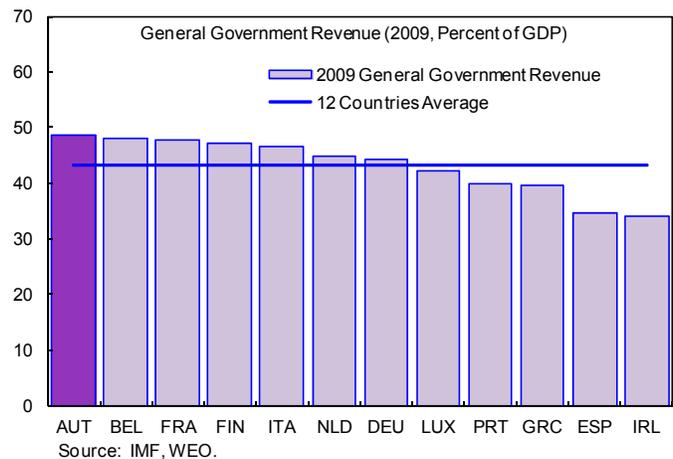
Box 4. Fiscal Federalism and the Austrian Stability Pact

Austria's federal system consists of the federal government, nine states (*Laender*), and some 2,350 municipalities.

Intergovernmental fiscal relations are characterized by a strong disconnect between spending and taxing powers, reflecting fragmentation and overlaps in responsibilities across government levels. While the sub-national government levels spend almost one third of general government outlays, their taxing power is very limited—and only exists at municipality level (communal tax based on enterprises payroll and real estate tax). Resources come mostly from transfers, co-financing, and shared taxes (notably personal income and corporate taxes and the value added tax). The complexity of financial flows is augmented by the existence of numerous extra-budgetary entities at all levels. Fiscal relations are regulated in a fiscal equalization law that is periodically re-negotiated, usually in connection with the internal Austrian Stability Pact. The current law is valid for 2008–13 if not renegotiated.

The internal stability pact suffers from design and implementation issues. In 1999, the “Austrian Stability Pact” was instituted to share fiscal consolidation burdens across layers of government. The pact sets annual numerical targets for the headline deficit of central government, *Laender*, and municipalities. Before the crisis, over-achievement at the federal level had often compensated under-performance at the *Laender* level. No sanctions were enforced. Nominal deficit targets may furthermore be procyclical, although there is some leeway for temporary deviation. Finally, there seems to be room for improvement in information exchange and coordination among partners. The most recent pact, supposed to be valid from 2008 to 2013, is unsurprisingly off track since 2009.

16. **Staff saw little scope for increasing revenues.** Austria has one of the highest overall tax-to-GDP ratios and labor-tax wedges in the European Union, but some taxes are low or nonexistent (general wealth, inheritance, and gift taxes). In this context, while advising against large tax increases, staff saw targeted tax increases as possible in complementing the effort on the expenditure side. Raising the real estate tax, set on the basis of outdated valuations and only yielding $\frac{1}{4}$ percent of GDP (whereas property taxes in the EU-15 yield on average around 2 percent of GDP) would improve municipalities' taxing power, and there was room for increasing fuel taxes that are lower than in neighboring countries, including most recent EU Member states.



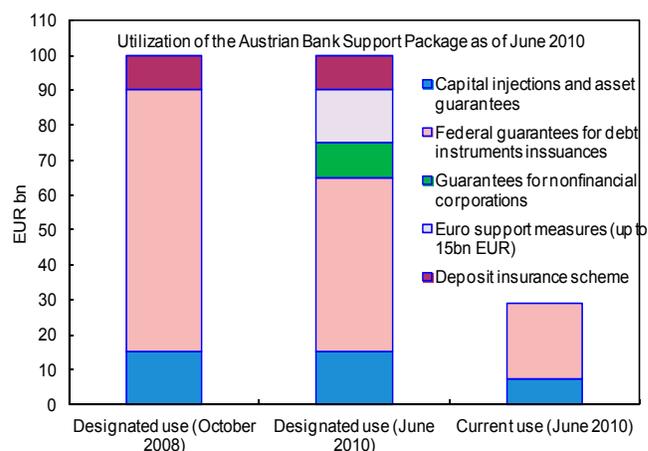
IV. FINANCIAL SECTOR: MANAGING REMAINING RISKS AND STRENGTHENING FINANCIAL STABILITY

Financial stability

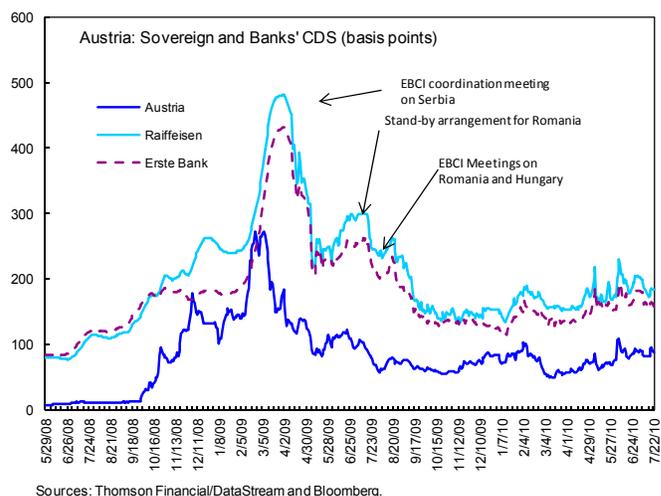
17. **Public support helped reduce market pressures on banks.** The global financial crisis and the bursting of credit bubbles in some CESEE countries weakened the Austrian banking sector. Public financial support, together with the EU/IMF-supported programs in some CESEE countries, was instrumental in improving market confidence, as evidenced by declining CDS spreads. In addition to government capital injections, asset guarantees and guarantees on issuances at the national level, banks benefited from increased liquidity from ECB operations—but with their share of the total tender volume remaining comparable with pre-crisis levels. Some banks (notably KommunalKredit and Hypo Group Alpe Adria) had to be nationalized and will be restructured, including on a cross-border basis.

18. **Banks broadly maintained their exposures to European Bank Coordination (“Vienna”) Initiative economies, contributing to their stabilization.** Exposure was maintained vis-à-vis the countries that acceded the EU in 2004 and 2007 and South Eastern European Countries, but was reduced by more than a third vis-à-vis CIS countries.

19. **Capitalization continued to improve on the back of capital increases and deleveraging (Figure 8).** While one bank relied solely on intra-group support, the other large banks received public capital injections, for a total of 7.4 billion euro, complemented in some cases by private capital. Their deleveraging has amounted to 13 percent of assets so far. Ratios also improved for the other banks, mostly on the back of private capital. However, while recent stress tests conducted by the OeNB suggest that the banking sector would on the whole be able to withstand a double-dip recession scenario, banks’ capital ratios currently appear to be slightly below peers and there is wide heterogeneity. In this context, the mission



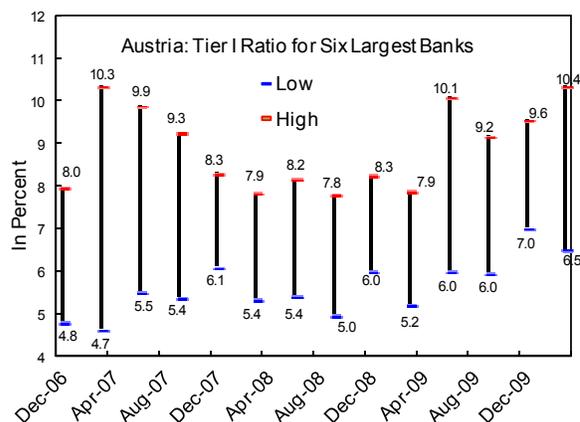
Source: OeNB



Sources: Thomson Financial/DataStream and Bloomberg.

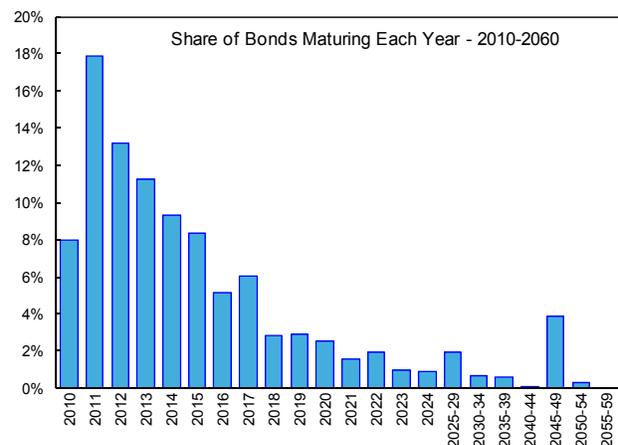
recommended to closely monitor the situation of individual banks and take appropriate action to reinforce capital buffers if needed.

20. **The banking sector registered a slight recovery in profitability in 2009, but nonperforming loans have not peaked yet.** Return on assets after taxes registered a slight increase, as profits from trading income increased substantially, but loan loss provisioning increased, to 2.8 percent as of the end of 2009 for Austrian non-bank customers, and 5.2 percent for subsidiaries in CESEE and CIS. At end-2009, for the largest banks, nonperforming loans reached an average of 2.3 percent of all loans in Austria and 9.7 percent of non-bank customer loans in CESEE and CIS countries—with large heterogeneity across countries. However, some banks are also restructuring loans, expecting that the recovery will restore customer solvency.



Source: OeNB.

21. **Looking ahead, banks will face a number of headwinds.** Some banks rely heavily on money and financial markets, and a high share of bonds will mature in the next few years (26 billion euro in 2011 alone). The sustainability of banks' earnings performance will be challenged as the currently favorable environment (low funding costs, a steep yield curve, and a rebound in markets) subsides and if the need for provisioning continues to rise. Banks' profitability will also be dented by anticipated bank levies. The authorities expressed concern about their introduction in neighboring countries—and the resulting possible multiple taxation of Austrian banks. The mission advised that bank taxes should be properly designed, and coordinated, to enhance the resilience of the financial sector.



Source: OeNB, based on Bloomberg.

22. **Banks would be strongly affected by Basel requirements as proposed in December 2009.** Liquidity requirements were seen as overly demanding by banks and the authorities. There was also high sensitivity to the definition of Tier 1 capital, with minority interests representing 25 percent of tier 1 capital in Austrian banks. However, no validated quantitative estimates of the impact of Basel proposal were available, as the quantitative impact study had not been completed. While recognizing the need to implement measures in

a manner that does not adversely affect economic recovery and noting ongoing calibration, staff stressed that strengthening capital and liquidity positions was needed in light of the crisis. The authorities agreed with the need to strengthen the global financial system but were particularly attentive to the fact that new requirements should not put customer oriented business models at a disadvantage.

23. **Direct exposure to euro area countries that have come under market scrutiny seems manageable.** According to BIS consolidated data, exposure to Southern euro area countries (excluding Italy) and Ireland represented about \$25 billion at end-2009 (6.8 percent of GDP), while exposure on Italy alone was also about \$25 billion. This compares with an exposure on CESEE of \$242 billion ($\frac{2}{3}$ of GDP). However, in addition to their direct exposure and if developments were unchecked, Austrian banks would also be affected through increased counterparty risk and more expensive funding, including as one large bank is a subsidiary of an Italian group.⁶

24. **In this context, staff concurred with the authorities on the need to keep the financial sector support package in place for the time being.** The authorities have obtained EC approval to extend the banking stabilization package until end-2010. Staff agreed that while care should be taken to limit distortions by tighter access costs and conditions, as agreed at the EU level, a stronger financial sector is necessary for the removal of financial support.

25. **Efforts to discourage foreign currency lending are being stepped up.** Despite a string of policy measures since 2003, foreign currency lending still constituted slightly less than a fourth of banks' loan exposure on an unconsolidated basis at the end of 2009. Tighter guidelines were defined by the Austrian Financial Market Authority (FMA) in 2010, with OeNB assessing compliance through on-site inspections. In Austria, bullet loans with repayment vehicles, often associated with fx lending—of which some three fourths were directly exposed to market risk in spring 2009—should no longer be available and when offered an fx loan, customers must have a natural hedge or the highest credit rating. Banks are expected to reduce volumes of fx loans over the long term. In the CESEE subsidiaries, about half of the lending was in foreign currency at the end of 2009. Austrian banks are requested to avoid non-euro denominated fx lending, and Austrian supervisors are working with other home and host supervisors. While fx loans to domestic households have started to decline, they have shown little decrease abroad. The authorities expressed hope that the European Systemic Risk Board would contribute to working out cooperative solutions among supervisors. Staff supported ongoing efforts to reduce this source of vulnerability while avoiding to undermine excessively the financing of CESEE countries.

⁶ By construction, this bank's exposures are counted as Italian exposures in BIS consolidated data.

26. **The insurance sector recovered in 2009.** Overall results of insurance companies recovered in 2009. FMA noted that stress tests conducted at end-2009 showed a clear improvement and that the two biggest companies were able to pass all EU-level stress tests. However, as pensions companies were unable to generate sufficient revenue in 2008, they had to request additional payments from employers (close to 0.3 percent of GDP) to meet defined benefit payouts (30 percent of the plans) and will often need to reduce pension payouts for defined contribution schemes. In state-sponsored retirement provision (Zukunftsvorsorge), and in line with the FSAP recommendations, minimum investment requirement in stocks was decreased in January 2010 to 30 percent and a life-cycle model introduced.

Supervision and regulation

27. **Staff welcomed the ongoing strengthening of supervision.** The OeNB is responsible for fact finding, including off-site and on-site bank supervision, while the FMA is responsible for decision making, including licensing and enforcement.⁷ Clear responsibilities and communication channels have been established between the two institutions and reflected in a joint report. The supervisory capacity and the number of inspections have increased, including on a cross-border basis, but the large number (more than 800) of small banks still implied a lot of reliance on off-site assessments. Also, the authorities do not have so far the ability to undertake on-site inspections in some non-EU Member states—Ukraine, Kazakhstan, and Russia—comprising 9 percent of all CESEE exposures. Staff supported ongoing effort to remedy this situation and FMA willingness to be able to impose greater financial penalties and supervise non-bank activities which have been a source of vulnerability.

28. **Staff also recommended extending FMA’s early intervention powers and introducing a specific bank resolution framework.** Staff advised putting in place a system mandating early remedial action, with powers entrusted to the FMA to intervene if needed to restructure a bank. The authorities felt early intervention powers were important but expressed reservations on a framework that would rely on hard triggers, as recommended in the 2008 FSAP update. Furthermore, staff recommended designing a specific bank resolution framework, as the existing one only provides for a limited range of options (receivership and insolvency under the standard company law) while other bank resolution methods (e.g. purchase and assumption, bridge banks, or mergers) are not explicitly recognized.

29. **Staff welcomed Austria’s action plan to remedy strategic deficiencies previously identified by the Financial Action Task Force (FATF).** Based on Austria’s commitment to further improve compliance, the FATF plenary removed Austria from its specific review list in June 2010. Austria has also accepted article 26 of the OECD model Tax convention.

⁷ The FMA also participated in interpreting and drafting supervisory legislation.

30. **In May 2010, the Republic of Austria acquired the OeNB's remaining shares from financial sector institutions and economic interest groups.** Regardless of the ownership structure, staff indicated that the operational and financial independence of the Central Bank had to be preserved.

V. STAFF APPRAISAL

31. **Decisive policy action is needed to preserve Austria's strengths and address weaknesses unearthed by the crisis.** As an open and competitive economy Austria's performance had been strong before the crisis. Going forward, significant integration with neighboring countries also bears risks, notably in the financial sector. This calls for determined fiscal consolidation, continued efforts to strengthen financial sector resilience, and structural measures to support potential growth.

32. **The increase in public debt should be reversed through steadfast consolidation.** As planned, the general government deficit should start decreasing in 2011, be brought below 3 percent by 2013, and continue to decrease thereafter to bring debt on a declining path. With a debt-to-GDP ratio expected to rise until 2013 even with the planned consolidation, a clear commitment to a lasting consolidation and sustainability should be signaled and measures defined early on. Also, the authorities should stand ready to take additional measures if needed.

33. **A well-designed and mostly expenditure-based consolidation, with participation of all government levels, could minimize the effects on growth and enhance sustainability.** Savings should be targeted in areas where spending is high and outcomes not commensurate (health) or where spending could be better targeted (subsidies, social benefits). In this respect, while the revised medium-term expenditure framework at central government level is welcome, participation of sub-national levels in consolidation should also be ensured. To this end, the current framework ("internal stability pact") needs to be strengthened and ceilings to local governments' debt and guarantees issuance need to be introduced. Across-the-board tax increases should be avoided.

34. **Potential growth should be supported by structural reforms.** In particular, special schemes and long transition periods which are undermining the 2003 pension reforms should be eliminated. Raising the effective retirement age would enhance sustainability and growth. In the services sector, competition should be stepped up, including through an effective transposition of the EU Services Directive.

35. **The overall situation of banks has improved but vulnerabilities remain.** As some banks have weaker capital positions and strong dependence on wholesale and market funding, the authorities should closely monitor the situation of individual banks, including on the basis of stress tests results, and ensure appropriate action is taken in a timely manner.

36. **Exit policy and new policy measures need to be carefully designed.** The extension of the current financial support package is appropriate. The authorities should furthermore ensure various measures and regulatory changes considered enhance the resilience of the financial sector, through proper design and taking into account their combined effects.
37. **Supervision should be further strengthened.** A number of positive steps have already been taken, but FMA powers should be further stepped up. In particular, a system mandating early remedial action and a proper resolution framework should be put in place.
38. **Providing continued financing to the CESEE region while reducing the share of foreign exchange loans will be a key challenge.** The authorities' efforts to implement and enforce tighter fx-lending standards in coordination with other supervisors are welcome.
39. **Steps taken by the authorities to ensure that their financial system cannot be used for unlawful purposes are welcome.** Compliance with FATF recommendations should be further strengthened.
40. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle.**

Table 1. Austria: Basic Data, 2005-11

Total area	83,850 square kilometers						
Total population (2009)	8.3 million						
GDP per capita (2009)	US\$ 44,150(€ 33,130)						
	2005	2006	2007	2008	2009	2010	2011
						Proj.	
	(Percentage changes at constant prices)						
Demand and supply							
GDP	2.5	3.6	3.7	2.2	-3.9	1.5	1.6
Total domestic demand	1.9	2.2	2.5	1.3	-2.3	0.5	1.0
Consumption	2.0	2.0	1.1	1.4	1.1	1.1	0.8
Gross investment	1.6	3.0	7.0	1.0	-12.7	-1.9	1.7
Foreign balance 1/	0.7	1.5	1.3	1.1	-2.0	1.1	0.7
Exports of goods and nonfactor services	7.4	7.7	8.6	1.0	-16.1	3.8	3.8
Imports of goods and nonfactor services	6.4	5.4	7.0	-0.9	-14.4	1.9	2.9
Output gap (percent of potential GDP)	-0.6	1.0	2.9	3.6	-1.5	-1.2	-0.8
	(Percentage changes; period averages)						
Employment and unemployment							
Employment	1.0	1.6	1.9	2.3	-1.4	0.2	0.3
Unemployment rate (in percent)							
Registered (national definition)	7.3	6.8	6.2	5.8	6.8	6.5	6.5
Standardized (Eurostat)	5.2	4.8	4.4	3.8	4.8	4.5	4.5
	(Percentage changes; period averages)						
Prices							
Consumer price index	2.1	1.7	2.2	3.2	0.4	1.5	1.7
Unit labor costs (manufacturing)	-0.7	-4.2	-1.7	1.0	9.7	-1.3	-0.3
	(Percent of GDP)						
General government finances 2/							
Revenue	48.4	47.8	47.9	48.3	48.8	47.5	47.6
Expenditure	50.2	49.4	48.5	48.8	52.3	52.3	51.7
Balance	-1.8	-1.6	-0.5	-0.5	-3.5	-4.8	-4.1
Structural Balance	-1.6	-2.2	-1.8	-2.0	-2.8	-4.3	-3.7
Gross debt (end of period)	63.9	62.1	59.2	62.4	67.1	70.1	72.5
	(Billions of euros)						
Balance of payments							
Trade balance (goods)	-1.0	0.3	-0.6	-1.0	0.3	2.4	3.2
Current account	5.3	7.3	5.2	5.3	7.3	7.2	7.7
(In percent of GDP)	2.2	2.8	1.9	1.9	2.6	2.5	2.6
	(Percent; period average)						
Interest rates							
Three-month interbank rate	2.2	3.1	4.3	4.6	0.7	...	...
10-year government bond	3.4	3.8	4.3	4.3	3.6	...	...
	(Levels; period average)						
Exchange rates							
Euro per US \$	0.80	0.80	0.73	0.68	0.69	...	...
Nominal effective exchange rate (2000=100)	105.3	105.5	107.0	107.9	108.3	...	...
Real effective exchange rate (1990=100)							
ULC based	108.1	105.9	106.7	107.6	109.9	...	...
CPI based	105.9	105.6	106.8	107.7	108.0	...	...

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

1/ Contribution to GDP growth.

2/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps.

Table 2. Austria: Medium-Term Macroeconomic Framework, 2007-15

In percent of GDP, unless indicated otherwise	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
National accounts									
GDP (growth in percent)	3.7	2.2	-3.9	1.5	1.6	1.7	1.8	1.8	1.8
Domestic demand (pp contributions)	2.4	1.2	-2.1	0.4	1.0	1.0	1.1	1.1	1.1
Final consumption	0.8	1.0	0.8	0.8	0.6	0.7	0.7	0.7	0.7
<i>of which</i> : Private consumption	0.4	0.2	0.7	0.7	0.6	0.5	0.5	0.5	0.5
Gross investment	1.6	0.2	-2.9	-0.4	0.3	0.3	0.4	0.4	0.4
Exports of goods and nonfactor services	4.9	0.6	-9.4	1.9	2.0	2.5	2.7	2.9	3.0
Imports of goods and nonfactor services	-3.6	0.5	7.4	-0.9	-1.3	-1.8	-2.1	-2.1	-2.2
Statistical difference	0.1	-0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Prices and unemployment									
CPI inflation (annual percent change)	2.2	3.2	0.4	1.5	1.7	1.7	1.7	1.9	2.0
Unemployment rate (percent)	4.4	3.8	4.8	4.5	4.5	4.4	4.3	4.3	4.3
External accounts									
Current account balance	3.5	3.3	2.3	2.1	2.2	2.1	2.1	2.1	2.1
Goods and services balance	4.6	4.5	3.5	3.8	3.8	3.6	3.5	3.4	3.3
General government accounts 1/									
Revenue	47.9	48.3	48.8	47.5	47.6	47.7	47.8	47.8	47.8
Expenditure	48.5	48.8	52.3	52.3	51.7	51.6	51.5	51.5	51.4
Balance	-0.5	-0.5	-3.5	-4.8	-4.1	-3.9	-3.7	-3.7	-3.6
Gross debt	59.2	62.4	67.1	70.1	72.5	74.2	75.8	76.8	77.6
Structural balance	-1.8	-2.0	-2.8	-4.3	-3.7	-3.7	-3.6	-3.6	-3.6
Memorandum items:									
Gross national saving	26.7	26.4	23.6	22.6	22.8	22.8	22.8	22.7	22.7
Gross domestic investment	23.2	23.2	21.3	20.5	20.6	20.6	20.6	20.6	20.6
Potential output (growth in percent)	1.8	1.5	1.2	1.1	1.2	1.4	1.5	1.7	1.7
Output gap (in percent of potential output)	2.9	3.6	-1.5	-1.2	-0.8	-0.4	-0.1	0.0	0.1

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

1/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps.

Table 3. Austria: Balance of Payments, 2007-15
(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Projections								
Current account	3.5	3.3	2.3	2.1	2.2	2.1	2.1	2.1	2.1
Trade	4.6	4.5	3.5	3.8	3.8	3.6	3.5	3.4	3.3
Exports	58.2	57.9	49.4	49.8	50.6	51.7	53.1	54.8	57.0
Imports	53.6	53.4	46.0	46.0	46.8	48.1	49.6	51.4	53.6
Goods	0.5	-0.2	-0.8	-0.1	0.1	0.1	0.0	-0.1	-0.1
Exports	43.6	42.9	35.5	36.1	36.8	37.9	39.2	40.7	42.7
Imports	43.2	43.1	36.3	36.2	36.7	37.8	39.1	40.8	42.8
Nonfactor services	4.1	4.7	4.2	3.9	3.7	3.5	3.5	3.4	3.4
Exports	14.6	14.9	13.9	13.7	13.7	13.8	14.0	14.1	14.2
Imports	10.5	10.3	9.7	9.8	10.1	10.3	10.5	10.7	10.8
Balance on Factor Income	-0.6	-0.6	-0.5	-1.1	-1.0	-0.8	-0.7	-0.6	-0.6
Credit	11.5	10.9	9.1	8.6	8.8	9.0	9.2	9.2	9.2
Debit	12.1	11.5	9.6	9.7	9.7	9.8	9.9	9.8	9.8
Current transfers, net	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Capital and financial accounts	-4.2	-4.5	-1.4	-2.1	-2.2	-2.1	-2.1	-2.1	-2.1
Capital account, net	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
FDI, net	-2.0	-4.5	0.8	-1.8	-1.7	-1.6	-1.5	-1.4	-1.3
Portfolio investment, net	8.3	9.5	-2.4	1.5	1.0	0.5	0.0	-0.5	-1.0
Financial derivatives	-0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	-9.6	-9.8	-0.9	-2.0	-1.7	-1.3	-0.9	-0.4	0.0
Reserve assets	-0.7	0.2	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.6	1.2	-0.9	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 Accounts, 2007-15

(In percent of GDP, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Projections								
Revenue	47.9	48.3	48.8	47.5	47.6	47.7	47.8	47.8	47.8
Taxes on production and imports	14.0	14.1	14.7	14.6	14.5	14.5	14.5	14.4	14.4
Property income	1.5	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Current taxes on income, wealth, etc.	13.4	14.0	12.8	11.9	12.0	12.2	12.4	12.5	12.5
Social contributions	15.8	15.9	16.6	16.5	16.5	16.5	16.5	16.4	16.4
Other	3.2	3.1	3.3	3.4	3.3	3.2	3.2	3.2	3.2
Expenditure 1/	48.5	48.8	52.3	52.3	51.7	51.6	51.5	51.5	51.4
Intermediate consumption	4.3	4.5	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Compensation of employees	9.1	9.2	9.9	9.8	9.7	9.7	9.7	9.6	9.6
Subsidies, payable	3.3	3.5	3.7	3.7	3.6	3.6	3.6	3.6	3.6
Interest	2.9	2.6	2.8	2.9	2.9	2.9	3.0	3.0	3.0
Social benefits	17.9	18.0	19.7	19.9	19.7	19.6	19.5	19.5	19.5
Transfers	9.8	9.6	10.1	9.9	9.8	9.7	9.7	9.7	9.7
Gross capital formation	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1
Other	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Overall balance (ESA 95 basis)	-0.5	-0.5	-3.5	-4.8	-4.1	-3.9	-3.7	-3.7	-3.6
Federal government	-0.6	-0.7	-2.8	-4.1	-3.4	-3.2	-3.0	-3.0	-2.9
Other levels	0.1	0.2	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Structural balance (ESA 95 basis)	-1.8	-2.0	-2.8	-4.3	-3.7	-3.7	-3.6	-3.6	-3.6
Fiscal impulse 2/	-0.4	0.2	0.7	1.5	-0.5	0.0	-0.1	0.0	0.0
Public debt	59.2	62.4	67.1	70.1	72.5	74.2	75.8	76.8	77.6
Memorandum item:									
Overall fiscal balance, EDP definition 3/	-0.4	-0.4	-3.5	-4.8	-4.1	-3.9	-3.7	-3.7	-3.6

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

1/ Assumes implementation of expenditure ceilings at federal level in 2011.

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 ESA95 is due to the inclusion of revenues from swaps.

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2005-10 1/
(In percent)

	2005	2006	2007	2008	2009
<i>Capital adequacy</i>					
Regulatory capital to risk-weighted assets 2/	11.8	11.8	12.7	12.9	15.0
Regulatory Tier I capital to risk-weighted assets 2/	8.2	8.0	8.8	9.3	11.1
Capital to assets	4.8	5.2	6.5	6.3	7.0
<i>Asset composition</i>					
<i>Sectoral distribution of bank credit to total gross bank credits</i> (as percentage of total bank credits)					
Nonbank financial institutions	3.6	3.7	3.3	3.2	3.2
Nonfinancial corporations	20.4	19.7	18.4	16.6	17.2
Households	20.1	18.9	17.7	15.4	16.4
<i>Of which: housing loans</i>	10.1	10.4	9.6	8.6	9.3
personal loans	10.0	8.5	8.1	6.8	7.1
Public Sector	5.4	4.9	4.0	3.1	3.5
Nonresidents	12.9	13.7	15.7	15.6	15.6
Domestic and non-domestic banks	37.6	39.1	40.9	46.1	44.1
<i>Geographical distribution of loans to total loans</i>					
Domestic	70.6	68.6	65.7	67.5	68.7
Cross-border	29.4	31.4	34.3	32.5	31.3
<i>Of which: EMU</i>	10.1	10.2	11.7	9.7	9.9
CEEC	9.4	9.6	11.6	12.9	13.2
Other	9.9	11.6	11.1	9.9	8.2
<i>Asset quality</i>					
Nonperforming loans to total gross loans 3/	2.6	2.1	2.2	2.0	2.3
Loan loss provisions (as % of loans to non-banks, domestic and non-domestic)	3.1	2.9	2.4	2.2	2.8
Loan-loss provisions to nonperforming loans 3/	71.5	75.3	76.4	64.0	73.8
Nonperforming loans net of loan-loss provisions to Tier 1 capital 3/	15.1	9.6	6.0	8.8	6.3
Total foreign currency-denominated loans to total loans	25.9	24.8	23.6	25.9	22.4
Foreign currency-denominated loans to residents to total claims on residents	20.1	18.7	16.2	18.0	17.2
Foreign currency-denominated loans to households to total claims on househ.	31.0	30.8	27.4	30.7	29.1
Foreign currency-denominated loans to corporations to total claims on corp.	13.4	10.8	8.1	9.1	8.5
Large exposures to capital	89.7	77.5	56.4	67.8	55.5
10-largest credit to net credits (loans to nonbanks) 3/	6.8	6.8	6.0	8.8	10.4
<i>Earnings and profitability</i>					
Return on assets 2/ 3/	0.6	0.7	0.8	0.1	0.1
Return on equity 2/ 3/	14.8	16.9	17.0	2.6	1.5
Net interest margin (net interest income as % of interest bearing assets)	1.1	1.0	1.0	0.9	0.9
Gross income as a percentage of average assets	2.3	2.2	2.1	2.0	1.7
Net interest income to gross income 2/ 3/	72.2	71.1	70.7	64.6	69.7
Noninterest income to gross income 2/ 3/	27.9	28.9	29.3	35.4	30.3
Trading income as a percentage of gross income	4.1	4.1	1.7	-4.0	2.8
Noninterest expenses as a percentage of gross income 2/	71.9	68.8	66.6	90.4	86.0
Personnel expenses as a percentage of noninterest expenses	50.1	50.5	50.4	50.6	51.4
Spread between domestic lending and deposit rates	1.2	0.9	0.8	1.3	1.0

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2005-10 1/ (concluded)
(In percent)

	2005	2006	2007	2008	2009
<i>Liquidity</i>					
Liquid assets to total assets	27.4	27.6	26.8	26.8	26.1
Liquid assets to short-term liabilities	68.0	68.6	67.2	67.8	76.2
Foreign currency-denominated liabilities to total liabilities	20.5	20.0	17.2	19.4	14.4
Deposits as a percentage of assets	65.3	63.8	62.6	63.4	61.5
Loans as a percentage of deposits	112.9	115.8	116.3	117.7	119.0
<i>Sensitivity to market risk</i>					
Off-balance sheet operations as a percentage of assets	207.5	208.1	200.2	190.2	198.2
<i>Of which:</i> interest rate contracts	171.9	170.7	159.5	140.2	155.2
forex contracts	33.1	35.1	38.6	47.4	40.5
other derivatives	2.4	2.5	2.2	2.6	2.5
Duration of assets (in percent of total assets)					
Less than 3 months	61.1	59.3	62.4	67.3	69.8
Between 3 months and 1 year	13.7	12.2	13.4	13.7	11.9
Between 1 and 5 years	12.4	11.5	10.7	10.1	11.5
More than 5 years	8.3	8.1	7.6	7.1	8.1
Duration of liabilities (in percent of total liabilities)					
Less than 3 months	58.6	54.4	56.9	60.0	61.7
Between 3 months and 1 year	13.4	13.5	14.6	16.4	13.9
Between 1 and 5 years	14.8	14.0	12.4	12.3	16.8
More than 5 years	9.1	8.9	10.0	9.4	9.4
Net open position in foreign exchange to capital	3.3	3.8	2.5	1.6	0.6
<i>Memorandum Items (EUR billions)</i>					
Regulatory capital 3/	51.8	59.5	63.1	87.8	92.7
Regulatory Tier 1 capital 3/	35.0	41.8	47.1	66.9	72.2
Risk-weighted assets 3/	353.4	393.3	362.3	454.8	443.9
Total assets	725.8	797.8	899.5	1,069.1	1,034.0
Total loans	535.4	589.4	654.9	797.5	756.5
Total deposits	474.2	509.2	563.2	677.5	636.0
Net interest income	7.1	7.2	7.4	8.2	8.8
Noninterest income	8.6	9.4	10.1	12.3	9.1
<i>Of which:</i> Income from securities and participating interests	2.7	2.9	3.5	7.2	3.3
Net fee-based income	3.9	4.3	4.7	4.2	3.6
Net income from financial transactions	0.6	0.7	0.3	-0.8	0.5
Other operating income	1.3	1.6	1.6	1.7	1.6
Noninterest expenses	10.1	10.8	10.8	11.4	11.1
Total operating income	15.7	16.6	17.5	20.6	17.9
Total operating expenses	10.1	10.8	10.8	11.4	11.1
Pre-tax operating profit	5.6	5.8	6.7	9.1	6.8
Pre-tax total profit	4.0	4.5	5.2	2.1	0.6
After-tax profit	3.7	4.0	4.8	1.9	0.2
Profits accrued from subsidiaries abroad	2.7	3.1	5.0	7.2	8.1
Net open foreign exchange position	1.7	1.5	2.0	1.4	0.6

Source: Austrian National Bank.

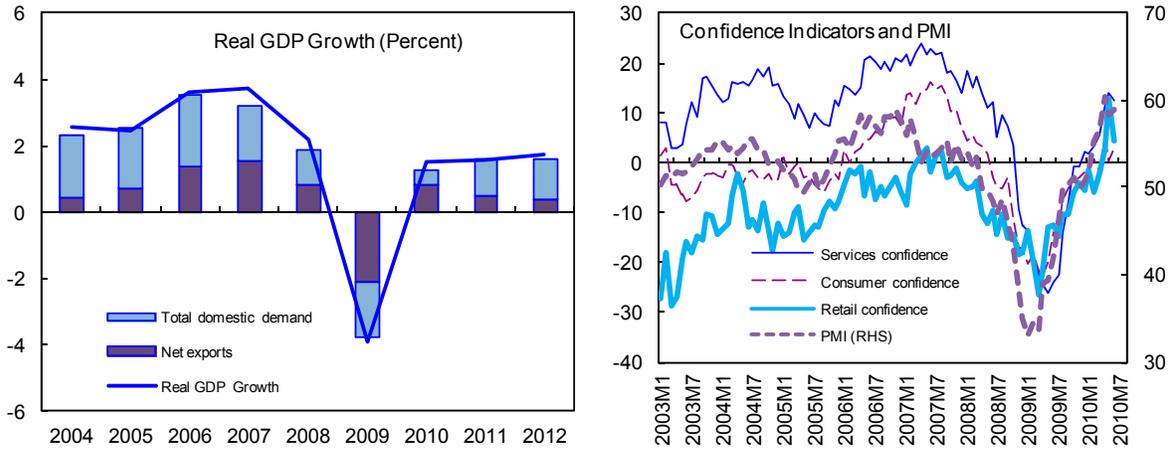
1/ Figures refer to the whole banking system, including foreign owned banks, unless noted otherwise.

2/ Figures refer to Austrian owned banks only.

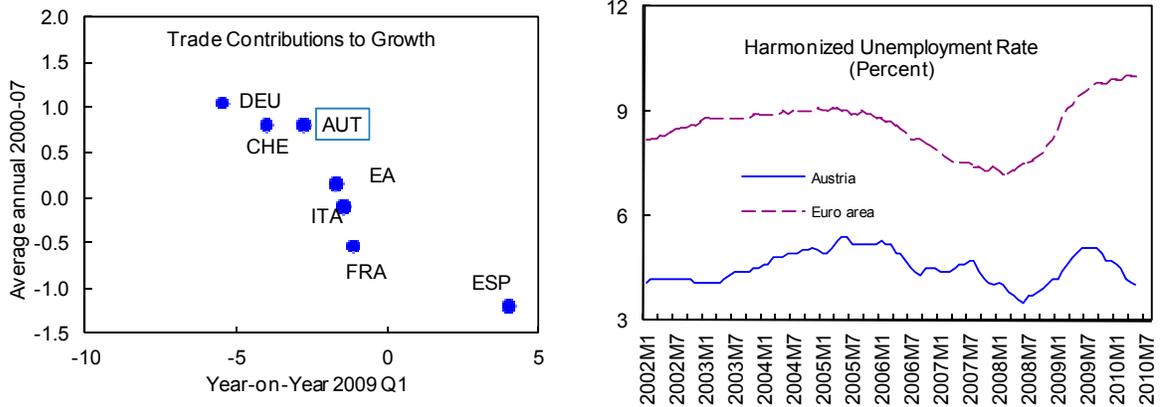
3/ Comparability in 2008 and 2009 is limited due to changes in reporting requirements or introduction of new reporting schemes.

Figure 1. Austria: An Overview

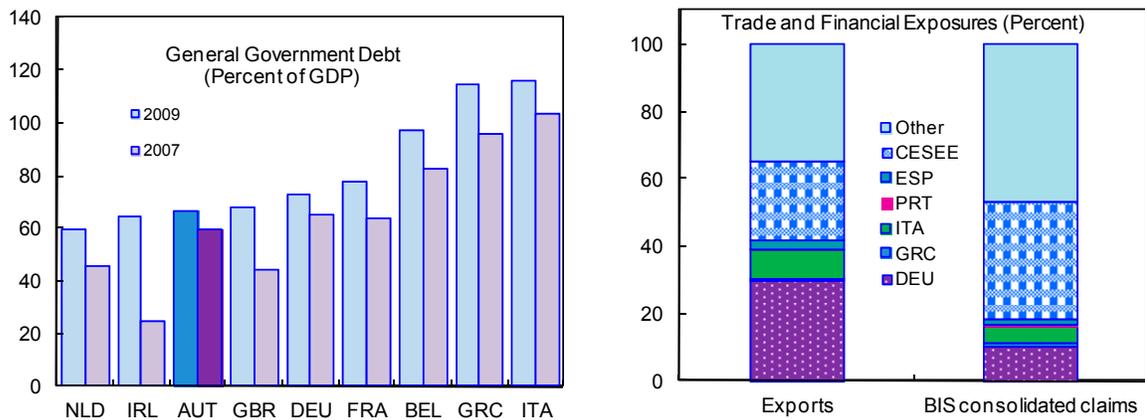
Helped by the revival in export demand, Austria is recovering from a sharp economic contraction.



As a very open economy Austria was exposed to a substantial trade shock. But the rise in unemployment has been contained.



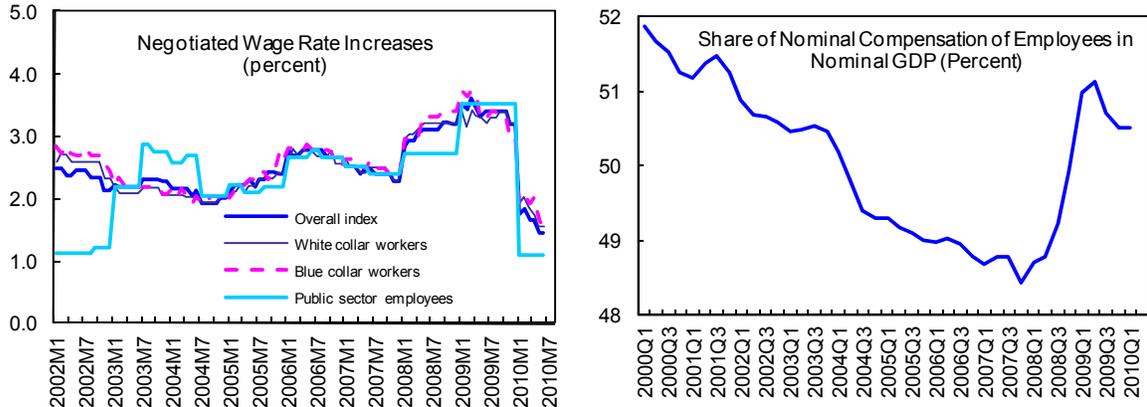
While government deficits and indebtedness remained below levels observed in many other EU countries, concentration of real and financial exposures on emerging European countries represents a source of vulnerability.



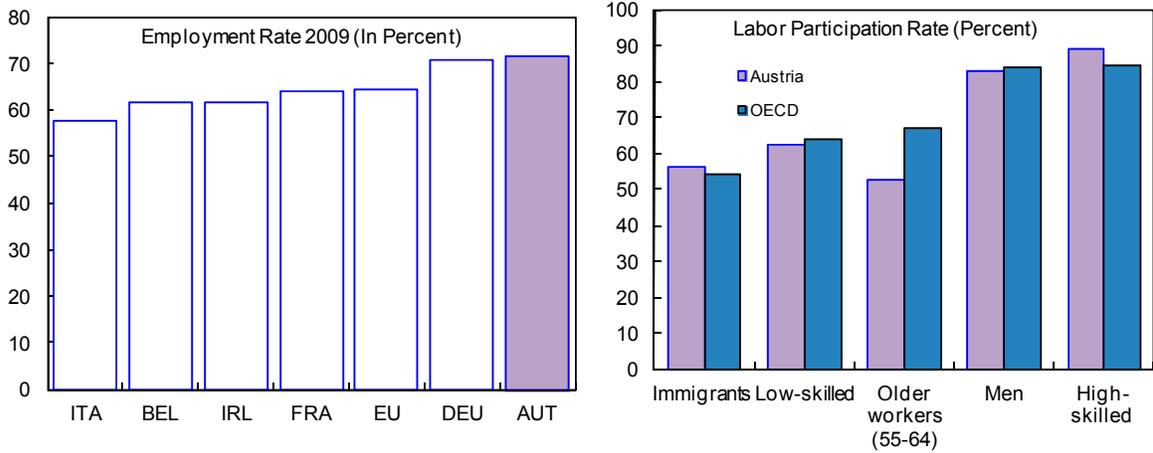
Sources: Austrian authorities; IHS; WIFO; ECB; Haver; WEO; REO; BIS, and other IMF staff estimates.

Figure 2. Austria: The Labor Market

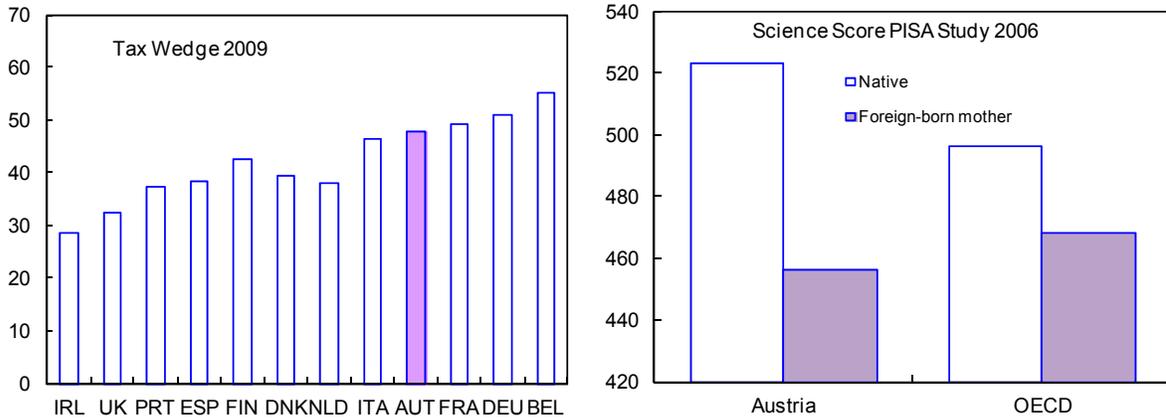
Except for 2008 /2009 wage agreements have been conservative, resulting in a decline of the labor share in value added.



Employment rates are relatively high in aggregate and for high-skilled workers, but low in other segments.



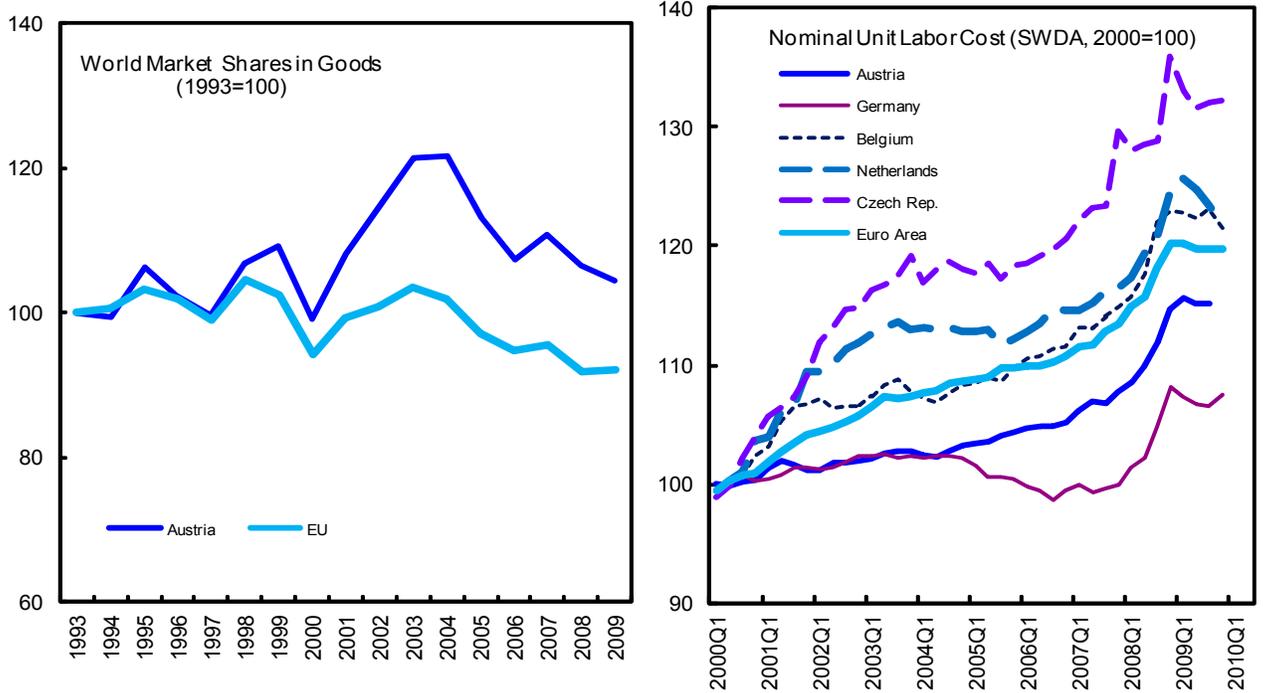
A high tax wedge and education gaps probably play a role.



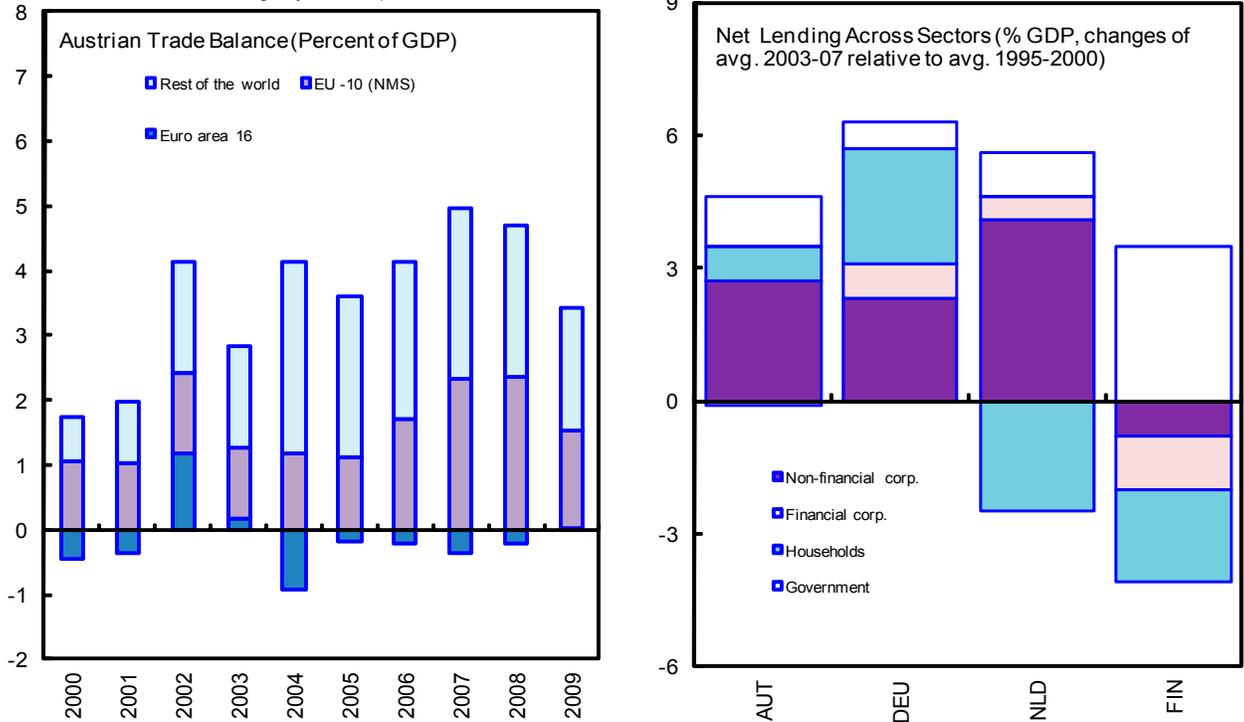
Sources: Austrian National Bank; Eurostat; Haver; OECD, and Fund staff calculations.

Figure 3. Austria: Competitiveness and Imbalances

Market shares have fluctuated, consistent with moderate increases in unit labor costs.



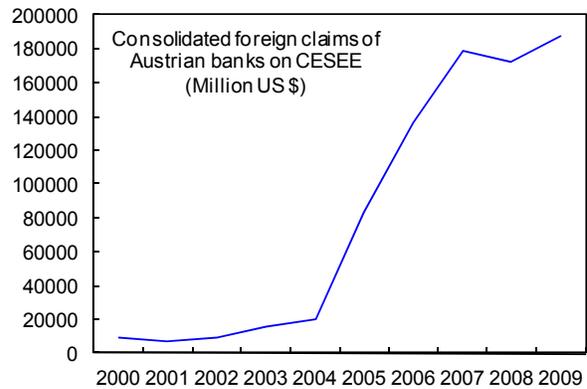
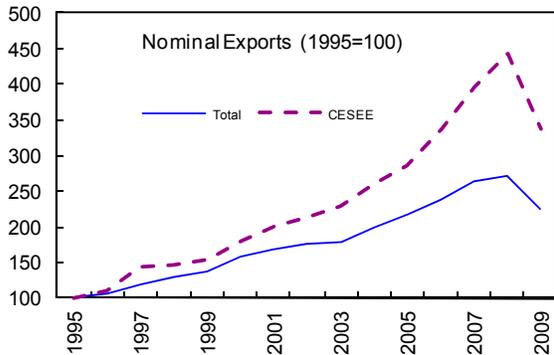
Trade surpluses were built up largely with CESEE countries. More broadly, the improvement in the current account balance reflected increased savings by the corporate sector.



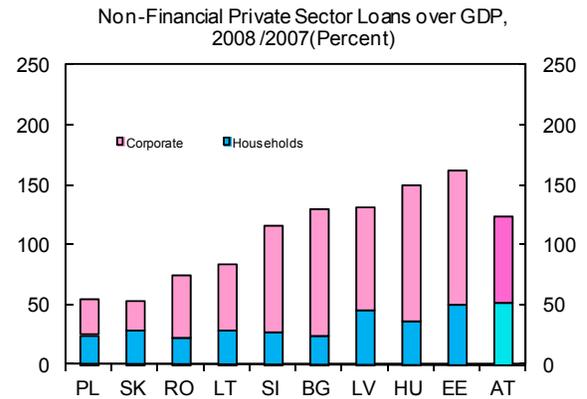
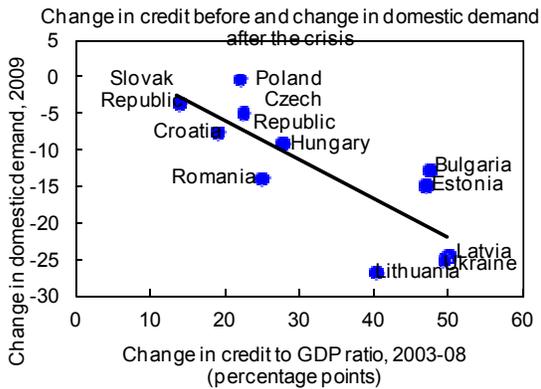
Sources: Austrian National Bank; European Commission; Eurostat; World Integrated Trade System; WEO; and IMF staff calculations.

Figure 4. Austria: Legacy Effects From Boom-Bust in CESEE Countries

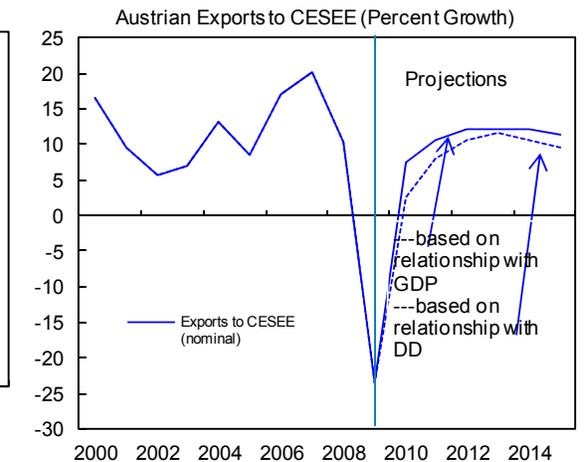
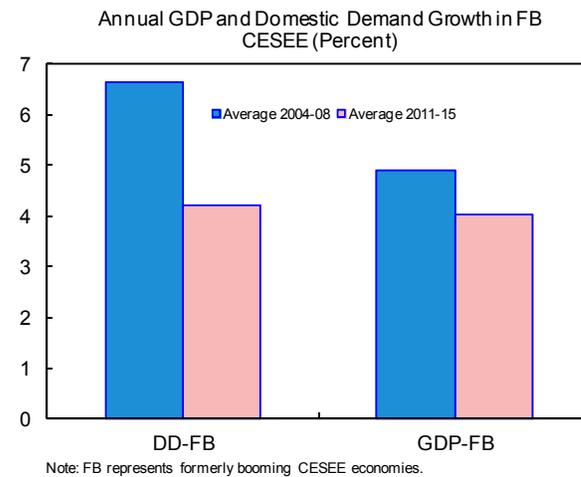
Pulled by economic and financial convergence, exports to CESEE have been growing faster than exports to the EU. Austrian banks expanded heavily in the region.



In some countries, credit boom-busts followed and leverage in the private sector is high.

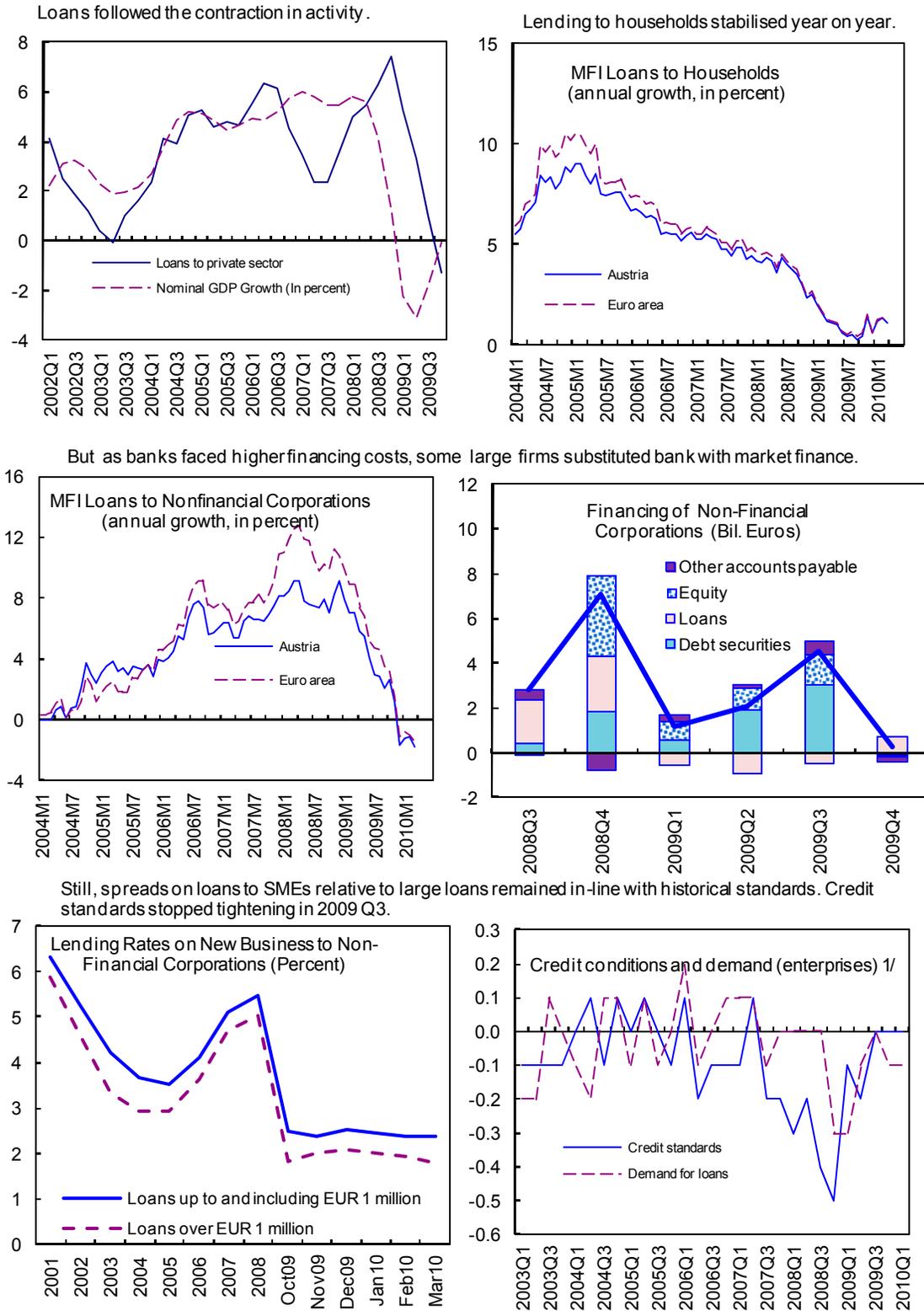


Domestic demand in CESEE's formerly booming economies could be more subdued, constraining the recovery in Austrian exports. A partial reallocation of resources in CESEE towards exports should however help mitigate the effect.



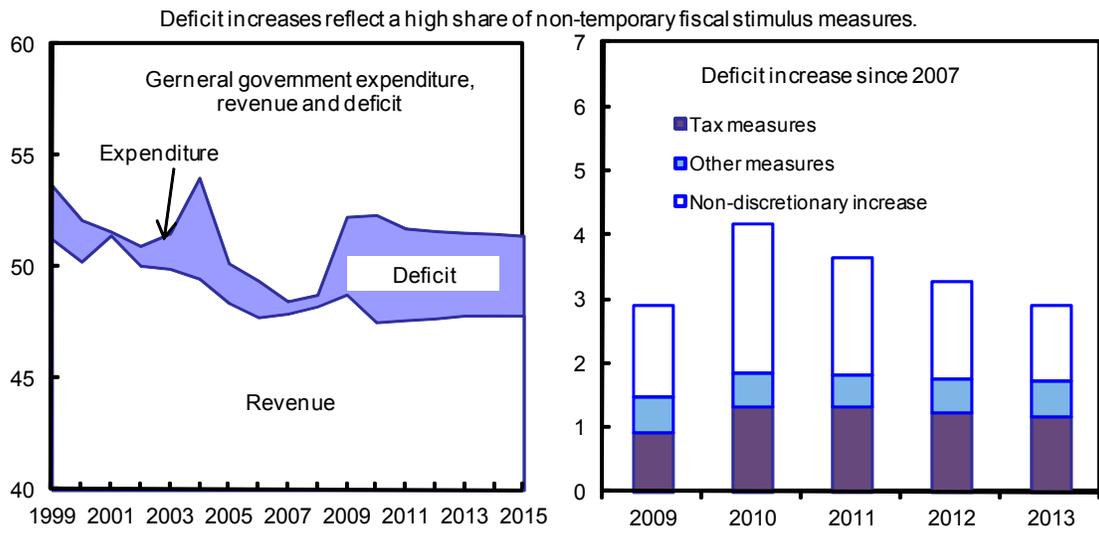
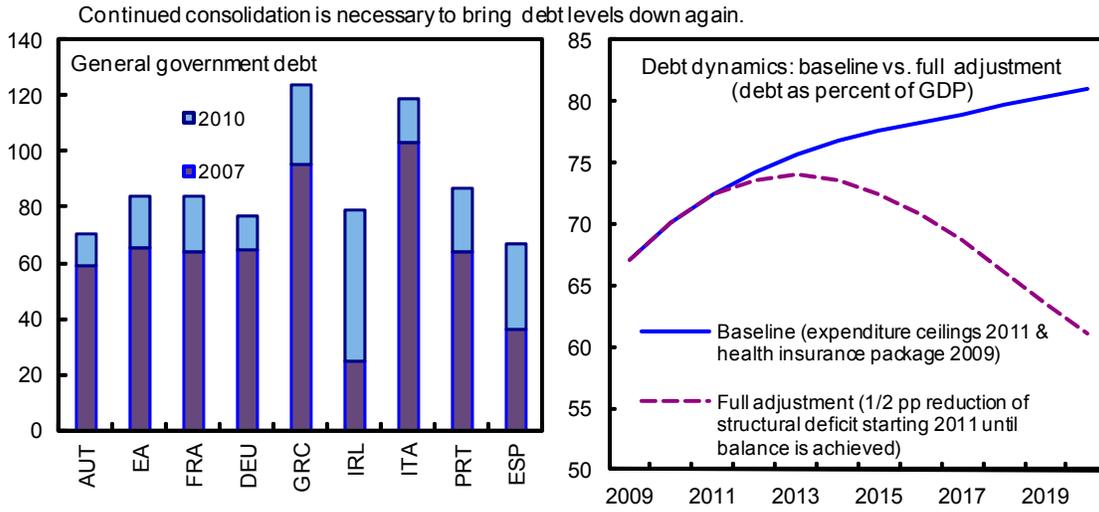
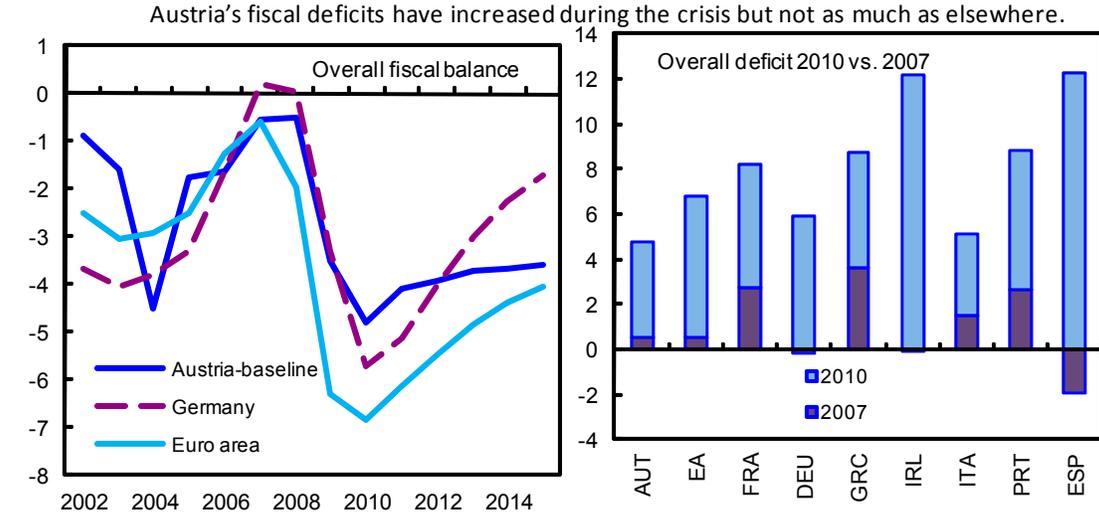
Sources: Austrian authorities; Eurostat; IHS; WIFO; Haver; WEO; REO; and IMF staff estimates.

Figure 5. Austria: Credit Conditions



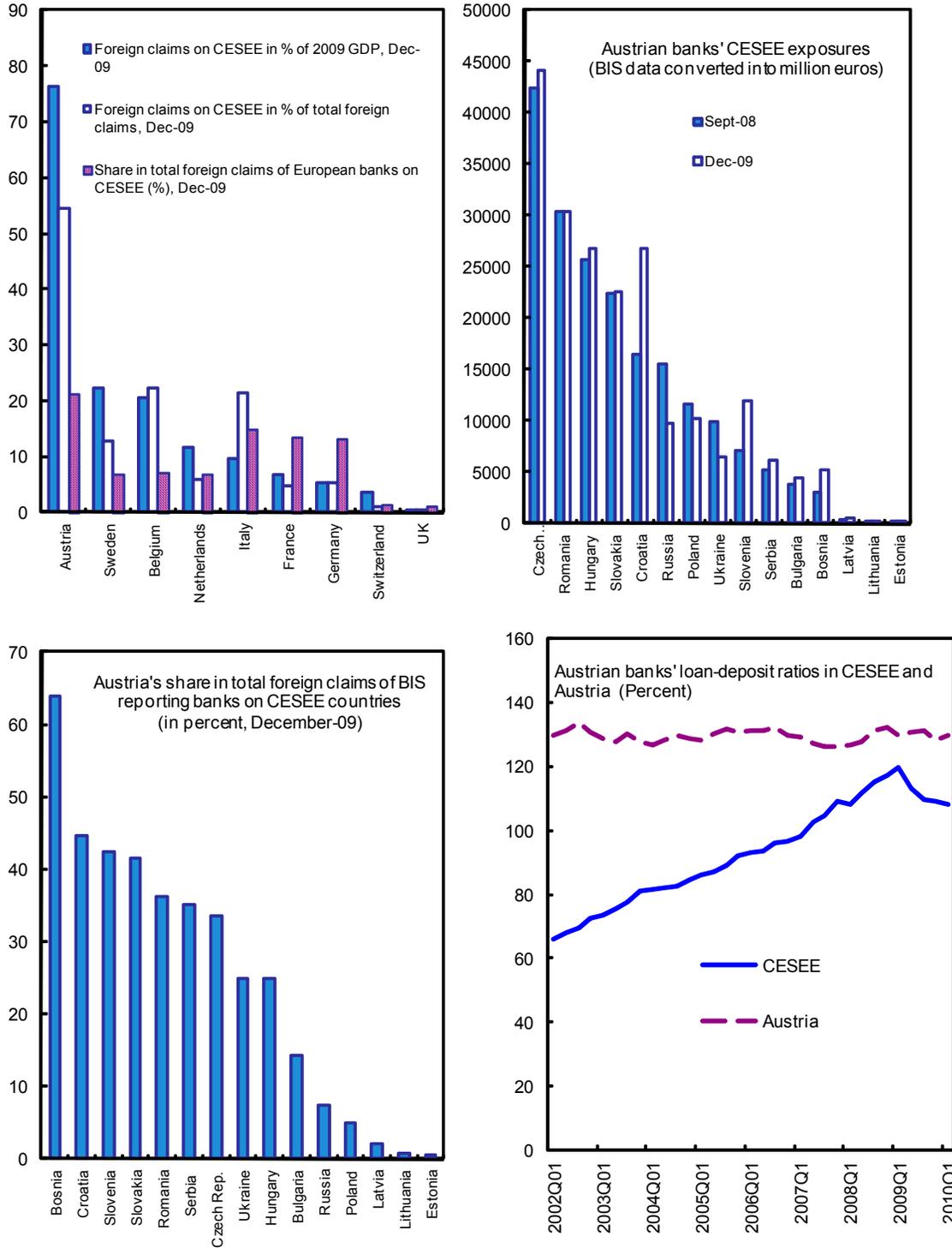
Sources: Austrian National Bank; Haver; IMF, IFS; ECB; and Eurostat.
 1/ Based on bank lending survey data. Minus means tightening/decreased.

Figure 6. Austria: Fiscal Trends 1/
(Percent of GDP)



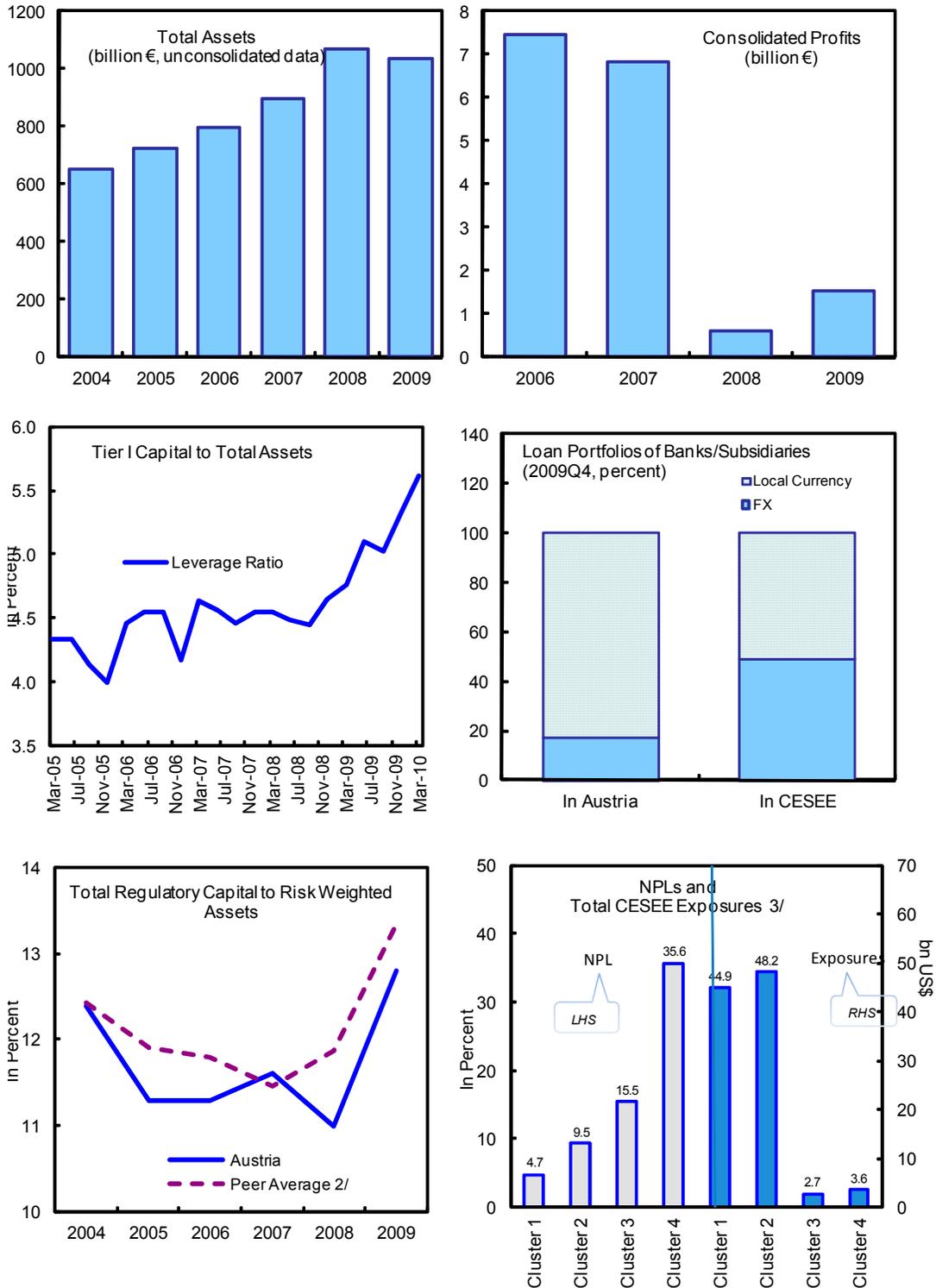
Sources: IMF, WEO (April 2010); and staff calculations.
1/WEO (April 2010) forecast from 2010 onwards.

Figure 7. Austria: Banks' CESEE Exposure



Sources: Austrian National Bank; BIS; and WEO.

Figure 8. Austria: The Banking System 1/



Sources: Austrian National Bank; GFSR.

1/ If not specified otherwise, the data refers to the whole Austrian banking system, including foreign owned banks.

2/ Peer Group includes: Austria, Belgium, Denmark, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden.

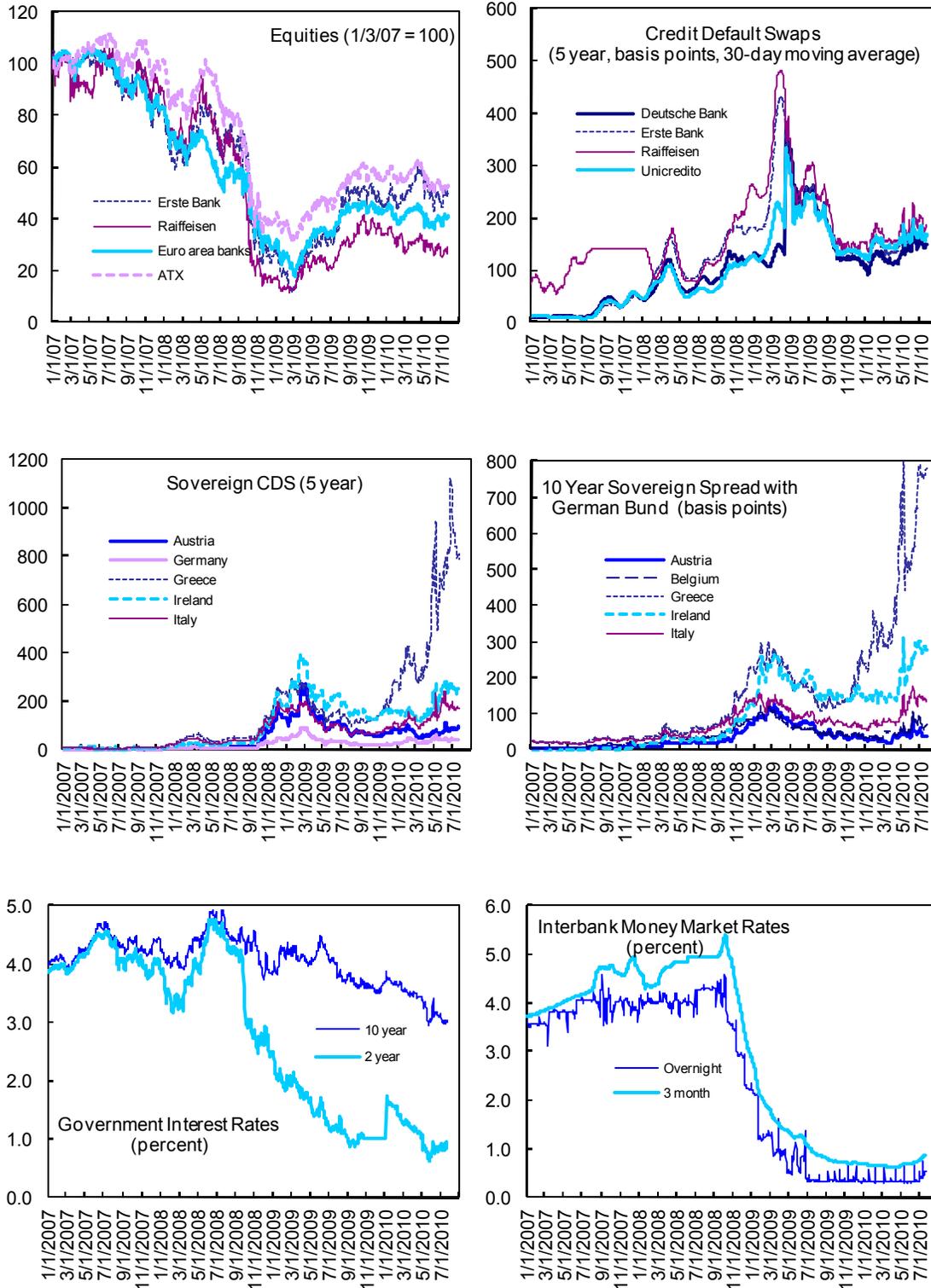
3/ Total CESEE exposures at 12/31/09 is approximately \$293 Billion.

Cluster 1 Countries: Belarus, Bulgaria, Macedonia, Poland, Slovak Republic, Czech Republic, Slovenia.

Cluster 2 Countries: Croatia, Hungary, Serbia, Russia, Albania, Romania. Cluster 3 Countries: Bosnia, Latvia.

Cluster 4 Countries: Ukraine, Kazakhstan, Montenegro.

Figure 9. Austria: Selected Financial Market Indicators 1/



Sources: Thomson Financial/DataStream and Bloomberg. 1/Data through July 22, 2010.

Annex I. 'Boom-Bust' in CESEE and Implications for Austria¹

This Annex provides an overview of economic linkages between CESEE and Austria, giving some order of magnitude of possible effects on Austria of a slowdown in CESEE activity relative to before the crisis.

Table A1. Financial and Real Linkages Austria-CESEE

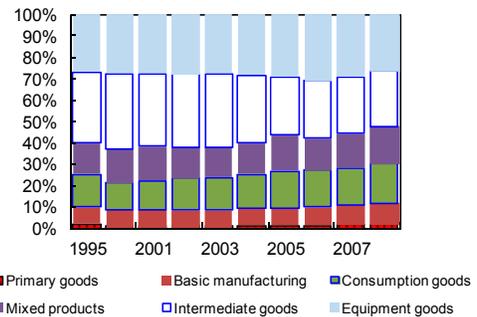
	Stock of FDI in CESEE (2007)	Exports to CESEE (2004-2008)	Imports from CESEE (2004-2008)	Net trade with CESEE (2004-2008)	Total gross investment income from CESEE (average 2004-2008)	Financial sector profits from CESEE (2004-2009)
Billion euro	51.1	28	21.9	5.9	6.9	2.3
% of total	49.9	19.3	16.4	55	30	46
% of GDP	18.7	10.9	8.4	2.2	2.7	0.9

Source: OeNB, WIIW and staff calculations.

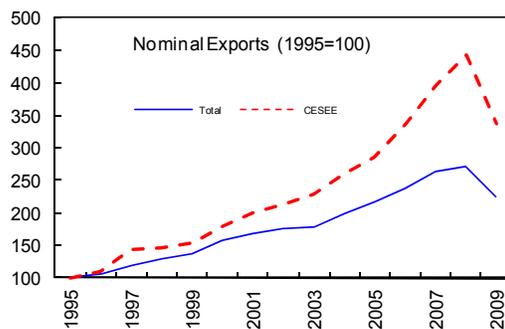
Note: In the case of CESEE, gross investment income is a good proxy for net investment income.

Austria's economic and financial integration with Central, Eastern and South Eastern European countries (CESEE) increased considerably up to the crisis (Figure 4, Table A1).² With substantial investments flowing to the region, by 2007, the CESEE region accounted for nearly half of the total stock of Austrian FDI, or close to 19 percent of GDP. Studies suggest that while Austrian firms may have outsourced part of their production to take

Goods exports to CESEE (million USD)

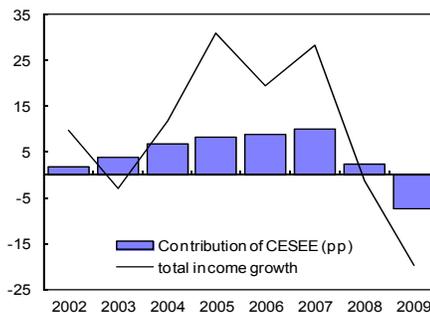


Source: CEPII, Chelem Database.



Source: OeNB

Gross investment income from CESEE (Percent and Percentage Points)



Source: OeNB

¹ This Annex has benefited from valuable inputs and comments provided by colleagues at the OeNB.

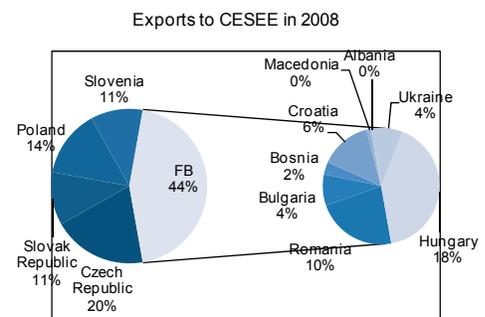
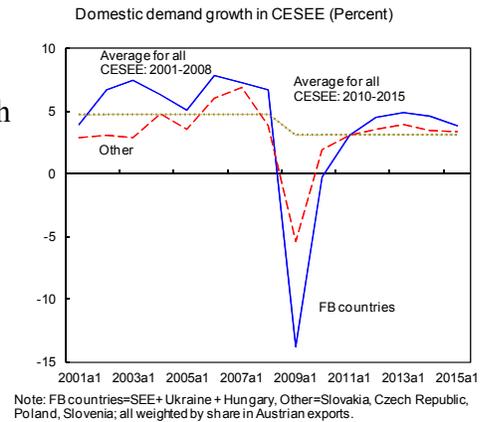
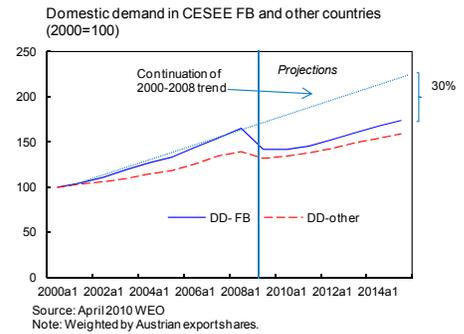
² CESEE refers to Hungary, Poland, Slovakia, Slovenia, Czech Republic, Romania, Bulgaria, Albania, Bosnia& Herzegovina, FYRM, Serbia, Montenegro, Croatia, Ukraine.

advantage of lower costs, market seeking motivations have typically dominated.³ In particular, Austrian banks established subsidiaries and in many countries control large parts of financial intermediation. Exports to CESEE also grew rapidly, now representing one fifth of total. Reflecting Austria's competitive advantage, intermediary and investment goods continue to dominate Austrian exports to the region, the rise in the share of consumption goods notwithstanding. The share of services in total exports to CESEE has been fluctuating around 22 percent, the largest sectors being transportation and travel, each accounting for around one third.

The catching up process in CESEE and resulting higher growth rates have boosted Austrian incomes.

Apart from its positive effects on growth and employment—estimates indicate that EU enlargement alone increased Austrian GDP growth by 0.4 percentage points each year, with also positive effects on employment⁴—integration with CESEE countries also boosted balance of payment surpluses. Trade surpluses with the region have averaged about 2 percent of GDP between 2004 and 2008, while gross investment income from CESEE averaged around 2.7 percent of GDP over the same period, steadily increasing its share in total gross investment income. Investment income from CESEE is dominated by returns on FDI and other investments (eg loans and deposits). In 2004–09, up to half of Austrian banks' profits came from the CESEE.

However, while some countries experienced more balanced growth, in others, the convergence process degenerated into a boom/bust credit cycle, whose legacy of debt overhang and depressed property markets is likely to weigh on domestic demand and future credit growth. In the SEEs, but also in the Ukraine or Hungary domestic demand collapsed in 2009, following in most cases large expansions of demand and credit in preceding years.⁵ Hungary and Croatia also



³ See Marin (2009).

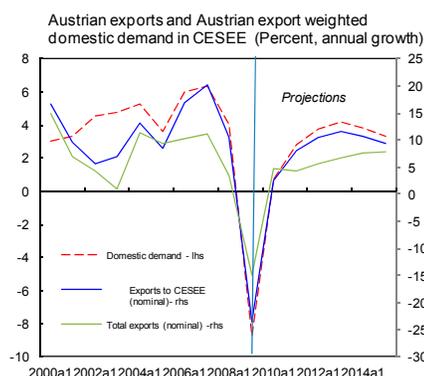
⁴ F. Breuss, "Oesterreich, 15 Jahre EU-Mitglied", *WIFO-Monatsberichte*.

⁵ Hungary experienced volatile growth already in 2004–07.

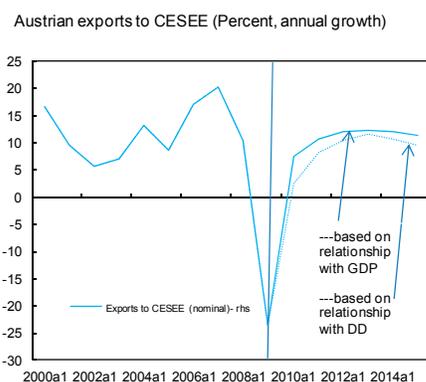
display relatively high ratios of private sector indebtedness, possibly putting pressure on agents to deleverage. The Spring 2010 WEO forecast for 2010–15 anticipates domestic demand in formerly booming (FB) economies to be well below levels and pace before the crisis, in contrast to the more balanced economies (Other) of the region⁶: the level of domestic demand in FB countries' in 2015 is projected to be about 30 percent less than what a simple continuation of the trend observed in 2000–08 would have suggested. For the other countries the difference is only 10 percent.

Austria's exposure to formerly booming economies is non-negligible and their rebalancing and hence expected more modest demand growth is likely to dampen Austrian exports and incomes. Over 40 percent of Austrian exports to CESEE (around 4 percent of GDP) went to FBs, with Hungary and Romania accounting for the bulk. Anticipated lower domestic demand in FBs could contain the recovery of Austrian exports. Simple correlations suggest a decline of nominal export growth to the region to 10 percent in 2010–15, down from close 14 percent in the four year period leading up to the 2009 recession.

Yet, the negative repercussions on Austria could be mitigated by the fact that exports to CESEE also reflect intra-industry trade, the result of the outsourcing activities of Austrian firms. A high import content of exports is likely to buffet the effects of an external shock. And demand for Austrian products may be more dependent on supply performance in CESEE (e.g. competitiveness of these economies) and on demand developments in third



Source: WEO, OENB and staff calculations



Source: WEO and Staff calculations.

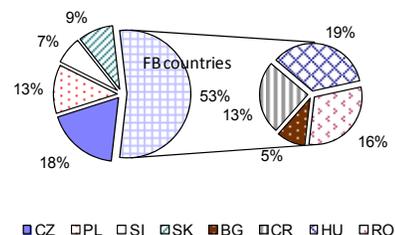
countries. Indeed, the prospects for overall GDP growth in CESEE, also for FBs while of course more subdued than in the past, compare favorably with domestic demand, and projections based on past correlations between exports and GDP would indicate somewhat

⁶Formerly booming' countries refer to Albania, Bosnia Herzegovina, Croatia, Serbia, Romania, Bulgaria, FRYM, Hungary and Ukraine. These countries experienced strong swings in credit and/or domestic demand and/or record relatively high levels of private sector indebtedness.

higher export growth than based on the relationship with domestic demand. It should be noted though that the relationship with GDP is somewhat weaker than with domestic demand.

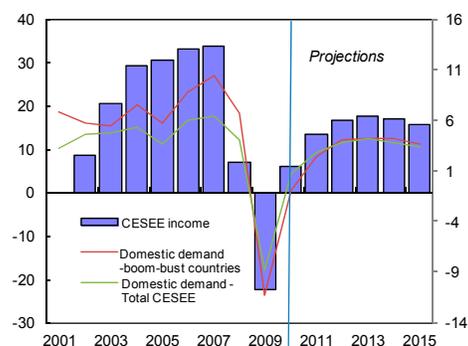
Incomes from abroad are also likely to be affected. Over half of gross income (1 percent of GDP) originated in FB countries. The share of consumer/real-estate/financial sector activities in FDI in these economies is estimated to be large, between 50–70 percent, with the share of returns of these sectors in total returns exceeding 80 percent. Again, for illustration, simple correlation between investment income and demand growth in CESEE indicates that income from the CESEE could be growing just over half the rate recorded in 2004–08.

Gross investment income (2004-2009 average)



Source: OeNB/AUFIN

Gross investment income from CESEE (lhs) and domestic demand growth in CESEE (rhs) (Percent growth)



Source: OeNB, WEO and staff calculations.

Losses in the financial sector, where Austrian FDI is concentrated, are expected to rise further, but should remain manageable in a scenario of ongoing economic recovery in the region. Profitability of banking sectors in the region and thus of Austrian banks is being hampered by rising nonperforming loans, subdued demand for new credit and increased capital requirements. The average NPL ratio of Austrian banks' subsidiaries in CESEE stood at just under 10 percent at end-2009. Based on the evidence of previous crises, estimations in the Spring IMF GFSR project NPLs in CESEE to keep rising in 2010 and to improve only gradually in 2011.⁷ OeNB simulations also suggest a further, but limited overall decline in the financial sectors' operating results by about 7 percent by 2011 relative to end-2009 in the baseline scenario. Renewed stresses, however, could double the amount of shrunk profits.⁸

Finally, however, while individually, the effects of an overall slower growth rate in CESEE appear small, jointly, the implications could be more substantial. Table A2

⁷ Box 1.2, Chapter "Non-performing loans in Central and Eastern Europe—Is it different this time?"

⁸ OeNB Financial Stability Report (June 2010).

below provides an overview. The effect on GDP growth could range between 0.1 and 0.2 percentage points each year and the effect on the current account balance could be around 0.4 percent of GDP.⁹

Table A2. Summary of Effects of Lower Growth in CESEE on Austria

Impact (2011-2015)	Lower domestic demand (CESEE) in 2011-15 relative to pre-crisis	Lower GDP (CESEE) in 2011-2015 relative to pre-crisis
	Spring WEO+past correlations	Spring WEO+past correlations
<u>Assumptions</u>		
Lower AUT export (growth) to CESEE /1	-4pp p.a	-2pp p.a
Lower gross income growth /1	-10pp	
<u>Effect on GDP</u>		
Lower net trade contribution of CESEE to AUT GDP growth/2	-0.2pp p.a	-0.1 pp p.a.
<u>Effect on current account balance as % of GDP</u>		
From lower net trade contribution	-0.2pp p.a	-0.1 pp p.a.
From lower gross income	-0.25 pp p.a	

Source: OeNB; and staff calculations.

/1 Relative to pre-crisis period.

/2 OeNB assumptions on import content.

⁹ Trade elasticities used by OeNB would imply a roughly similar result.

INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2010 Consultation with Austria

(In Consultation with Other Departments)

July 29, 2010

	Contents	Page
I.	Fund Relations	2
II.	Statistical Issues	4

Annex I. Austria: Fund Relations

(As of 30 June 2010)

Mission: Consultation discussions were held in Vienna during June 18–June 30, 2010. The authorities released the mission’s concluding statement, which is available at: <http://www.imf.org/external/np/ms/2010/062910.htm>

Staff team: Ms. Waysand (head), Ms. Herzberg, Mr. Steinlein (all EUR), Ms. Rawlings (MCM). Mr. Prader, Alternate Executive Director for Austria, attended the meetings.

Country interlocutors: 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 at the federal and local government level, the OeNB, and the FMA. The mission also met with the parliamentary budget committee, representatives of economic research institutes, the employers’ organization, the federation of trade unions, and commercial banks. There was a press conference at the end of the mission.

Fund relations: Austria is on a 12-month consultation cycle. The last consultation was completed on June 30, 2009. The report is available at: <http://www.imf.org/external/pubs/cat/longres.cfm?sk=23301.0>

FATF: The Fund published its Report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism in November 2009. The report is available at: <http://www.imf.org/external/pubs/ft/scr/2009/cr09299.pdf>

Based on its action plan and commitments the FATF plenary removed Austria in June 2010 from the specific review list.

I. Membership Status:

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

II. General Resources Account:	SDR Million	Percent Quota
Quota	1,872.30	100.00
Fund holdings of currency	1,429.80	76.37
Reserve position in Fund	442.52	23.63

III.	SDR Department:	SDR Million	Percent of Allocation
	Net cumulative allocation	1,736.31	100.00
	Holdings	1,750.90	100.84

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:** None

VI. **Projected Payments to Fund:**
(SDR Million; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Principal	--	--	--	--	--
Charges/Interest	--	0.01	0.01	0.01	0.01
Total	<u>--</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>

VII. **Implementation of HIPC Initiative:** Not Applicable

VIII. **Exchange System:**

As of January 1, 1999, the currency of Austria is the euro. 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. The most recent notification was made on March 19, 2008. Furthermore, national restrictions apply with respect to certain terror organizations and their activists within the EU, implementing decisions in the Common Foreign and Security Policy (CFSP) framework of the EU.

Annex II. Austria: 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 transition to the new European System of Accounts 1995 (ESA 1995) has complicated the analysis of national accounts and fiscal data. The reclassification of public hospitals in 1997 introduced a break in the national account series on public and private consumption. Annual fiscal data for 1995 onward are derived from ESA 1995 data reported to Eurostat, using bridge tables created in a collaborative effort by the Fund and Eurostat. Data on outlays by function have been revised and are available from 1995 onward on a comparable basis according to major functional categories. Quarterly fiscal data reported through Eurostat are disseminated in the IFS.
3. 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 30 July 2010)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	07/29/10	07/30/10	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	June 2010	07/20/10	Monthly	Monthly	Monthly
Reserve/Base Money	June 2010	07/30/10	Monthly	Monthly	Monthly
Broad Money	June 2010	07/30/10	Monthly	Monthly	Monthly
Central Bank Balance Sheet	June 2010	07/15/10	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	June 2010	07/30/10	Monthly	Monthly	Monthly
Interest Rates ²	07/29/10	07/30/10	Daily	Daily	Daily
Consumer Price Index	June 2010	07/14/10	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Q1 2010	06/30/10	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	June 2010	07/30/10	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	June 2010	07/30/10	Monthly	Monthly	Monthly
External Current Account Balance	Q1 2010	06/30/10	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q1 2010	06/30/10	Quarterly	Quarterly	Quarterly
GDP/GNP	Q1 2010	06/11/10	Quarterly	Quarterly	Quarterly
Gross External Debt ⁵	Q1 2010	06/30/10	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 on Austria
August 30, 2010

1. **This statement provides information that has become available since the staff report was circulated to the Executive Board on July 30, 2010.** The information does not alter the thrust of the staff appraisal.
2. **Supported by a strong contribution of net exports, Austria's economic growth picked up as expected in the second quarter.** Following a flat outturn in the first quarter, real GDP rose by 0.9 percent q-o-q in Q2. Exports accelerated, while gross fixed capital formation continued to contract. Conditions in the labor market further improved over the summer, with the harmonized seasonally-adjusted unemployment rate falling to 3.9 percent in June and vacancies in July up by one third compared with a year ago. Inflation declined to 1.7 percent y-o-y in July from 1.8 percent in June.
3. **CEBS stress tests indicated that participating Austrian banks were able to maintain a tier 1 capital ratio well above 6 percent in the stressed scenarios.** The results, published in July, were consistent with earlier national tests run by the Austrian central bank.
4. **In light of the broad agreement reached in July 2010 by the Group of Governors and Heads of Supervision of the Basel Committee, while Austrian banks will still need to strengthen their capital positions compared with previous (Basel II) requirements, the increase will be more limited than what was implied by the December 2009 proposals.** In particular, the Committee will allow some partial recognition of minority interests in core capital. The Governors and Heads of Supervision are expected to finalize the calibration and transition arrangements in September.
5. **Reported non performing loans (NPL) of Austrian banks have continued to rise.** Erste Bank and Bank Austria reported an increase in their NPL ratios from 6.6 percent and 3.5 percent at the end of 2009 to 7.3 percent and 4.1 percent respectively at the end of June 2010.
6. **A Memorandum of Understanding on financial supervision is being concluded with Russia.**



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EXTERNAL
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700 19th Street, NW
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IMF Executive Board Concludes 2010 Article IV Consultation with Austria

On August 30, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Austria.¹

Background

While severe, Austria's recession had limited effects on unemployment. In light of its financial and economic openness, the contraction in world trade and the financial crisis impacted considerably on activity. Investment declined sharply but consumption helped cushion the recession, supported by tax cuts and various labor market measures together with large increases in real wages.

A gradual export-led recovery is underway, with gross domestic product (GDP) growth expected to reach 1½ percent in 2010 and 2011, after a 3.9 percent contraction in 2009. However, uncertainties are elevated and mainly center on developments in the international financial environment.

In the medium term, potential growth is unlikely to return to pre-crisis levels. It will be affected by population ageing and ongoing weakness in investment, due in part to lower growth prospects in some Central, Eastern and South Eastern European (CESEE) countries.

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. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Austria's fiscal position has weakened significantly in recent years, although to a lesser extent than the euro area average. As a result of the recession and as a consequence of stimulus measures of around 2 percent of GDP, mainly consisting of permanent tax cuts, general government deficit and debt levels are expected to reach respectively 4¾ percent and 70 percent of GDP in 2010.

Public support helped reduce market pressures on Austrian banks. The global financial crisis and the bursting of credit bubbles in some CESEE countries where Austrian banks are heavily exposed have weakened the sector. Public financial support, together with the EU/IMF-supported programs, was instrumental in improving market confidence, as evidenced by declining credit default swap spreads. Capitalization has continued to improve on the back of capital increases and deleveraging, but there is marked heterogeneity across banks and nonperforming loans have yet to peak. A particular risk stems from the extent of foreign currency loans made by subsidiaries in the CESEE region.

Executive Board Assessment

Executive Directors commended the authorities for their timely policy response, which has helped mitigate the impact of the global crisis. They noted that, as an open and competitive economy, Austria is well placed to benefit from the recovery in world trade, although considerable risks remain to the growth outlook. Directors also observed that, while Austria's significant integration with other countries in central and south-eastern Europe has been beneficial, it has also exposed the economy to higher risks, notably in the financial sector. In this context, Directors encouraged the authorities to step up efforts to strengthen the fiscal position, improve the resilience of the financial system, and enhance medium-term growth prospects through structural reforms.

Directors welcomed the authorities' plan to embark on a decisive fiscal consolidation path beginning in 2011. They saw the planned pace of consolidation as broadly appropriate and encouraged the authorities to set out concrete commitments and measures early on. Directors noted, in particular, that well-designed measures, which focus mostly on expenditure and involve participation of all levels of government, could minimize the effects on growth and enhance fiscal sustainability. Given the already high overall tax burden, revenue measures should be well targeted. Directors also recommended strengthening the current fiscal framework ("internal stability pact") and introducing ceilings to local governments' debt and guarantees issuance.

Directors observed the improvement of the overall financial position of banks, but noted that more efforts are needed to enhance the resilience of the financial sector. In this context, they noted that, while care should be taken to avoid distortions, the extension of the current financial support package is appropriate. Directors also welcomed recent reforms to the supervisory framework and recommended that regulatory changes and all other measures under consideration be designed carefully. To strengthen supervision and intervention powers, Directors encouraged the authorities to consider a system mandating early remedial action and a proper resolution framework for financial institutions. They also advised the authorities to

monitor closely the situation of individual banks in light of the results of stress tests and stand ready to take action as appropriate.

Directors welcomed the authorities' efforts to enforce tighter foreign-exchange lending standards in cooperation with other supervisors. They recognized, however, that reducing the share of foreign exchange loans, while providing continued financing to central and south-eastern Europe, will be challenging. Directors also welcomed the authorities' action plan designed to address FATF recommendations.

With medium-term potential growth expected to be lower compared with pre-crisis levels, Directors welcomed efforts to raise labor participation in some segments of the population (older, low skilled, and foreign-born workers) and boost product market competition. In this regard, they saw scope to revisit special schemes and long transition periods in the implementation of the 2003 pension reform, which are undermining the necessary increase in the effective retirement age. They also encouraged measures to increase competition in the services sector, including through an effective transposition of the EU Services Directive.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2010 Article IV Consultation with Austria is also available.

Austria: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011
	Projections					
Real economy						
Real GDP (change in percent)	3.6	3.7	2.2	-3.9	1.5	1.6
Domestic demand (change in percent)	2.2	2.5	1.3	-2.3	0.5	1.0
CPI (period average, percent change)	1.7	2.2	3.2	0.4	1.5	1.7
Unemployment rate (in percent)	4.8	4.4	3.8	4.8	4.5	4.5
Gross national saving (percent of GDP)	25.1	26.7	26.4	23.6	22.6	22.8
Gross domestic investment (percent of GDP)	22.3	23.2	23.2	21.3	20.5	20.6
Public finance (in percent of GDP)						
General government balance (ESA 95 basis)	-1.6	-0.5	-0.5	-3.5	-4.8	-4.1
General government balance (EDP definition) 1/	-1.5	-0.4	-0.4	-3.5	-4.8	-4.1
General government debt	62.1	59.2	62.4	67.1	70.1	72.5
Interest rates (in percent)						
Three-month interbank rate	3.1	4.3	4.6	0.7	...	...
10-year government bond	3.8	4.3	4.3	3.6	...	...
Balance of payments (percent of GDP)						
Trade balance (goods)	0.1	0.5	-0.2	-0.8	-0.1	0.1
Current account balance	2.8	3.5	3.3	2.3	2.1	2.2
Fund position (as of June 30, 2010)						
Holdings of currency (percent of quota)				76.4		
Holdings of SDRs (percent of allocation)				100.8		
Quota (millions of SDRs)				1,872.3		
Exchange rates						
Exchange rate regime				Member of euro area		
Euro per U.S. dollar	0.80	0.73	0.68	0.69	...	...
Nominal effective rate (2000=100)	105.5	107.0	107.9	108.3	...	...
Real effective rate (1990=100) 2/	105.9	106.7	107.6	109.9	...	...

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

1/ Maastricht Excessive Deficit Procedure (EDP) include revenues from swaps.

2/ Based on relative normalized unit labor cost in manufacturing.

**Statement by Johann Prader, Alternate Executive Director for Austria
August 30, 2010**

The Austrian authorities appreciate the consultations with the Fund and commend the staff for the high quality of the staff report. They broadly concur with the staff's assessment of Austria's economic situation and its general recommendations on economic, fiscal and financial policies.

The staff report shows that the worst of the past recession is over and all macroeconomic indicators, including on employment and unemployment, are improving. The main challenge is to consolidate the fiscal position without hampering the growth potential, whilst maintaining the social balance. We also note the Fund's interest in the Austrian financial system and its engagement in CESEE.

Short-term and medium-term outlook

Most recent data show that Austria, which suffered from a severe decline of exports last year, is now benefiting from the resumption of international trade. This has brought capacity utilisation in manufacturing back close to average, which gives confidence that investment activity could also turn around towards the end of the year. Private consumption showed continued moderate growth throughout the crisis, not least thanks to substantial fiscal stimulus measures. The short-term outlook for the remainder of the year is positive, as tourism could also gain market shares. Notably, also some CESEE countries benefit from the current improvement of economic activity, while some others are still in the stage of adjustment, as rightly stated in the staff report.

The staff report points at factors which might lower GDP-growth in the medium to long-term. While not giving rise to major concerns or questions about the growth model of Austria, these factors will be monitored and taken into account, when formulating the medium-term economic and fiscal strategies.

Fiscal policy

At 3.5 % and 4.7 % of GDP in 2009 and 2010, the general government deficit reflects the biggest stimulus package ever and the operation of automatic stabilizers. Even if the absolute level of the deficit has remained below the euro area average thanks to the relatively good performance before the crisis, the government is firmly committed to embark on a decisive consolidation path. In line with the staff report and European procedures, fiscal consolidation will start in 2011. Current plans provide for a fiscal deficit of 2.3 % of GDP in 2014, thus well below the staff's medium-term macroeconomic framework. With the new budget framework law in place at the federal level, expenditure ceilings for the years to 2014 have already been set by Parliament. The spending ministries are currently developing instruments to cope with the ceilings, which will be implemented with the 2011 federal budget, scheduled

for adoption by the end of the year. The authorities could agree with the staff that consolidation should focus more on the expenditure side, but other factors necessitate also measures to raise revenues.

Financial sector

In 2009, market confidence in Austrian banks was restored, owing to public financial support and a more favourable environment created by stepped up central bank liquidity operations as well as EU/IMF programs in CESEE. At year-end 2009, the banking sector reported a recovery in bottom-line profitability despite higher risk costs, and capitalization levels continued to improve on the back of capital increases and deleveraging. The new Basel requirements will, however, make a further strengthening of Austrian banks' capital position necessary.

As evidenced by the latest OeNB stress tests, the Austrian banking sector has shown resilience to risk. The results of the CEBS stress testing exercise confirmed this assessment for the major banks, even though Austrian banks were subjected to a more severe CESEE scenario than their competitors. Furthermore, the disclosure of sovereign portfolios revealed only a comparatively low direct exposure of Austrian banks to Euro area countries that have come under market scrutiny.

As of today, it is noteworthy that irrespective of market turbulences, Austrian banks have lived up to their commitment as long-term investors in CESEE. The responsible role played by foreign banks in CESEE should also be considered in the discussion on the introduction of banking taxes in the region – disproportionately high tax levels will certainly not be helpful for its recovery process and its banking systems. Austrian banks were among the most active banks in the European Bank Coordination Initiative and continue their cooperation under the auspices of the EBRD in the “Vienna Initiative Plus”. In this respect, Austria has taken a prominent role to contribute to the solution of the FX lending issue in CESEE by agreeing with banks on a set of guidelines to curb the most risky forms of foreign currency lending in CESEE. A level playing field - to be achieved via the “Vienna Initiative Plus” – will be essential for the long-term success of these measures. In the domestic market, the Austrian authorities, in 2010, imposed a de-facto ban on foreign currency loans to un-hedged private households in Austria, after a string of softer measures proved to be insufficient.

We agree on the importance of keeping the financial sector support package in place for the time being and of closely monitoring the withdrawal of monetary stimulus measures, as the banking sector still faces a challenging environment. This concerns inter alia the refinancing of maturing bonds, the unfolding of credit risks in Austria as well as in CESEE, the sustainability of current operating profitability levels and the challenges arising from regulatory changes.