INTERNATIONAL MONETARY FUND

AUSTRIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

July 31, 2014

KEY ISSUES

Context: Austria did not experience a severe boom-bust cycle and came through the crisis relatively well. The main impact was on the banking sector and public debt. With cyclical slack low and the recovery taking hold, this is the time to resolve crisis legacies and address long-standing structural issues.

Outlook and risks: The recovery is taking hold, driven by a pick-up in exports. The most acute risks are mainly geopolitical and could in particular lead to financial spillovers.

Financial sector policies: Bank restructuring should now be rapidly completed and bad asset disposal accelerated. Large internationally active banks should stand ready for further capital increases, and the EU banking union framework needs to be swiftly transposed at the national level.

Public expenditure reforms: More decisive expenditure reforms in key areas such as pensions, health care, subsidies, and fiscal federalism would generate savings that could be used for both an accelerated debt reduction and lower labor taxation.

Boosting potential output growth: Enhancing IT adaptation, improving the performance of the education system, facilitating access to financing for innovative start-ups, and reducing administrative barriers for new businesses would raise potential growth and labor productivity.

Approved By
Philip Gerson (EUR) and Sean Nolan (SPR)

Discussions took place in Vienna from June 20 - July 1, 2014. The staff team comprised Mr. Bas Bakker (head), Ms. Almira Buzaushina and Messrs. Siegfried Steinlein and Aaron Thegeya (all EUR). Ms. Tingyun Chen and Ms. Solange de Moraes Rego provided support at headquarters. Messrs. Prader and Just (OED) also participated in the discussions. The mission met with Vice-Chancellor and Minister of Finance Spindelegger, OeNB Governor Nowotny, Labor Minister Hundstorfer, other senior officials, parliamentarians, and representatives of the social partners, the banking sector and think tanks.

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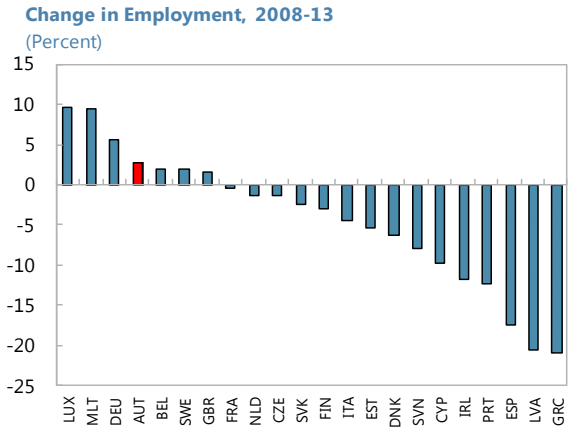
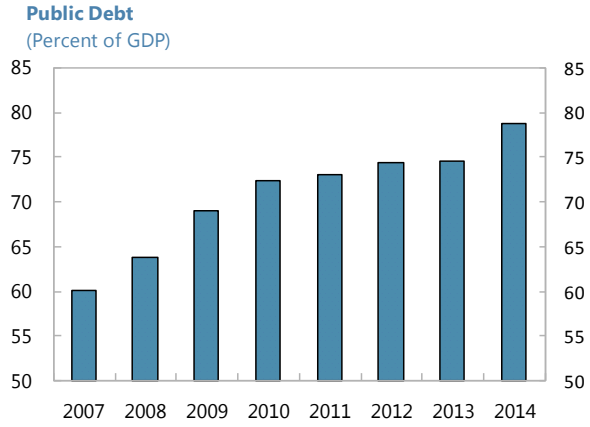
INTRODUCTION

Austria did not experience a severe boom-bust cycle and came through the crisis relatively well. The main impact was on the banking sector and public debt.

1. Austria came through the global economic and financial crisis relatively well, reflecting the absence of large pre-crisis domestic imbalances (Figure 1). In the run-up to the 2008–09 crisis, household and corporate debt levels had remained moderate. The household saving rate had not experienced the sharp drop of countries with a housing boom, but had in fact increased. Tax revenues did not rise rapidly, so the growth of government spending had remained modest. As a result, there were buffers to weather the crisis. Households could smooth consumption by letting the household saving rate decline. Firms were not under severe pressure to cut costs, and could absorb demand shocks through lower profit margins and keep employment relatively stable. The government could act counter-cyclically, in contrast to boom-bust countries, which were forced to consolidate strongly after sharp revenue drops.



2. The main impact of the crisis was on the internationally active banking system and public debt. Pre-crisis, Austrian banks expanded rapidly in CESEE, channeling funds they attracted in Western Europe to finance the credit boom in the region. As their funding dried up post-Lehman, and their assets suffered from the end of the credit boom in CESEE, internationally active Austrian banks came under pressure and needed government support. Together with the downturn, this has contributed to an increase in public debt from 60 percent of GDP in 2007 to around 80 percent of GDP in this year.



3. After a rebound in 2010/2011, a new slowdown occurred in 2012 and 2013, mainly reflecting trade and confidence spillovers from the euro area crisis.

4. In sync with the euro area, the economy seems now on a more stable recovery path, creating an opportunity for resolving crisis legacies and long-standing structural issues. The following areas are key:

- **Banking sector:** The medium-sized banks nationalized during the crisis are still restructuring, and internationally active large banks remain subject to risks from CESEE, most recently in Russia, Ukraine and Hungary.

- **More ambitious structural public expenditure reforms to bring down debt faster and reduce the high tax burden on labor.** Debt reduction under current plans leaves debt above AAA peer levels, and will not build sufficient buffers to cope with intensifying aging cost pressures, potential further bank restructuring costs, and residual risks from banks' CESEE exposure as well as other contingent liabilities. High social security contributions and income tax rates discourage labor supply and hamper potential growth.[1]

- **Raising potential output and productivity growth to bring Austria closer to the technological frontier:** Austria's productivity per hour is 20 percent lower than in the US, and the gap is widening. The gap likely reflects a multitude of factors, including weaknesses in IT adaptation, education, and the availability of private venture capital.

5. In September 2013, the governing coalition of Social Democrats and Austrian People's Party was re-elected, albeit with a slimmer majority. In the previous legislative period, the government had taken several structural expenditure reform steps in the right direction, including on pensions and health care. These measures were confirmed in the coalition agreement. However, this new agreement and the fiscal framework 2015–18 contain no major additional structural expenditure measures, reflecting a divergence in views among coalition partners on many policy issues.

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

Background

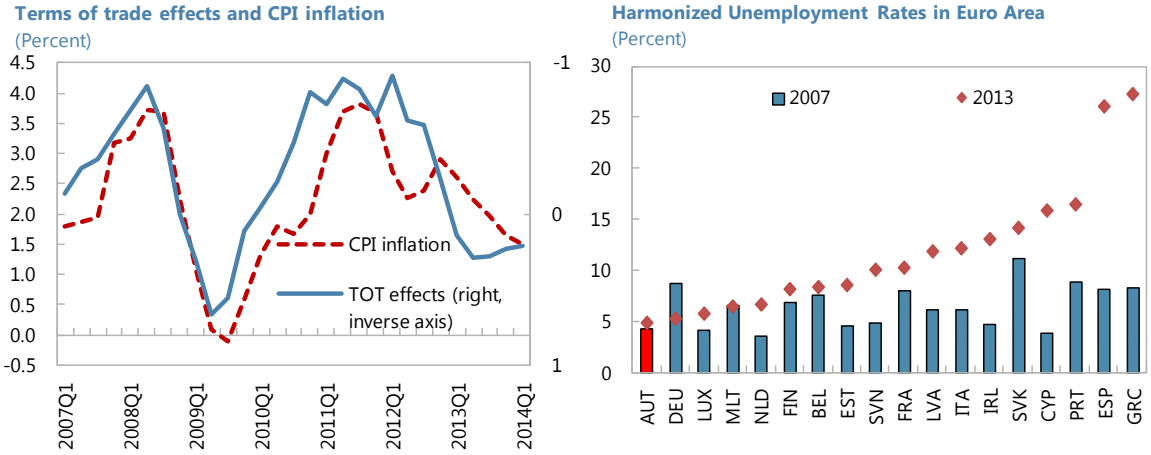
6. The recovery is taking hold and financial markets have eased further (Figures 2 and 3). GDP, which had stagnated for about a year, resumed growth in the second half of 2013. Staff currently projects growth of 1½ percent in 2014[2] and 1¾ percent in 2015, compared with 0.3 percent in 2013. The recovery is following the typical pattern for Austria: it is being driven by a pickup in exports, with investment and consumption expected to follow suit.

7. Inflation has come down, but is high relative to other euro area countries, and the risk of deflation is low. Inflation has fallen from near 4 percent y/y in late 2011 to 1.5 percent in May. The decline was largely the result of lower import prices/terms of trade gains; there are few *domestic*

[1] See IMF 2013 Staff Report for Austria and related Selected Issues Paper.

[2] A downward revision of ¼ percentage point from the 2014 April WEO projections, reflecting a disappointing first quarter.

pressures that pull inflation down. Indeed, staff currently projects 2014 full-year inflation of 1.7 percent, well above the euro area projection of 0.7 percent for 2014 and also above the rate in Germany.[3] Relatively high inflation is largely driven by the services sector, and reflects a tight labor market. With the lowest unemployment rate in the euro area (currently around 5 percent), wage cost increases since 2008 have been amongst the highest in the euro area.



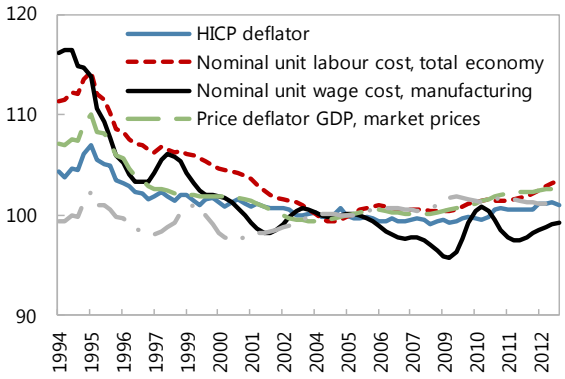
8. Geopolitical developments pose risks *(see risk matrix).* Two internationally active Austria-based banks (RBI and Italian-owned Unicredit Bank Austria) face spillovers from Ukraine and Russia. Banks also suffer idiosyncratic country risks from policy actions in Hungary. Other risk factors include the ECB's comprehensive balance sheet assessment, which may lead to surprises on banks' CESEE asset quality; and lower-than-expected growth in emerging markets and the euro area that would predominantly be transmitted via exports to Germany or through strong real and financial sector ties with Italy.

9. As regards outward spillovers, funding shocks for Austrian banks would spill over to CESEE (Figure 4). Funding pressures would likely lead to a cutback in parent funding to CESEE subsidiaries, constraining credit growth in host countries.

[3] In the past two years inflation has also exceeded German inflation by ½ percentage point on average.

10. Austria's current account and real effective exchange rate are broadly in line with fundamentals (Figure 5). EBA sends conflicting signals: the current account is above the norm,[4] but so is the real exchange rate. In both cases, the results do not reflect policy gaps but an unexplained residual. Austria's current account surplus last year (2.7 percent of GDP) was equal to its average over the past ten years—a sharp contrast with Germany and the Netherlands, which saw sharp increases. The real exchange rate has been stable as well, and Austria's export performance has been about average—not as good as Germany's, for example, but much better than Italy's. Austria's IIP is near zero, giving it an intermediate position among euro area countries. Going forward, there are no indications that the current account surplus or underlying competitiveness would change substantially.

Austria: Real Effective Exchange Rates
(Euro area indices)



The authorities' view

11. Authorities' and staff forecasts and risk assessment are broadly in line. Growth forecasts of the Austrian Central Bank (OeNB) and the two leading economic research institutes (WIFO and IHS) hover around 1½ percent in 2014 and 1¾ percent in 2015. Projection differences for unemployment and inflation between these institutions and with staff are also small. The authorities broadly agreed on the risks identified by staff.

12. The authorities agree there are no clear signs of real exchange rate under-or overvaluation, but are somewhat more worried about the persistent inflation difference with Germany. The gap is attributable to persistently higher services and administrative price increases.

[4] According to EBA, in 2013, the difference between the cyclically adjusted current account (3.4 percent of GDP) and the cyclically adjusted current account norm (1.5 percent) was due to an unexplained residual of 2.4 percentage points—the contribution of the policy gap was negative.

Risk Assessment Matrix[5]

Potential Deviations from Baseline			
Source of Risk	**Likelihood of Risk**	**Expected Impact**	**Policy Response**
Sharp increase in geopolitical tensions surrounding Russia/Ukraine and the Middle East. Idiosyncratic country risks (e.g. Hungary).	Medium	High Lower profits and higher NPL ratios for internationally active Austria-based banks that have subsidiaries in Ukraine, Russia, and Hungary; potential spillovers to sovereign spreads; growth effects due to lower exports and if commodity supply from Russia is disrupted, especially gas.	Encourage banks to increase capital buffers and follow adequate risk provisioning policies; explore alternatives to commodity supply from Russia.
Protracted period of slower growth in advanced economies, especially euro area; CESEE; Turkey or other emerging markets (including China).	High	Medium Lower exports and growth; higher NPLs and lower profits of internationally active banks, especially if there is a further concentration of banks' risk exposures in individual CESEE countries.	Potential growth-enhancing structural reforms and diversification of export markets; increased capital buffers and adequate risk provisioning of Austrian banks.
Unanticipated outcomes from ECB comprehensive assessment and stress tests.	Medium	Medium Higher bank capital needs could elevate bank and sovereign spreads.	Encourage banks to increase capital buffers; proper communication about process and results.
Significantly more expensive or limited funding for Austrian banks.	Low	Medium Cutback in parent funding to CESEE subsidiaries, constraining credit growth in CESEE.	Encourage banks to increase capital buffers to mitigate risk perceptions by market participants; strengthen stability of local funding of subsidiaries.
Higher-than-anticipated cost of bank restructuring; and residual fiscal risks from banks' CESEE exposure.	Medium	Medium Unfavorable debt dynamics and higher sovereign spreads.	Accelerated public debt reduction and more ambitious fiscal balance target.

[5] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Potential Deviations from Baseline (concluded)			
Source of Risk	**Likelihood of Risk**	**Expected Impact**	**Policy Response**
Unsustainable rise in real estate prices.	Medium	Medium Higher domestic NPLs to the extent that unsustainable mortgage lending emerges.	Monitoring of risk indicators; make new macroprudential instruments available (LTV, DTI, etc.).
Surges in global financial market volatility.	High	Low Potential safe-haven inflows and lower spreads.	n/a
Bond market stress from re-assessment of sovereign risk in the euro area.	Low	Low Potential safe-haven inflows and lower spreads.	n/a

POLICY DISCUSSIONS

The discussions focused on the key reform priorities for the still fresh legislative period: (1) completion of bank restructuring and further strengthening of macro-financial stability; (2) public expenditure reforms to enable both faster debt reduction and lower labor taxation; and (3) raising productivity and bringing Austria closer to the technology frontier.

A. Completing Bank Restructuring and Strengthening Macro-Financial Stability

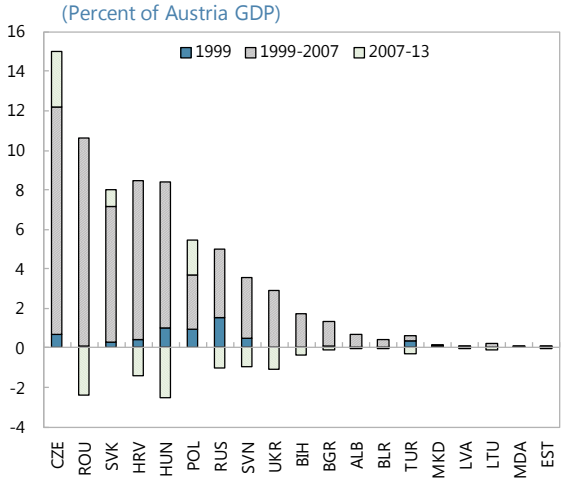
Background

13. During the pre-crisis boom years, Austrian banks expanded aggressively—but in CESEE, not in Austria. Incentives to expand in the two markets were very different: banking in CESEE was very profitable, while profitability in the domestic Austrian market is structurally low. Banks funded their expansion through bond issuance and other borrowing in Western European markets, rather than through deposit taking from the nonfinancial sector in Austria.

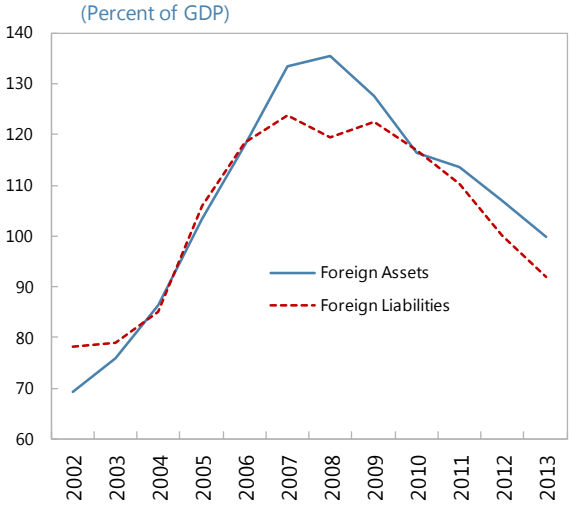
14. This expansion created vulnerabilities that became evident in the aftermath of Lehman. As their funding dried up, and their assets suffered from the end of the credit boom in CESEE, Austrian banks came under pressure. Except for Italian-owned Unicredit Bank Austria, all Austria-based banks with major activities in CESEE received government support. Two of these banks had to be fully or partly nationalized and they have been retreating from the region.[6]

[6] The problems of a third nationalized bank (Kommunalkredit) were rooted mainly in its considerable bond and CDS exposure to the euro area periphery (for more background on restructuring banks, see 2013 IMF Staff Report, Box 1).

Foreign Claims of Austrian Banks on CESEE
(Percent of Austria GDP)

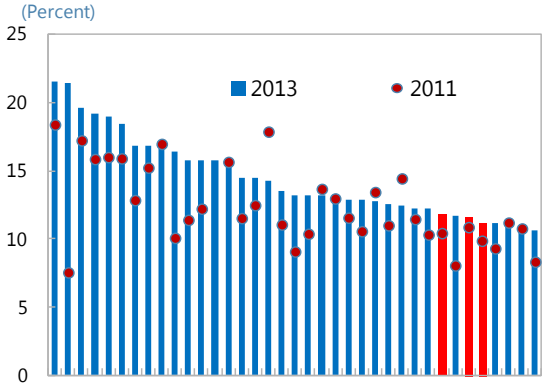


MFIs Foreign Assets and Liabilities
(Percent of GDP)



15. Austrian banks have continued to shift to a new model, in which credit of their CESEE subsidiaries is to a much larger extent funded by local deposits rather than by parents. The shift was further encouraged by the supervisory guidance adopted by the authorities in 2012 ("sustainability package"), which aimed to limit excessive parent bank funding by introducing a benchmark of 110 percent for the "loan-to-local-stable-funding ratio" on net new lending.[7]

Selected Large European Banks: Tier I Ratio 2011-2013 1/
(Percent)



1/ Austrian banks in red, non-Austrian banks in blue.

16. Large banks have strengthened their capital position, but capital gaps with peers remain (Figure 6). After a recent rights issue by RBI, all three large banks now have fully-loaded Basel III CET1 ratios of around 10 percent. Capital remains below that of peers, in a context of residual market concern about what the ECB balance sheet assessment will reveal about the asset quality and collateral valuation in CESEE. Leverage ratios are comparatively favorable, reflecting the banks' focus on more traditional loan business.

17. The restructuring of fully or partly nationalized banks has made progress, but challenges remain.

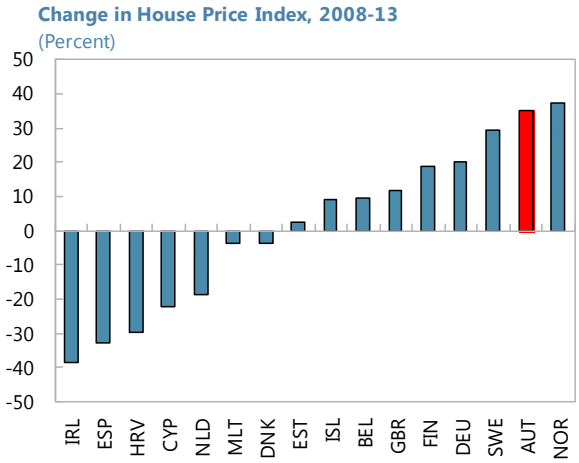
- After considering various resolution options for Hypo Alpe Adria, including a bankruptcy,[8] the authorities have decided to sell the SEE subsidiaries and wind down the remaining assets in a

[7] For details on the supervisory guidance, see IMF 2012 Staff Report for Austria and related Selected Issues Paper.

[8] The government opted for the bad bank rather than a bankruptcy, as most of the bonds of HAA are guaranteed by the state of Carinthia. As Carinthia is not able to honor the guarantees that would be called in a bankruptcy, the

(continued)

government-owned "bad bank" (defeasance structure without a banking license).[9] The respective legislative package passed the Austrian Parliament in July. The restructuring includes a bail-in of €890 million in subordinated debt guaranteed by the state of Carinthia,[10] and an effective wipe-out of the guarantee.[11] Negotiations with potential buyers for the going-concern SEE subsidiaries are ongoing; under an EU state aid decision, they need to be re-privatized by mid-2015.



- Another restructuring bank, the partly nationalized apex institution of the cooperative "Volksbanken" association (Volksbanken AG), has substantially downsized its balance sheet but faces difficult further disposal challenges. This and the ongoing ECB balance sheet assessment may lead to higher capital needs, which could affect lower-tier banks and the Volksbanken association as a whole.

- As for Kommunalkredit and KA Finanz, the wind-down seems to be proceeding in line with the authorities' plans, but further public capital needs cannot be excluded there either.

18. Neither the non-financial corporate sector nor the household sector is overleveraged, but housing prices warrant monitoring (Figure 7). Non-financial corporate debt hovers around the euro area median, and increased much less in the pre-crisis years than in other countries. Household debt is lower than the euro area average, and there has been little pressure to deleverage.[12] However, a considerable share of household borrowing consists of Swiss-franc denominated bullet loans and variable-interest housing loans.[13] Housing price increases have been strong in recent years but purchases have been to a large extent cash-financed and the strongest growth has been predominantly limited to Vienna and some tourist hotspots.

Policy Discussions

federal government would have had to either bail-out Carinthia (eliminating the cost savings of a bankruptcy) or let Carinthia go bankrupt, with possibly severe contagion effects on other states and banks.

[9] Technically, the "bad bank" consists of two entities: a small one with a banking license for the Italian part, and a bigger one without for the rest.

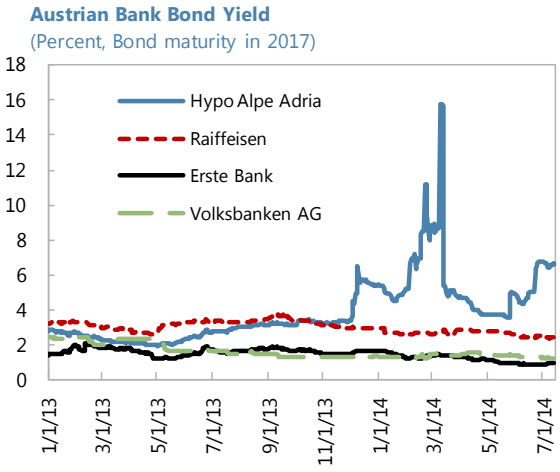
[10] The law also bails in €800 million non-guaranteed funding from the former HAA-owner Bavarian Landesbank.

[11] Technically, the law voids the underlying debt. In the absence of this debt, the guarantee no longer exists.

[12] The household saving rate has declined since 2009.

[13] The share of foreign currency loans has been declining in recent years, as the Austrian authorities have taken steps to rein in new foreign currency loans.

19. The mission and the authorities agreed that the strengthening of capital positions and the transition toward a new funding model have reduced vulnerabilities of internationally active banks. The ongoing shift to a new funding model for subsidiaries in CESEE has helped reduce external debt of Austrian banks, made both the parent banks and their subsidiaries less vulnerable to funding shocks, and diminished the likelihood of future boom-bust cycles in CESEE countries. Moreover, as increased local deposits have substituted for a decline in external funding, the level of credit has not declined in most CESEE countries so far.[14] The mission cautioned that the 2012 supervisory guidance for the largest three banks should continue to be applied judiciously, in close coordination with host countries, to avoid unduly restraining credit growth in still nascent recoveries.



20. Risks remain elevated, however, and further strengthening of the capital position of large banks would create stronger buffers to absorb them. Bank profitability suffers from the continued low interest rate environment and, specifically in CESEE, has been under pressure as a result of rising NPLs, risk costs, and write-offs. Russia, where credit growth had been strong, became a major profit contributor.[15] Current events in Ukraine and Russia put this important source of profitability and internal capital generation increasingly at risk. Further losses can also be expected from policy actions in Hungary regarding foreign-exchange denominated loans.[16]

21. The mission welcomed that a decision had been made on the resolution of Hypo Alpe Adria. It appreciated the attention the authorities had given to the systemic importance of the bank for some countries in the SEE region, by avoiding Hypo´s bankruptcy.

22. Views differed on the retroactive voidance of the state of Carinthia's guarantee of €890 million of HAA subordinated debt. The authorities explained that the voidance was designed and intended as an isolated case. They saw the bail-in as in line with the new European resolution framework that would come into effect in 2016 and argued that bond holders should have exercised better due diligence and understood that Carinthia would never be able to honor the guarantees it had issued.[17] While agreeing that bailing in of subordinated debt was in line with the

[14] Notable exceptions include the Baltics, Hungary, and Slovenia.

[15] In 2013, RBI and Bank Austria derived respectively around 75 and 60 percent of their profits from Russia.

[16] Hungary's parliament recently passed a law requiring banks to compensate borrowers for unfair lending practices, referring to application of unilateral adjustments of the interest rate and the use of an exchange rate spread. The law applies to both foreign-exchange and Hungarian Forint-denominated loans.

[17] The World Bank, which holds €150 million of subordinated Hypo debt, will also be affected.

future European frameworks, the mission argued that the voiding of the state of Carinthia's guarantee was a separate issue, and that such a move would undermine the credibility of similar guarantees issued by other sub-national bodies, potentially damaging the Austrian "brand" in the future.

23. The mission argued that the bank restructuring agenda should be rapidly completed and asset disposal accelerated. Governance of the Hypo "bad bank"/AMC needs to ensure efficient asset disposal over a limited timeframe. The sale of the Hypo SEE subsidiaries should be completed as rapidly as possible, while avoiding disruptive effects in host countries. For Volksbanken AG, speedy asset disposal, including of its Romanian subsidiary, remains equally essential. The restructuring of the Volksbanken association needs to take into account the structurally low profitability in the domestic banking market.

24. The evolving European Banking Union framework is being implemented at the national level, but key decisions are still pending. According to the authorities, preparations for the Single Supervisory Mechanism (SSM) are on track. As regards the Single Resolution Mechanism (SRM), no decision on the designation of the national resolution agency had yet been made; and the discussion on a revamping of the deposit insurance schemes (DGS) at the occasion of the introduction of EU-mandated DGS pre-funding had not progressed since last year's Article IV consultation. As regards AML/CFT, in February 2014, the FATF recognized that Austria had made significant progress in addressing deficiencies identified in the June 2009 mutual evaluation report and decided that the country should be removed from the regular follow-up process. Nevertheless, given possible spillovers from events in Russia/Ukraine on the real estate sector, the authorities are encouraged to closely monitor this sector.[18]

25. Similarly, the creation of a workable macroprudential framework is lagging behind. While the legal basis for a Financial Market Stability Board has been created, at the time the mission discussions took place, the appointment of its members still needed to go through parliament.[19] The envisaged macroprudential toolkit remains limited to various capital buffers and the possibility to change risk weights on exposures secured by mortgages on immovable property for financial stability considerations according to the CRR/CRD. However, the set of instruments does not comprehend sector-specific instruments, such as LTV or DTI ratios targeted to housing market developments. The authorities explained that the agenda had been dominated by the resolution of Hypo Alpe Adria bank, and that they would focus their attention to these issues next.

[18] The FATF reports noted that the number of suspicious transaction reported by real estate agents was 0 in both 2011 and 2012.

[19] The members of the macroprudential authority, the Financial Market Stability Board, were appointed in July 2014.

Box 1. Pre-Crisis Imbalances and Post-Crisis Growth

Austria's better performance during the crisis likely reflects that few private sector imbalances were built up during the pre-crisis years.

- Households did not go on an asset price and credit-fueled consumption boom. Many EU countries experienced housing price booms during the pre-crisis years—including in particular in Spain, Ireland, the UK and Eastern Europe—which boosted consumption, increased household debt and led to a sharp decline in the saving rate. Austria was different: housing prices remained flat, household borrowing was modest, and its saving rate increased.
- The corporate sector did not over-borrow and corporate profitability did not deteriorate. In many countries the corporate debt-to-GDP ratio increased sharply, with the largest increase in Ireland, Bulgaria and Spain. Profit shares declined in many countries as well, as overheating labor markets increased wage bills and reduced profit margins. On both fronts Austria was again different: the increase in corporate debt was modest, and profitability increased moderately.

In countries with imbalances, their unwinding led to pro-cyclical behavior of the private sector, which contributed to an often severe downturn.

- Households slashed consumption as housing price booms went bust and credit dried up. As household net worth deteriorated sharply, wealth effects went into reverse, and households were forced to increase their saving rate—sometimes very steeply. Hence, households could not smooth consumption; instead the increase in their saving rate contributed to the recession.
- The corporate sector had to slash costs, as financing dried up and debt levels were no longer sustainable.[1] Non-profitable production capacity was shut down, and the workforce was reduced to save costs and restore profit margins. The result was high unemployment and a sharp decline in production. The increase in profit margins was particularly large in the Baltics, Ireland, and Spain—which all had very sharp increases in unemployment.

In Austria the private sector behaved counter-cyclically, which mitigated the downturn.

- Households reduced their saving rate, mitigating the decline in consumption. Consumption growth remained positive in 2009, and in fact was (marginally) faster than in 2007 and 2008.
- Firms did not need to slash costs, and employment remained relatively stable. Firms instead absorbed costs of a temporarily under-utilized workforce.

The public sector made a further difference. In the pre-crisis years, in many countries the private sector boom indirectly contributed to a public spending spree, as a surge of boom-related tax revenues generated room to boost public expenditure. When the private sector boom ended, tax revenues dropped sharply, forcing the governments to retrench. Austria was different here as well, as expenditure had remained under control during the boom years, there was no need to retrench during the crisis—and in fact there was room for countercyclical policy.

[1/] See Bas B. Bakker and Li Zeng, "Reducing the Employment Impact and Corporate Balance Sheet Repair" in Jobs and Growth: Supporting the European Recovery, edited by Martin Schindler, Helge Berger, Bas B Bakker, and Antonio Spilimbergo (2014).

Box 2. Austria's Banking Sector as Inter-Mediator of Western European Savings

Austria's banks have large *gross* foreign assets, in large part the result of the rapid expansion in Central, Eastern and Southeastern Europe (CESEE) during the pre-crisis years. But *net* foreign assets are close to zero, as foreign liabilities are high as well. This is because much of Austrian banks' expansion has been funded by banks and investors in Western Europe.

After the banking sectors in CESEE were opened to foreign investors in the mid to late 1990s and with a view to EU accession of some CESEE countries,[1] Austrian banks entered CESEE markets mainly through a series of mergers and acquisitions, becoming dominant players in many markets. Their exposure to CESEE became large not only relative to the size of the host countries (for example, by 2007, Austria's claims on Croatia accounted for over 50 percent of Croatia's GDP), but also relative to the size of Austria's GDP. By 2007, exposure to CESEE amounted to 70 percent of GDP—more than any other Western European country.

In the years leading up to the crisis credit expansion in CESEE was increasingly funded by transfers from parent banks to their subsidiaries, rather than from local deposits in the host countries. This allowed credit to grow much more rapidly, boosting profits of Austrian banks. Parent banks not only provided funding to their subsidiaries, but in many countries also provided direct cross-border loans to the nonfinancial private sector.

Austrian banks funded this expansion through externally issued bonds and loans. Net issuance of international debt securities rose from US$2 billion in 1997 to US$27 billion in 2007. Additional funds were attracted in the interbank deposit market. Overall, external debt of Austrian banks stood at US$430 billion in 2007.

The global crisis showed that this funding structure had made Austrian banks vulnerable to shocks—with repercussions for CESEE. After Lehman Brothers defaulted in September 2008, Austrian banks with major activities in CESEE came under pressure. Almost all of them needed government support, and two had to be fully or partially nationalized. As it became much more difficult for Austrian banks to obtain new funding, they stopped or strongly curtailed new funding to their subsidiaries. The result was that the credit expansion slowed sharply, and in many countries came to a sudden stop.

Since 2008, there has been a gradual reduction in Austrian banks' external assets and liabilities. Net issuance of debt has been negative since 2009, and the stock of outstanding bonds has fallen from US$173 billion to US$132 billion. On the asset side, Austrian banks have reduced their cross-border funding to CESEE, as their subsidiaries have gradually shifted their funding mix away from parent bank funding towards funding from local deposits. This mix has shifted as a result of both demand and supply factors, the relative importance of which has varied over time and by country.[2] In the aftermath of Lehman Brothers and from mid 2011 (when the euro area crisis intensified), supply factors were important, notably rising funding costs and tighter credit conditions. Later on, when economic growth had weakened, demand factors became increasingly important. As credit demand in many countries was weak, while deposit growth was relatively robust, it became attractive for subsidiaries to pay back parent funding. The macro-prudential guidance issued by the Austrian supervisor in 2012 may also have played a role.

In short, Austrian banks are an important intermediator of Western European savings into CESEE. This has increased the pool of funding for CESEE, and allowed capital to flow from richer to poorer countries. However, the transmission works not only in good times, but also in bad times: when financial markets in Western Europe dry up, CESEE feels the impact.

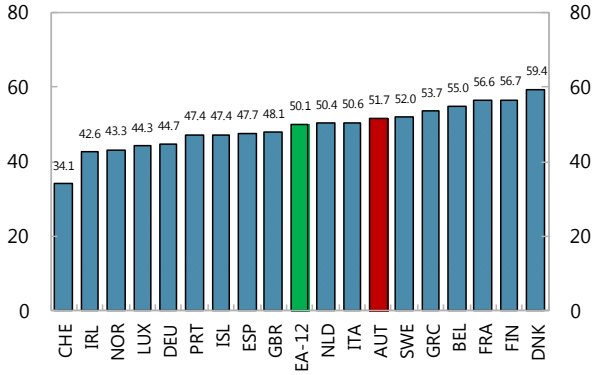
[1/] See chapter 1 of the book "How Emerging Europe came through the 2008/09 crisis: An Account by the IMF's European Department" (2012), edited by Bas B. Bakker and Christoph Klingen.

[2/] See IMF, CESEE Regional Economic Issues (Spring 2014).

B. Rationalizing Public Expenditure to Accelerate Debt Reduction and Reduce Labor Taxes

Background

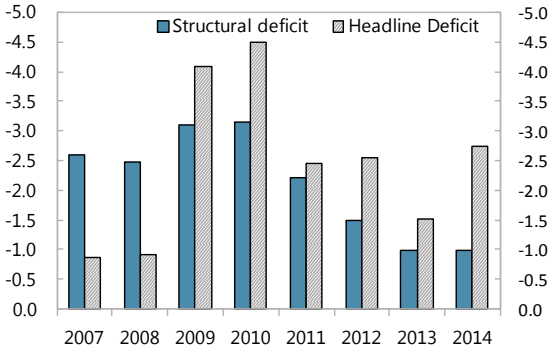
Total government expenditure
(2012, in percent of GDP)



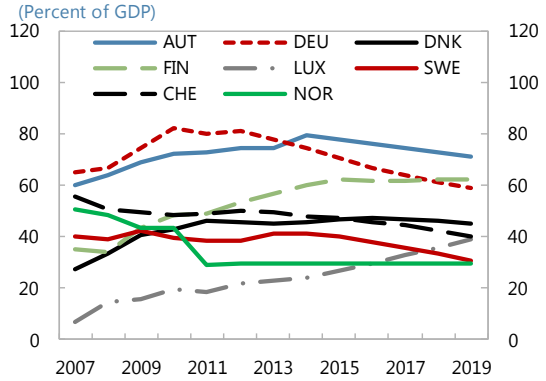
26. Austria's public expenditure-to-GDP ratio is high (Figure 8). It is well above the EU average, and 7 percentage points higher than in Germany. More positively, it has increased less than in most other countries during the past decade, reflecting the absence of procyclical expenditure surge during the boom years and solid GDP growth (Figure 9).

27. The counterpart of Austria's elevated spending level is a high tax burden, especially on labor. Austria's tax wedge on labor is one of the largest in the OECD (Figure 10). This has contributed to relatively low employment among the low-skilled[20] and a high share of part-time workers, including among women *(*Figure 11*)*.[21] And with tax brackets not indexed to inflation, the tax burden tends to drift up over time, holding back growth of real disposable incomes.

Deficit
(Percent of GDP)



Debt Ratios of AAA-rated Countries, 2007-19
(Percent of GDP)



28. Austria's structural deficit is not high, but as this deficit excludes a number of expenditures, including for bank support, debt dynamics are not as favorable (Figure 12). On current plans, the structural deficit will decline from 1 percent of GDP in 2013 to ½ percent of GDP from 2016 onwards. Due to bank restructuring costs,[22] the debt ratio will decline only from

[20] In 2013, the employment rate of the low-skilled was 48 percent, compared with 79 percent for the higher skilled.

[21] See 2013 IMF Staff Report and related Selected Issues Paper. The low employment rate among older workers also mirrors relatively generous (early) retirement rules and benefits.

[22] In 2014, the restructuring of Hypo Alpe Adria will boost the headline deficit by 1.2 percent of GDP, and will add 4½ to 5 percent of GDP to debt directly, propelling the debt ratio to around 80 percent of GDP. Bank restructuring costs are the main driver for an increase of the headline deficit to above 2½ percent of GDP, up from 1½ percent in

(continued)

75 percent in 2013 to around 70 percent in 2020.[23] As a result, from 2014 on, Austria will have the highest debt ratio among European AAA countries and be relatively more exposed to changes in the currently low interest rate environment. While debt is sustainable within the medium-term horizon of the Fund's debt sustainability analysis (DSA),[24] in the next decade, without further reforms, aging cost will lead to upward pressures on the deficit that would reverse debt dynamics.[25]

29. Comparisons with other countries show several areas where spending stands out (Figures 13 and 14).

- Old-age social benefits are high in spite of a still relatively favorable old-age dependency ratio. Austria has a lower old-age dependency ratio than Germany, but Austria's spending exceeds that of Germany by 3½ percentage points.

- Subsidies and capital transfers are about 3¾ percentage points of GDP higher than the euro area[26] average. While this partly reflects support to banks and accounting differences,[27] even abstracting from support to banks and hospitals, subsidies and capital transfers are 2¼ percentage points of GDP higher than in Germany. Significant savings could be made by reducing aid to railways, and by better targeting and avoiding duplication of other subsidies.[28]

- Health care spending is relatively high. OECD analysis suggests that Austria could save about 2 percentage points of GDP in health care spending, without endangering outcomes. A particular problem is the inefficiently large number of hospitals.

30. Spending levels are also boosted by complex intra-governmental financing arrangements and lack of subnational tax autonomy, which provides little incentive to contain spending at the sub-national level.

2013. The structural and even more so the headline deficit were lower than expected in 2013 at respectively 1 and 1½ percent of GDP, due to unbudgeted windfalls from the auctioning of telecom licenses that over-compensated higher-than-anticipated capital transfers to restructuring banks.

[23] The debt projections assume that the Hypo Alpe Adria defeasance structure will recover about 2 percentage points of the transferred asset in the amount of some 5½ percent of GDP until 2020. The projections do not yet take forthcoming revisions to GDP and the perimeter of general government into account, which will take place in the context of the introduction of ESA2010.

[24] See Annex I.

[25] The latest official projections foresee an increase in old-age related spending (pensions, health and long-term care) from an already high level of 23.8 percent of GDP in 2015 to 28.3 percent of GDP in 2050.

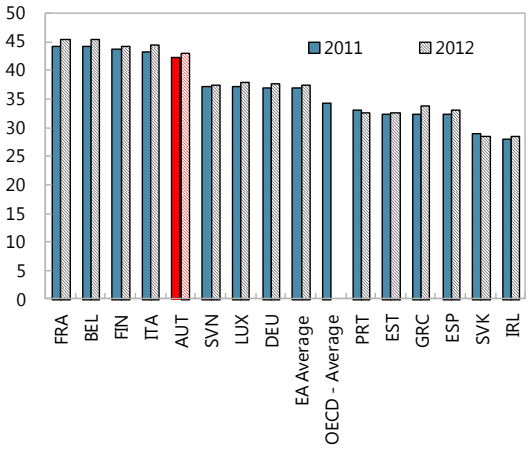
[26] Euro area-12, comprising Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

[27] In other countries with different health care financing systems, hospital expenses may show up under health care rather than subsidies.

[28] The deficiencies of the subsidy system were comprehensively analyzed by a government working group (see Arbeitsgruppe Verwaltung Neu (2010): Arbeitspaket 5: Effizientes Foerderungswesen, Wien).

Policy Discussions

Total Tax Revenue
(Percent of GDP)

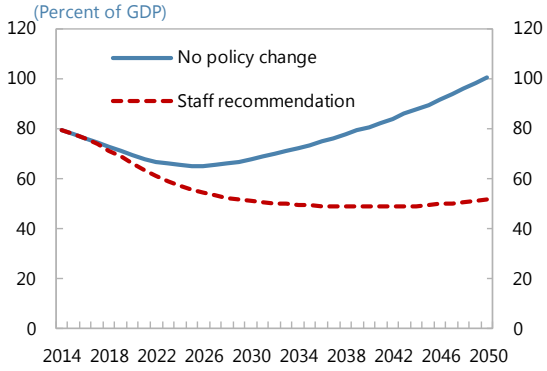


31. The mission and the authorities agreed that the tax burden on labor was too high and should be reduced. While the current debate in Austria focuses on reducing income taxes only (the most prevalent idea is reducing the lowest income tax bracket from 36 to 25 percent), the mission argued that consideration should also be given to lowering social security contributions, which start at a level well below the threshold for income taxation.

32. Views within Austria differed on how a tax cut should be financed. This is partly because specific proposals for the design of a tax reform were still being elaborated, and a tax reform commission chaired by the Ministry of Finance had just had its inaugural meeting. But there is also considerable disagreement between the two coalition partners. The Social Democrats advocate a revenue-neutral tax reform, with a lower income tax financed by higher net wealth and inheritance/gift taxes. In contrast, the conservative Austrian People's Party argues that tax reductions should be funded through expenditure cuts. Current expenditure plans, however, leave no room for cutting taxes.

33. The mission argued that a meaningful reduction of the tax burden on labor would only be possible if expenditures were addressed. It acknowledged that there was some scope for financing labor tax reductions by selectively abolishing tax exemptions and increasing real estate and environmental taxes. Real estate taxes are particularly low, reflecting both low rates and low valuations.[29] But it cautioned that the yield of such measures should not be overestimated, and warned that revenue-neutral tax reforms tend to be rare.

Austria: Illustrative Debt Dynamics 1/
(Percent of GDP)



1/ For details, please see Figure 12.

34. The mission argued that more decisive expenditure cuts and fiscal federalism reforms would not only create room for reducing taxes, but also help to bring debt down faster. More specifically, it argued that

- **Expenditure cuts totaling about 1 percent of GDP over the next four years would help put debt on a steeper downward path.** The resulting

[29] The real estate tax is levied at a basic federal rate of 0.2 percent, multiplied by a municipal coefficient (up to 500 percent), which generally means a tax rate of 1 percent on the tax values (unit values determined in 1970–80s tend to be far below the market values).

structural surplus of ½ percent of GDP should be maintained until the pre-crisis debt level of 60 percent is reached in the first years of the next decade (Figure 12). This would create sufficient buffers for absorbing aging cost, potential additional bank restructuring outlays, and other contingent liabilities (including residual risks from Austrian banks' CESEE exposure).

- **Additional expenditure cuts would create room for reducing social contributions and labor taxes.** Such a reduction should put a major emphasis on reducing high social security contributions, which also affect income levels below the relatively high threshold at which income taxation kicks in. To reduce Austria's overall taxation level, social security contribution and tax cuts should be financed and phased in together with well specified expenditure reductions, while ensuring that the more ambitious fiscal balance target will be met. In addition, a streamlining of the tax system through a selective abolition of tax exemptions and the increase of environmental and real estate taxes could create some additional room for lowering the burden on labor.

35. Interlocutors agreed with the mission's assessment that *aggregate* spending is too high, but referred to political obstacles when *specific* expenditure reductions were discussed. On an abstract level, counterparts agreed that expenditure levels for pensions, subsidies, and health care could be reduced, but when it came to discussions about specific reform options, they referred to numerous political obstacles either within the governing coalition or in the relationship between the federal and the state levels.

36. Interlocutors did not have strong views on whether a more ambitious longer-term fiscal deficit target than currently pursued was needed. In large part this was because they were focused on the achievement of their 2016 structural deficit objective of ½ percent of GDP. Some wondered whether more fiscal consolidation would be desirable given the weak economic situation in Europe. The mission pointed out that extra consolidation would only be required after 2016, when the recovery was hopefully well established.

Box 3. The Scope for Fiscal Expenditure Rationalization in Austria

In the past decade, Austria's government expenditure growth has been very steady, thus avoiding the boom-bust pattern of some other European countries. However, expenditure levels are relatively high, and the difference with Germany has been widening. Compared with other countries, spending is particularly high for pensions, capital transfers and subsidies, including in the transport sector. Potential for efficiency gains appears to exist in health care spending.

In the past decade, Austria's expenditure to GDP ratio has increased less than in most other EU countries, although the starting level was already high (Figure 8). This is the result of relatively modest expenditure growth, and robust GDP growth.

At the same time, Austria has managed to avoid the boom-bust in public expenditure that characterized some of the other European countries (Figure 9). With no expenditure surge in the pre-crisis years, the government was not forced to retrench expenditure post 2009. The absence of an expenditure boom in Austria partly reflects the absence of a revenue boom.

Nevertheless, Austria's expenditure to GDP level is high compared with other countries. The expenditure to GDP ratio was 51.7 percent in 2012, 1.6 percentage points higher than the euro area-12 (EA-12) average. The difference with Germany—a country that has also come through the crisis relatively well—is much larger (7 percentage points in 2012) and has widened significantly over the past decade.

A cross-country analysis of public spending by different type of categories shows several areas where spending stands out. Looking at main categories by economic and functional classification[1] in Austria and its peer countries[2], Austria's expenditure is particularly high for subsidies in health care (hospital services) and in economic affairs (transport sector), for capital transfers in economic affairs (transport sector and bank rescues), and for social benefits in social protection (to a large extent old-age pensions) (Figure 13).

Public pension spending is high and will increase further due to aging. Current high spending reflects both a high replacement rate and low effective retirement age. While the old-age dependency ratio is still relatively favorable, this will change going forward. According to the European Commission (EC) 2012 Ageing Report, the old-age dependency ratio[3] in Austria is projected to increase by about 23 percentage points between 2015 and 2050 (Figure 14). As a result, spending on pensions will rise further—the latest official projections foresee an increase in public pensions spending from 13.9 percent of GDP in 2015 to 16.4 percent in 2035, one of the highest in the euro area.[4]

Raising effective and statutory retirement ages would help mitigate cost pressures. The 2012 pension reform is a step in the right direction (and current official projections already assume a rise in the effective retirement age and in the labor force participation among the 55–64 years old),[5] but, according to the OECD, further adjustments may be needed, such as raising the deduction in case of early retirement from currently 5.1 to above 6 percent to achieve full actuarial neutrality and a more rapid increase of the statutory retirement age[6] for women, which is not currently envisaged.[7] Developments in the effective retirement age and employment rate among older workers are intended to be closely monitored so as to take additional measures if necessary.

Austria's subsidies and capital transfers are among the highest in the region, even abstracting from support to banks and hospitals (Figure 13). Given Austria's peculiarity in accounting for public expenditure in health, in particular for hospital services,[8] we subtract subsidies for hospital services from the total amount of subsidies. Excluding in addition capital transfers due to bank rescues, Austria's expenditure on subsidies in broad sense is still one of the highest in the region (3.9 percent of GDP in 2012) and by 2.3 percentage points higher than in Germany. The biggest bulk of these subsidies goes into the transport sector (mainly railways, OeBB), both in form of subsidies and capital transfers. As the "Administrative Reform Working Group" points out, the Austrian system of subsidies and transfers has many deficiencies such as insufficient targeting, unsatisfactory ex-post evaluation, and transparency gaps that allow for multiple

Box 3. The Scope for Fiscal Expenditure Rationalization in Austria (concluded)

funding.[9] While the government plans to extend the coverage of the transparency databank for public subsidies to incorporate states and municipalities and to increase efficiency of capital transfers provided to OeBB,[10] the effectiveness of these measures in reducing subsidies in Austria is still to be assessed.

Potential for efficiency gains appears to exist in health care spending. According to the OECD, health care spending in Austria could be reduced by 2 percentage points of GDP without adversely affecting outcomes, if Austria's health care system was operating at the frontier level of efficiency.[11] In particular spending on hospital services—the main contributor to the high health expenditure—suffers from efficiency concerns,[12] not least due to fragmentation between spending and funding responsibilities between different levels of government. In the context of the health care reform 2013, the authorities plan to limit nominal health expenditure growth to nominal GDP growth by 2016 and keep it at the expected average nominal GDP growth (3½ percent) beyond 2016. However, the reform lacks concrete measures to reach the defined targets and could be further strengthened also by setting more ambitious goals for shifting from inpatient to outpatient care and by reinforcing preventive health care.

1/ According to the economic classification, total government expenditure is divided into intermediate consumption and taxes, compensation of employees, subsidies, property income, social benefits and social transfers in kind, other current transfers, capital transfers, and gross capital formation. Functional classification splits expenditure into ten functional groups such as general public services; defense; public order and safety; economic affairs; environmental protection; housing and community amenities; health; recreation, culture, and religion; education; and social protection.

2/ In this analysis Austria's peer countries comprise EA-12, Denmark, Iceland, Norway, Sweden, Switzerland, and United Kingdom.

3/ In the EC 2012 Ageing Report, the old-age dependency ratio is defined as population aged 65 and over as a percentage of the population aged 20–64

4/ See Bundesfinanzministerium fuer Finanzen (2013), Langfristige Bundgetprognose, April, Vienna.

5/ The 2012 pension reform that came into force on April 1, 2012, extends the number of contributory years entitling for the corridor pension and the long-term insurance pension from 37.5 to 40 years; restricts access to disability pension by tightening eligibility criteria and strengthening re-integration into work life ("fit2work"); increases the deductions in case of early retirement from currently 4.2 to 5.1 percent. Other measures include moderate adjustments of pension benefits (by 1 percentage points and 0.8 percentage points lower than CPI in 2013 and 2014, respectively).

6/ The statutory retirement age is set at 65 years for men and at 60 for women, and the retirement age for women will converge to men by 2033.

7/ See 2013 OECD Economic Survey for Austria.

8/ From the second half of 1990s to the early 2000, many state and municipal hospitals were transformed into private corporations owned by sub-national governments, but recorded outside public accounts. See ECFIN Country Focus, Vol, 11, Issue 1, January 2014.

9/ Arbeitsgruppe Verwaltung Neu (2010), Arbeitspaket 5: Effizientes Foerderungswesen, Vienna.

10/ See Oesterreichisches Stabilitaetsprogramm, Bundesministerium fuer Finanzen, April 2014, Vienna.

11/ See 2011 OECD Economic Survey for Austria.

12/ A hospital efficiency study developed in Austria suggests that up to one fifth of hospital costs could be saved. See Hofmarcher, M.M., Ch. Lietz and A. Schnabl (2005), "Inefficiency in Austrian inpatient care: An attempt to identify ailing providers based on DEA results", Central European Journal of Operations Research, Vol. 13 (4).

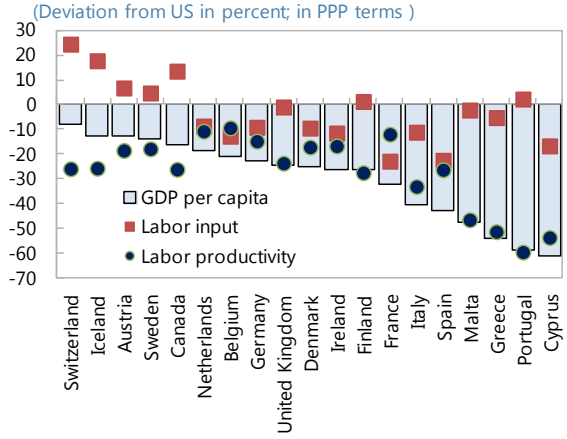
C. Raising Potential Growth Through Higher Labor Productivity

Background

37. High labor utilization has made Austria's per capita GDP one of the highest in Europe. Per capita GDP is 12 percent higher than in Germany, and exceeded only by Switzerland and Iceland (Figure 15). Labor *productivity* does not stand out as much: it is lower, for example, than in Belgium, Netherlands, France and Germany, although high productivity in some of these countries may be the flipside of their low employment ratio.[30]

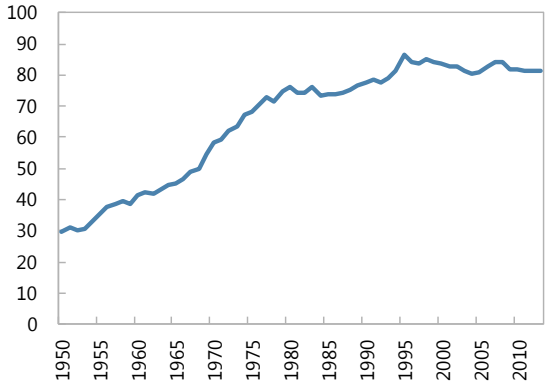
38. Taking a global rather than regional perspective, per capita GDP is well below the US—the result of lower productivity (Figure 16). Productivity per hour in Austria is almost 20 percent lower than in the US, which explains why per capita GDP is 13 percent lower, despite higher labor input. Moreover, labor productivity stopped catching up with the US in the mid 1990s, and has since fallen behind. Relatively low labor productivity is all the more striking given that capital intensity of production in Austria is high.

Real GDP per Capita and Contributors, 2013
(Deviation from US in percent; in PPP terms)



39. Falling productivity growth has also affected potential output growth (Figure 17). The decline in potential growth preceded the global crisis, and started in the late 1990s. It largely reflects a reduction in the growth rate of labor productivity, which peaked in the late 1990s and has been on a downward trend since.

Ratio of Labor Productivity in Austria to US



40. Austria's productivity growth decline is also visible in the productivity of capital which has fallen steadily in the past few decades. This decline is strikingly different from the increase observed in the US, the UK, the Netherlands, and the Scandinavian countries (Figure 18).

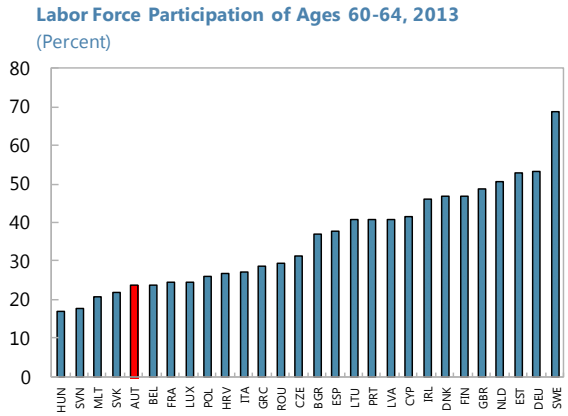
Policy Discussions

41. The authorities agreed with the mission that low labor productivity growth was an issue, and discussions focused on possible explanations. Contributing factors that were mentioned included

[30] In countries with low employment ratios, only the most productive workers tend to be employed.

- Lower adaptation of IT. It is striking that in the past decade the largest differences with the US have been in manufacturing and IT (Figure 16).
- Cultural attitudes towards risk taking, and limited "second chances" for those who had experienced bankruptcy.
- Lack of private financing for start-ups. This may be due to the bank-based financial system, which mainly provides financing to existing firms, and provides little venture capital to new startups. (Figure 16).

- Red tape and excessive regulation. Administrative costs for startups are high, particularly within services sectors, and barriers for inward FDI are high as well (Figure 19).
- Austria's production structure (which focuses on medium-tech rather than high-tech sectors).



42. The mission pointed out that raising the effective retirement age would further raise potential output, by raising labor supply. This would be particularly important as the population ages, as raising the retirement age would limit the shrinkage of the working force.

STAFF APPRAISAL

43. Austria has come through the global economic and financial crisis relatively well, reflecting the absence of large pre-crisis domestic imbalances. Employment and output have recovered to well above 2008 levels, and unemployment has remained low by international standards. The main impact of the crisis has been on the banking sector and public debt.

44. With the recovery taking hold, this is a good time to resolve crisis legacies and address long-standing structural issues. The agenda includes: completing bank restructuring and strengthening macro-financial stability; expenditure reforms to bring down debt and taxes; and boosting potential growth by moving closer to the technology frontier and raising labor force participation.

45. Austria has a high tax burden, especially on labor, and an elevated public expenditure level. This partly reflects social choices, including a generous social safety net. But spending is also

higher than in countries with similar social models, such as Germany. In addition, debt dynamics are not as favorable as the low structural deficit suggests. The debt ratio will decline only from 75 percent in 2013 to around 70 percent in 2020. And in the next decade, aging costs will lead to upward pressures on the deficit that, without further reforms, will reverse debt dynamics.

46. More decisive expenditure and fiscal federalism reforms would help create room for both faster debt reduction and tax cuts. Expenditure cuts of about 1 percent of GDP by 2018 would lead to a structural surplus of ½ percent of GDP and bring down debt faster, thus creating buffers for absorbing aging cost, potential additional bank restructuring outlays, and other contingent liabilities. Additional expenditure cuts beyond this relatively modest amount would create scope to reduce the tax burden on labor, including from social security contributions.

47. Key expenditure reforms would include: (i) increased statutory retirement ages, including through faster unification of male and female statutory retirement; (ii) closing the gap with effective retirement; (iii) deeper cuts and ultimately better targeting of subsidies, including through the re-evaluation of expensive infrastructure projects; and (iv) more ambitious health care reforms. A closer link of expenditure and revenue responsibilities through the introduction of meaningful tax autonomy at the subnational level would further help prioritize expenditure. These reforms should be decided in conjunction with the next medium-term fiscal framework 2015–19.

48. The restructuring of fully or partly nationalized banks has made progress. The sale of the Hypo SEE subsidiaries should now be completed as rapidly as possible, while continuing to avoid disruptive effects in host countries. While bailing in of subordinated debt is in line with the European frameworks and will help reduce resolution costs and moral hazard, the retrospective effective voiding of the state of Carinthia's guarantee on €890 million of such debt—while designed and intended as an isolated case—would undermine the credibility of similar guarantees issued by other sub-national bodies. For the Volksbanken sector, speedy asset disposal in the apex institution (OeVAG) and rapid implementation of a streamlined association structure with a smaller number of institutions remain essential in light of a domestic banking market with structurally low profitability.

49. The transition toward a new funding model and the strengthening of capital positions have reduced vulnerabilities of internationally active banks, but risks remain. As in the past, further transition steps to the new funding model should not be implemented abruptly so as to avoid unduly restraining credit growth in still nascent recoveries. The capital positions of large internationally active banks have been strengthened, but further efforts are needed; and risks remain, including from exposures to Russia and Ukraine.

50. The national transposition of the European Banking Union framework should proceed swiftly. Important steps include the designation of a national resolution agency, pre-funding and streamlining the deposit guarantee schemes, and further progress on the macroprudential front.

51. Boosting potential output by raising labor productivity and increasing labor force participation would improve longer-term economic prospects and help mitigate the impact of aging. Enhancing IT adaptation, expanding access to financing for start-ups and reducing

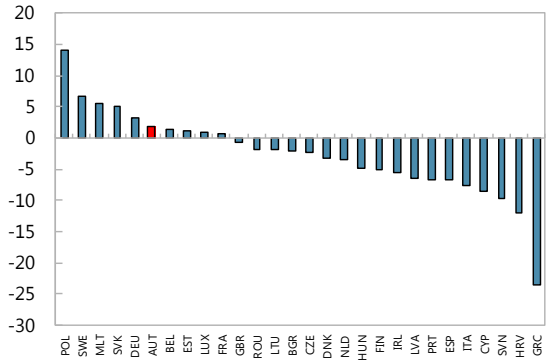
administrative barriers for new businesses would all help expand the economy's production frontier. Increasing the labor force by reducing the tax burden on labor and raising the effective retirement age would further boost economic potential.

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

Figure 1. Austria: The Big Picture

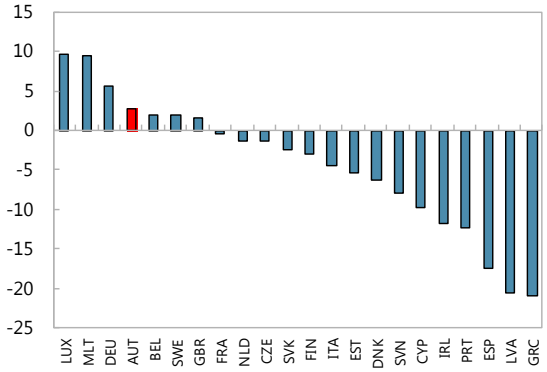
Austria's GDP has held up better than many other countries...

Cumulative Real GDP Growth, 2008-13
(Percent)



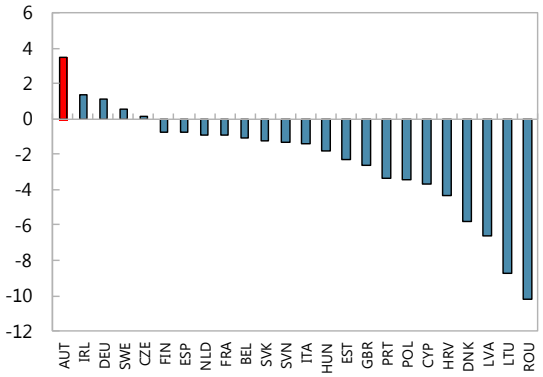
...and so has employment...

Change in Employment, 2008-13
(Percent)



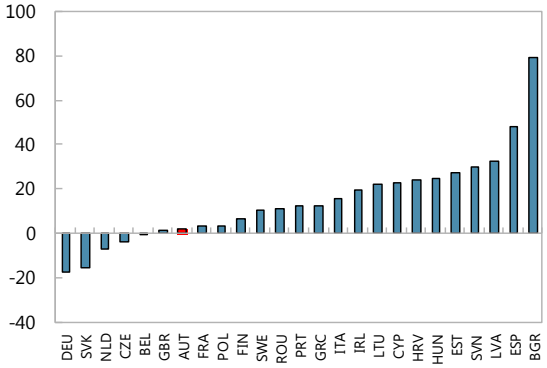
...reflecting the absence of large pre-crisis imbalances within households...

Change in Household Gross Saving Rate 1/, 2002-07
(Percentage points)



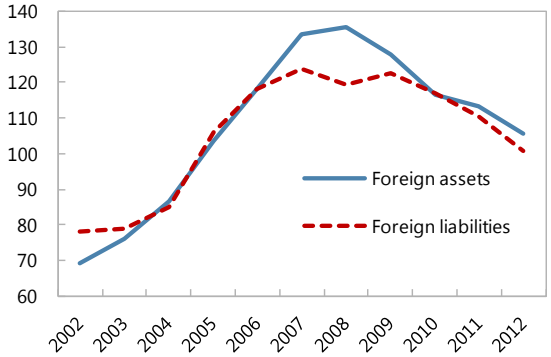
...and in the corporate sector.

Change in Corporate Debt to GDP Ratio, 2002-07
(Percentage points)



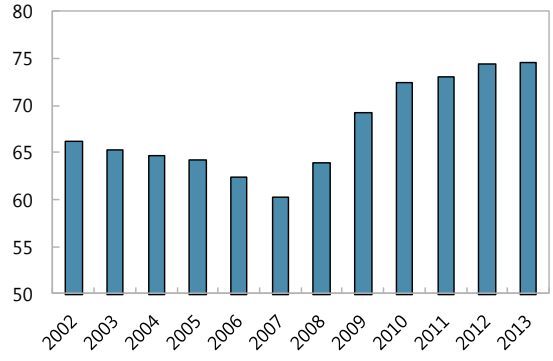
The main impact of the crisis has been felt in the intemationally active banking system...

MFIs Foreign Assets and Liabilities
(Percent of GDP)



...and in public finances.

Public Debt
(Percent of GDP)



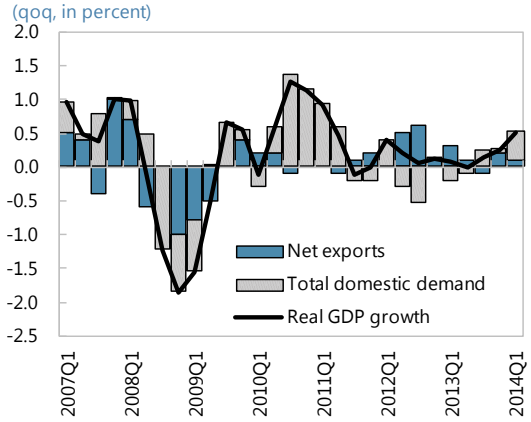
Sources: Eurostat, Haver Analytics, WEO and IMF staff estimates.
1/ Data include Households and NPISH. Household gross saving rate is calculated as a percent of gross disposable income.

Figure 2. Austria: Recent Economic Developments

Growth is picking up...

Real GDP Growth and Growth Contributions

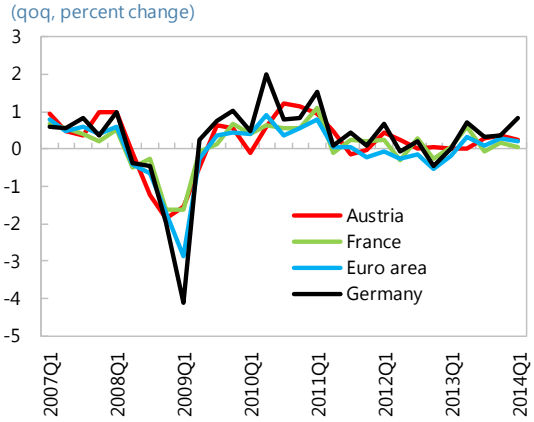
(qoq, in percent)



... in line with peers.

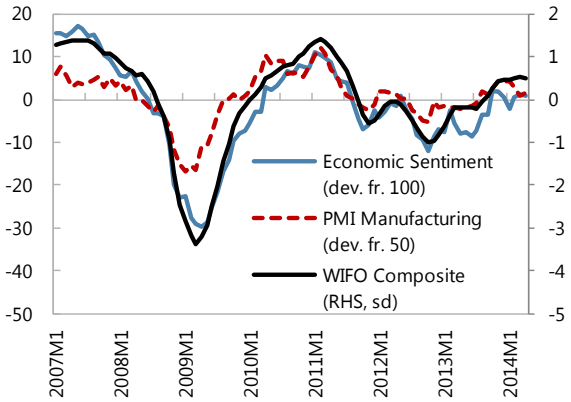
Real GDP Growth

(qoq, percent change)



There are signs for further growth acceleration.

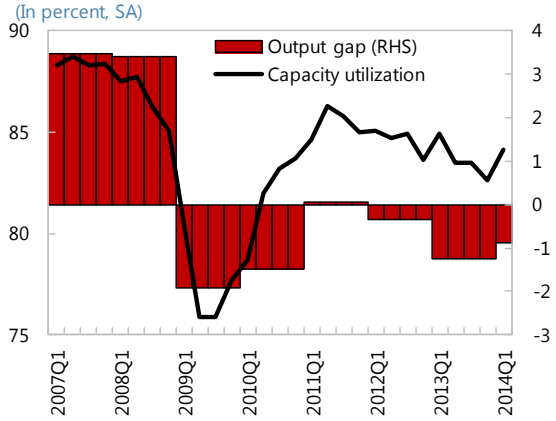
Leading Indicators



The output gap is small.

Capacity Utilization

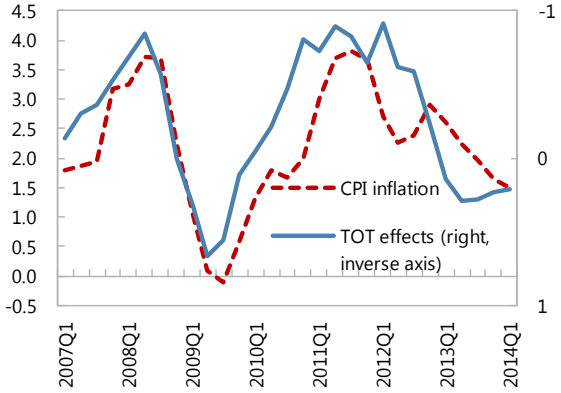
(In percent, SA)



Inflation has declined because of terms of trade improvements...

Terms of trade effects and CPI inflation

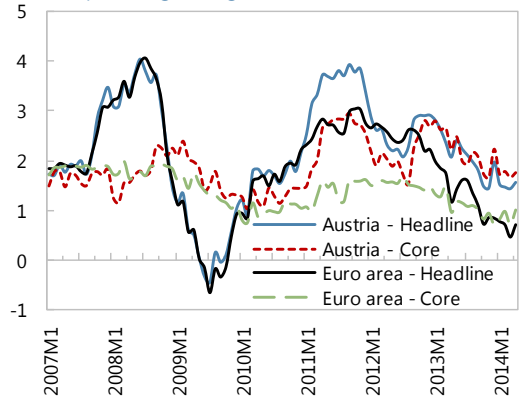
(Percent)



... and in line with euro area downward trends.

Harmonized CPI

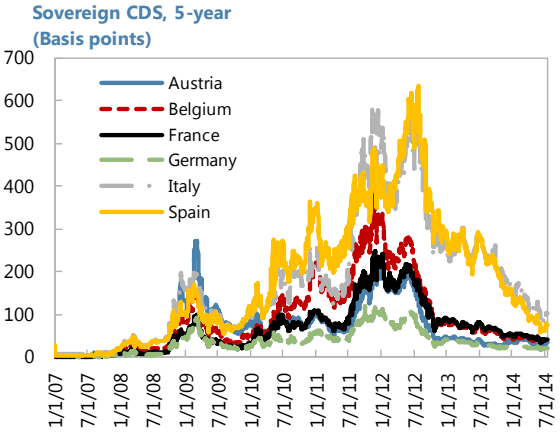
(Annual percentage change)



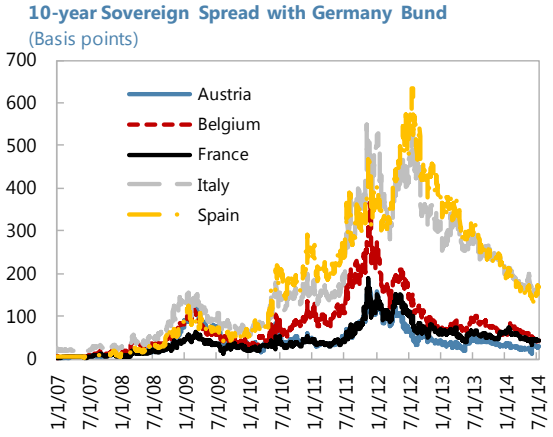
Sources: Austrian authorities; WIFO; Eurostat; Haver Analytics; WEO; and IMF staff calculations.

Figure 3. Austria: Financial Market Indicators

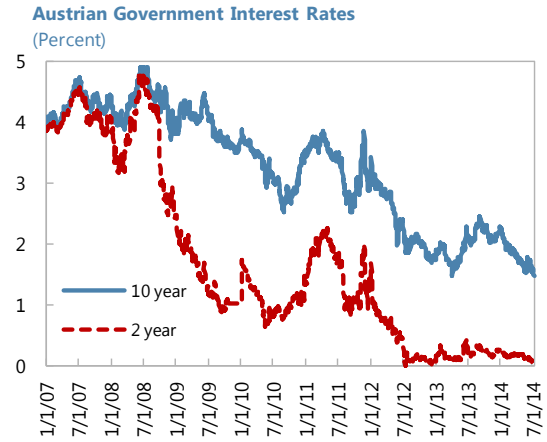
The market perception of sovereign creditworthiness has improved since late 2012...



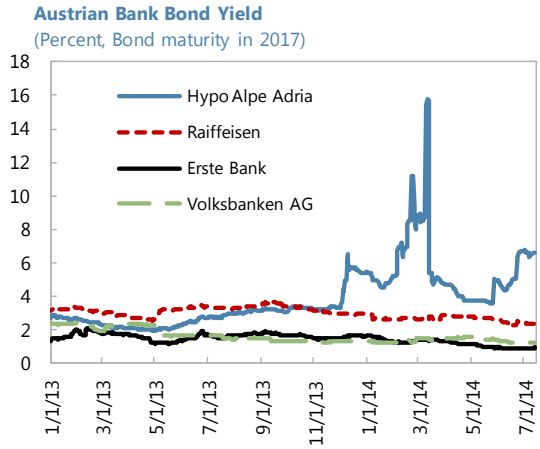
...but spreads with Germany are not yet at pre-crisis levels...



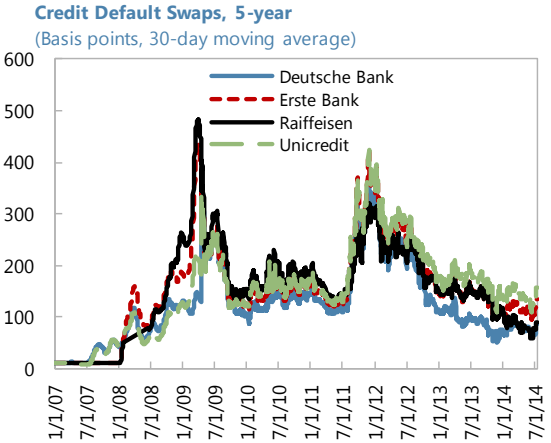
...while interest rates are at historic lows.



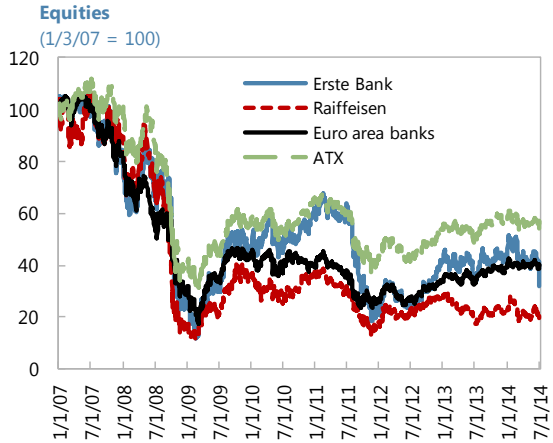
Bank bond yields are stable except for Hypo Alpe Adria.



Perceptions of bank default risk have declined...



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

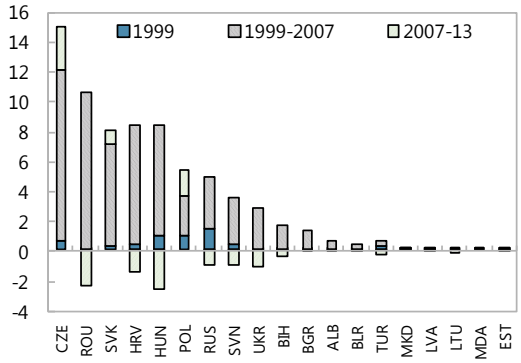


Sources: Bloomberg and Thomson Financial/DataStream.

Figure 4. Austria: External Linkages

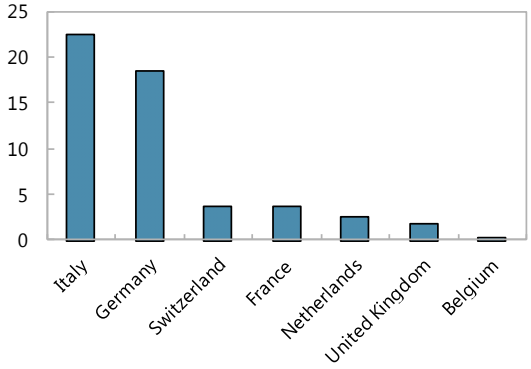
Austria's banking sector has significant exposure to CESEE.

Foreign Claims of Austrian Banks on CESEE 1/
(Percent of Austria GDP)



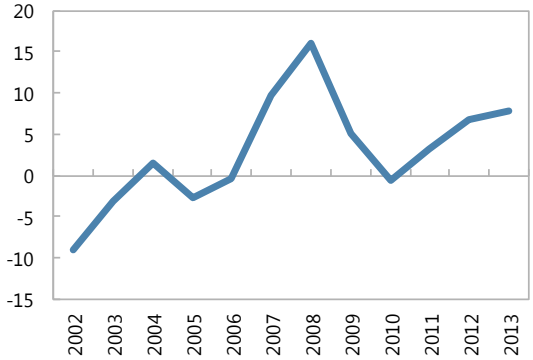
Italian and German banks provide the major source of funding to Austria.

Claims of Foreign Banks on Austria 1/, 2013
(Percent of Austria GDP)



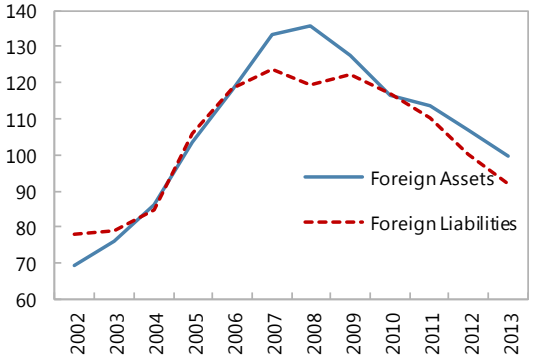
The intermediation role of banks is illustrated by their low net IIP...

MFIs Net IIP
(Percent of GDP)



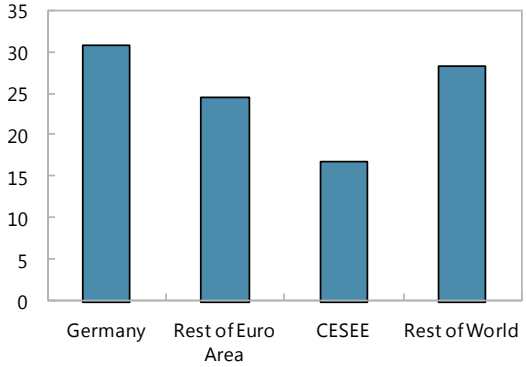
...and high assets and liabilities.

MFIs Foreign Assets and Liabilities
(Percent of GDP)



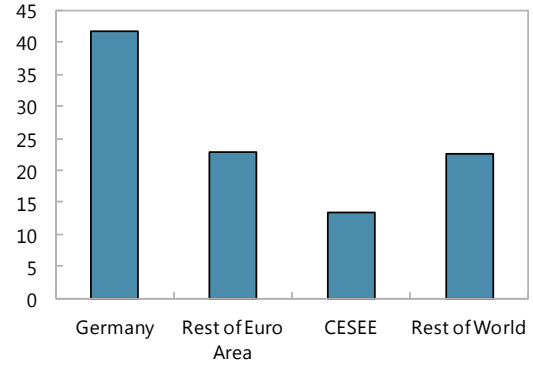
The largest share of Austria's exports is to Germany...

Composition of Exports, 2013
(Percent of Total)



...which is also the source of most imports.

Composition of Imports, 2013
(Percent of Total)

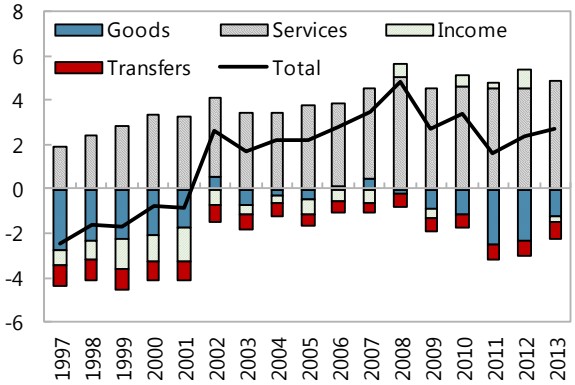


Sources: Bank for International Settlements, Haver Analytics, IMF Direction of Trade Statistics.
1/ Data are consolidated on an immediate borrower basis. Missing observations are interpolated. BIS data include outstanding loans and holdings of securities. Note that the exposure of Unicredit Bank Austria is included in foreign claims of Italian banks rather than Austrian banks. The Russian exposure of Raiffeisen Bank International is not reported to the BIS as it is considered confidential information due to its large share in the total foreign exposure.

Figure 5. Austria: External Sector

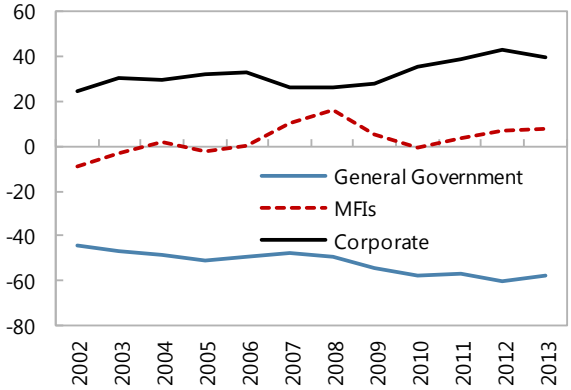
Austria has a moderate current account surplus which reflects tourism.

Current Account Balance
(Percent of GDP)



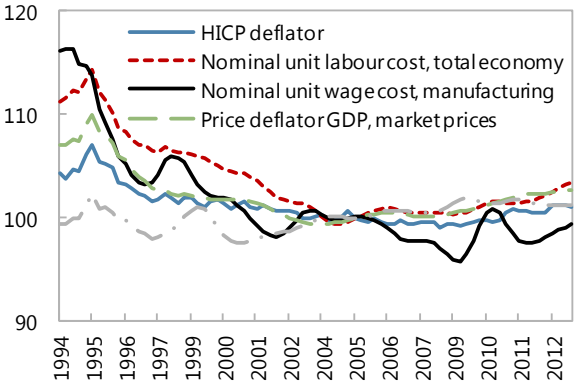
Its net international position is near zero.

Net International Investment Position by Sector 1/
(Percent of GDP)



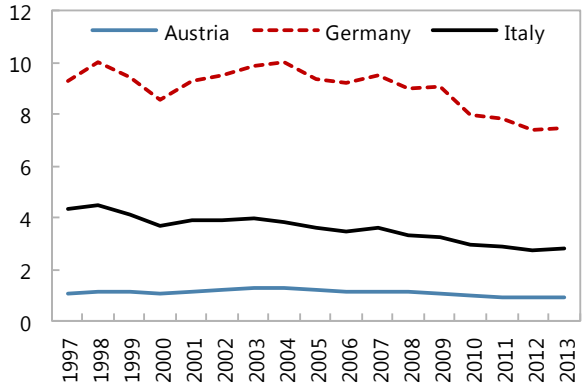
The REER has been broadly stable over the past decade…

Austria: Real Effective Exchange Rates
(Euro area indices)



…and so has its share of world exports.

Share of World Exports
(Percent)

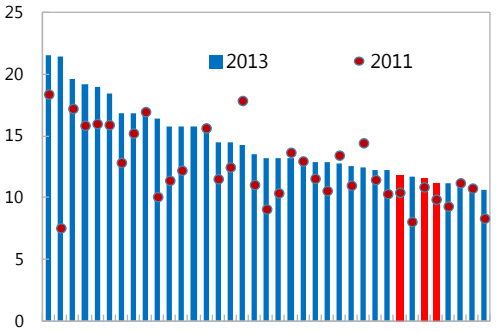


Sources: Direction of Trade Statistics, EU Cost Price Indicators for Euro area, Haver Analytics, OeNB.
1/ Sectors include portfolio (debt and equity), loans and currency/deposits. Corporate sector also includes direct investment, SPEs and trade credit.

Figure 6. Austria: Banking Sector

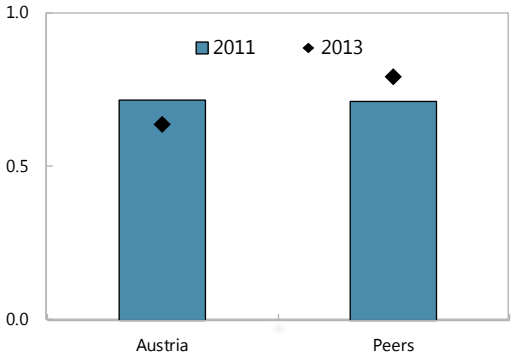
Bank capitalization is improving...

Selected Large European Banks: Tier I Ratio 2011-2013 1/ (Percent)



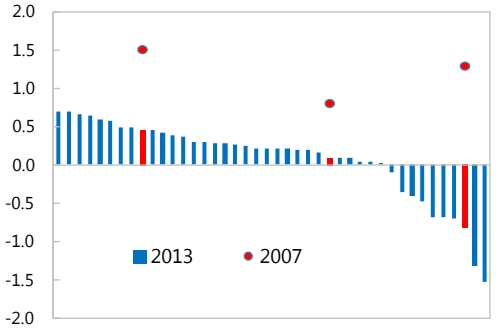
... but market valuations are still lagging behind.

Price to book ratio of Austrian Banks



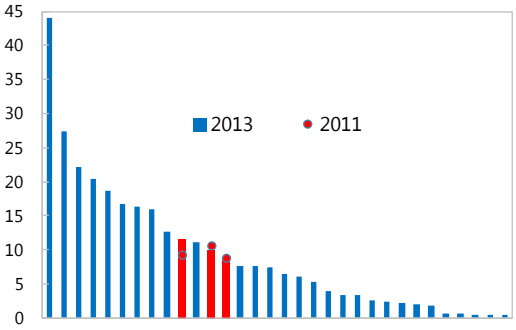
Return on assets remains low...

Selected Large European Banks: Return on Assets 2007-2013 2/ (Percent)



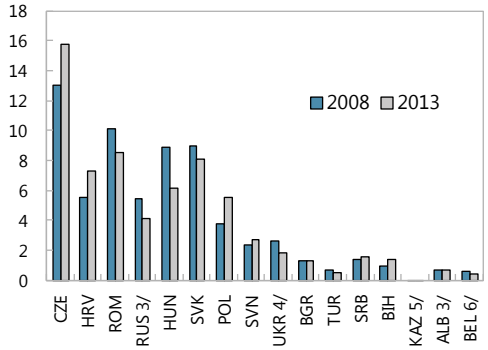
...with NPLs remaining high...

Selected Large European Banks: Nonperforming loans ratio, 2011-13 1/ (Percent)



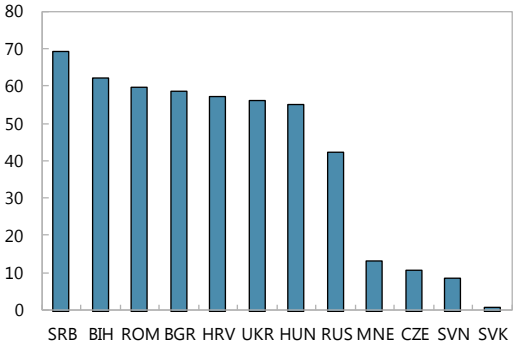
...against high CESEE exposure...

CESEE Exposures
(Percent of 2013 GDP)



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

Sharp Foreign Currency Loans in Austrian Banks' CESEE Exposure

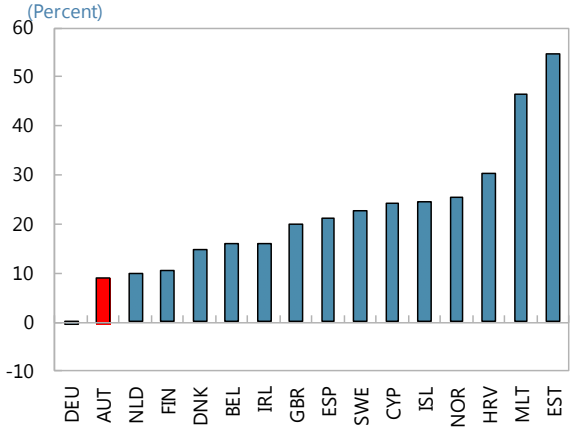


Sources: OeNB; Bloomberg; SNL Financial; BIS consolidated banking statistics; and IMF staff calculations.
1/ Austrian banks are shown in red and non-Austrian banks are shown in blue. The set of "large European banks" includes 2 Belgian banks, 1 Danish bank, 4 French banks, 3 German banks, 2 Irish banks, 5 Italian banks, 1 Dutch bank, 1 Norwegian bank, 5 Spanish banks, 4 Swedish banks, 1 Swiss bank, and 6 British banks.
2/ Series includes foreign-owned banks and is adjusted for currency movements and provisions.
3/ 2012Q3.
4/ 2013Q1.
5/ 2013Q2.
6/ 2012Q4.

Figure 7. Austria: Housing Prices

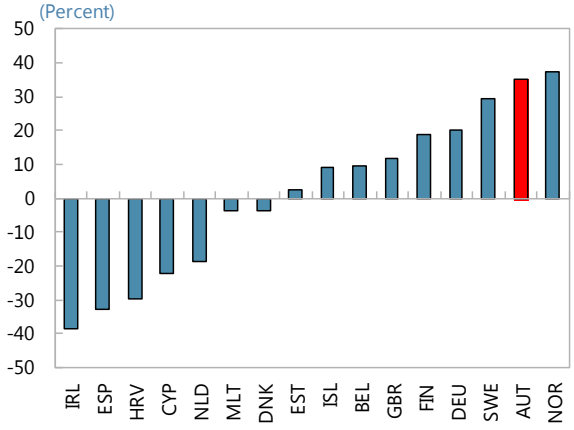
Austria's housing prices, which had remained subdued during the boom years...

Change in House Price Index, 2005-07
(Percent)



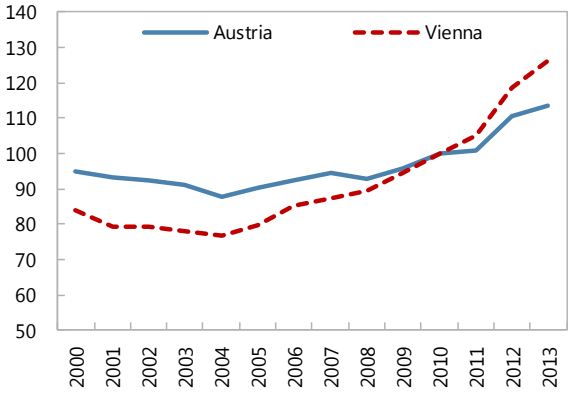
...have increased rapidly since then.

Change in House Price Index, 2008-13
(Percent)



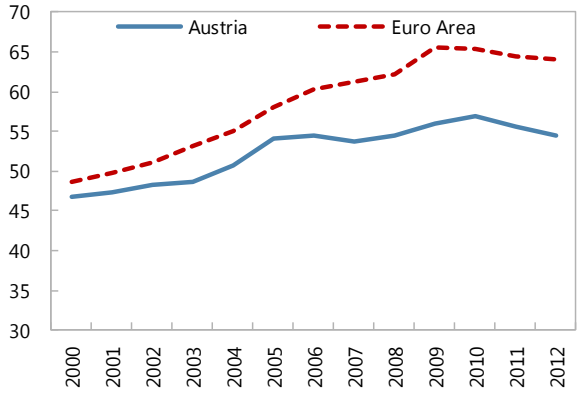
Housing prices have increased more rapidly in Vienna than the country average.

Real House Prices
(2010 = 100)



However, household debt has not increased much.

Household Loans 1/
(Percent of GDP)

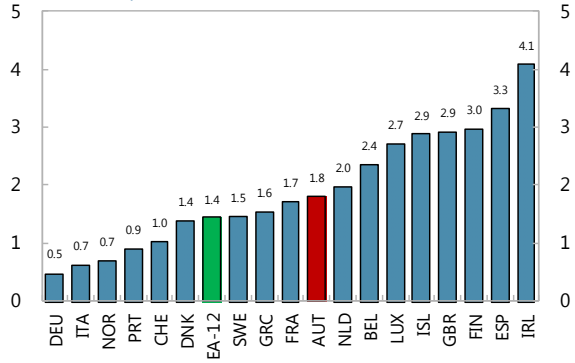


Sources: Eurostat, Haver Analytics, Statistics Austria.
1/ Includes total of short-term and long-term loans.

Figure 8. Austria: Long-Term Government Expenditure Growth

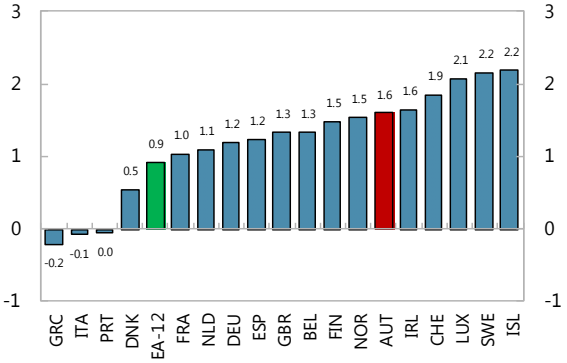
In the last ten years, Austria's government expenditure growth has grown about 2 percent annually...

Average annual real government expenditure growth
(2002-12, in percent)



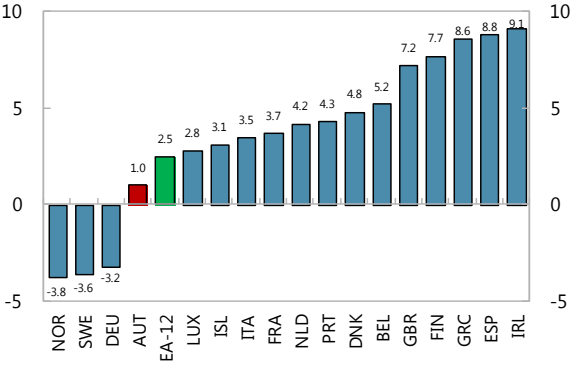
... slightly faster than GDP growth.

Average annual real GDP growth
(2002-12, in percent)



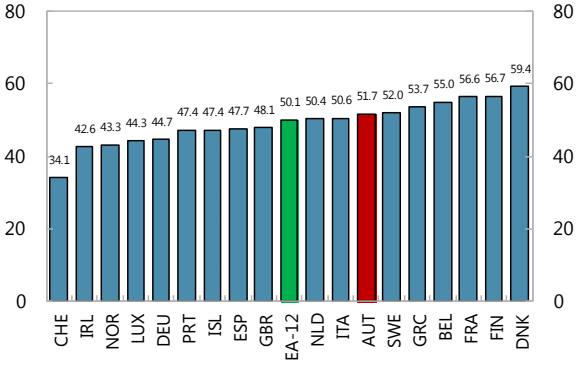
The share of expenditure in GDP has increased less than in other countries.

Change in total government expenditure over GDP
(2002-12, in percentage points)



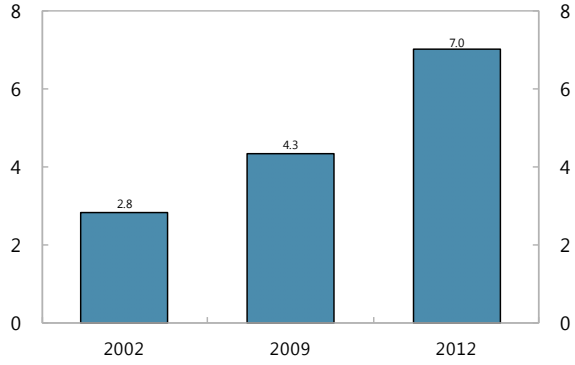
But the level is high.

Total government expenditure
(2012, in percent of GDP)



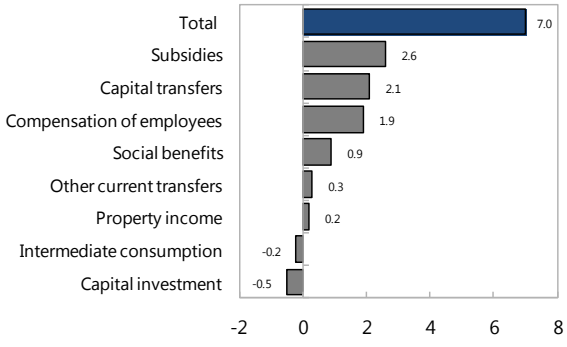
The gap in expenditure to GDP between Austria and Germany widened further.

Government expenditure: Austria minus Germany
(in percentage points of GDP)



Subsidies and capital transfers in particular stand out.

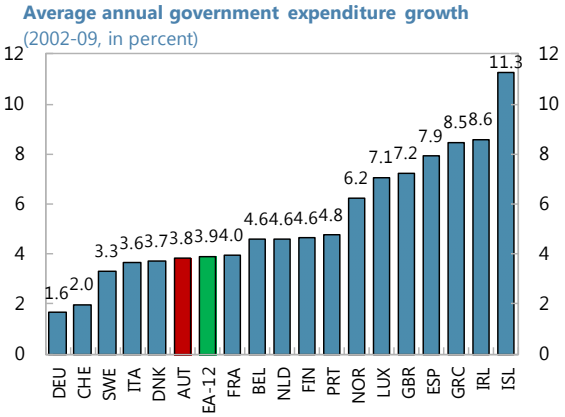
Government expenditure: Austria minus Germany
(2012, in percentage points of GDP)



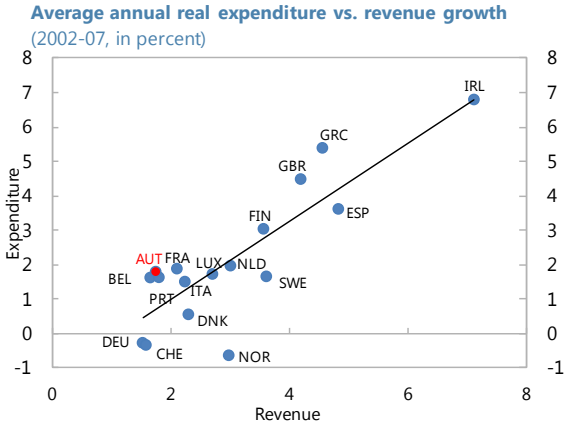
Sources: Eurostat and IMF staff estimates.

Figure 9. Austria: Volatility of Government Spending

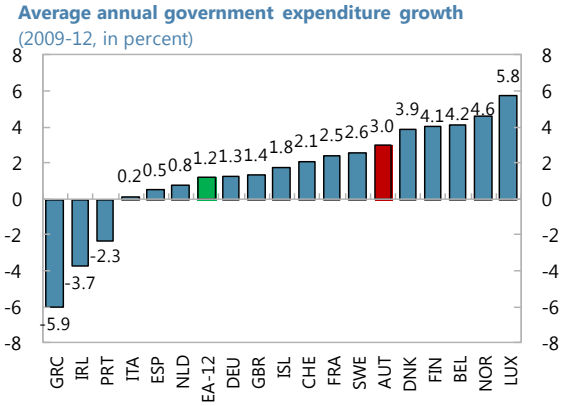
Austria didn't have a public expenditure surge during the pre-crisis years...



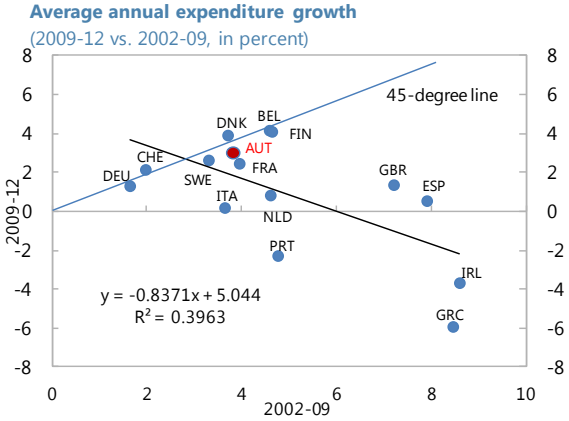
... as Austria didn't have a revenue/spending boom during that period.



As a result, Austria didn't have to retrench expenditure post 2009.



Procyclicality of expenditure has been much less than in other countries.

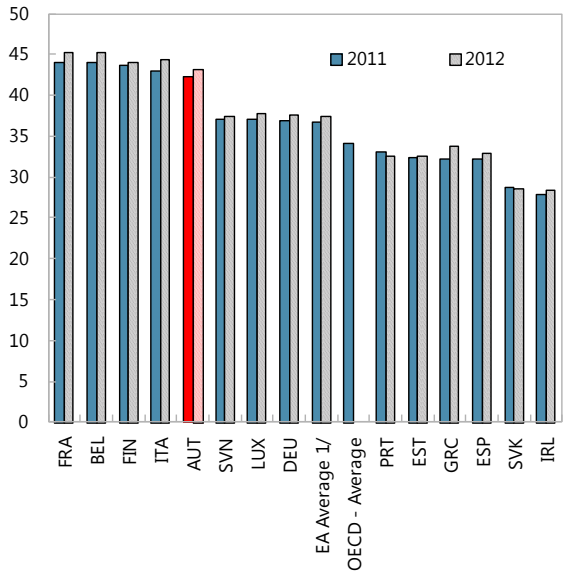


Sources: Eurostat and IMF staff estimates.

Figure 10. Austria: Tax Burden on Labor

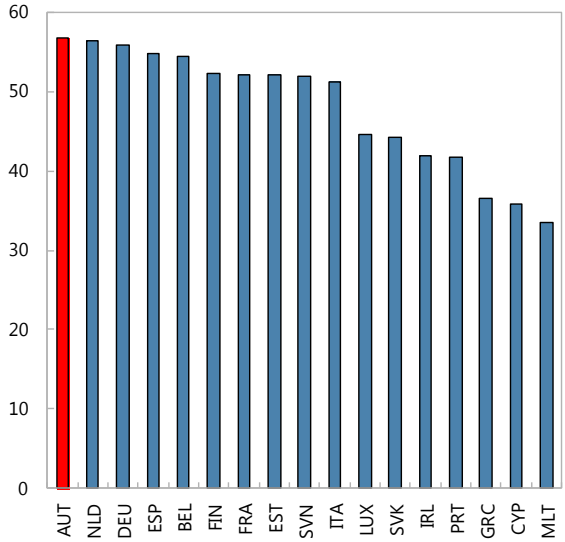
Total tax revenues are high...

Total Tax Revenue
(Percent of GDP)



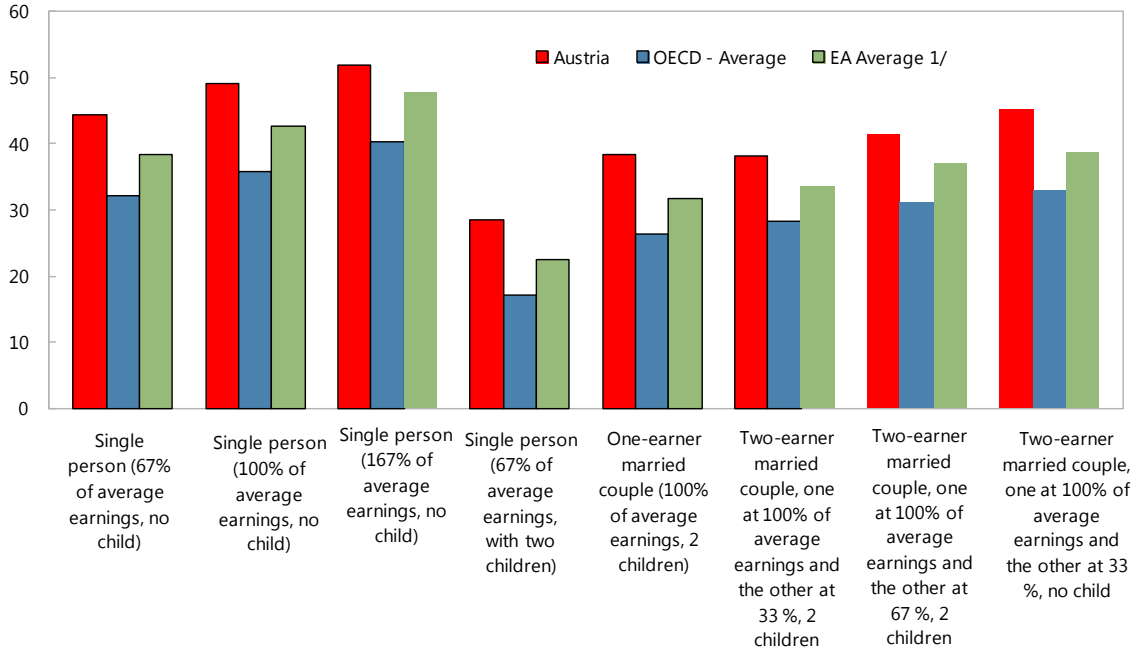
...and so is the share of labor taxes...

Share of Taxes on Labor in Total Taxation, 2011
(Percent)



...leading to high tax wedges across family compositions.

Average Tax Wedge across Family Types, 2013
(Percent)



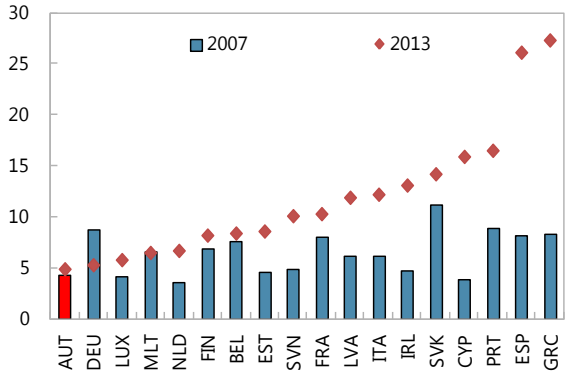
Sources: OECD; and Commission Services.
1/ Euro area average includes OECD members only.

Figure 11. Austria: Labor Market Conditions

Austria's overall unemployment rate is amongst the lowest in the Euro area...

Harmonized Unemployment Rates in Euro Area 1/

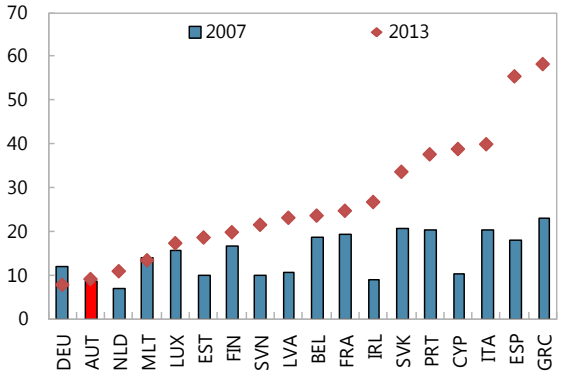
(Percent)



...and so is the youth unemployment rate.

Harmonized Youth Unemployment Rate in Euro Area 2/

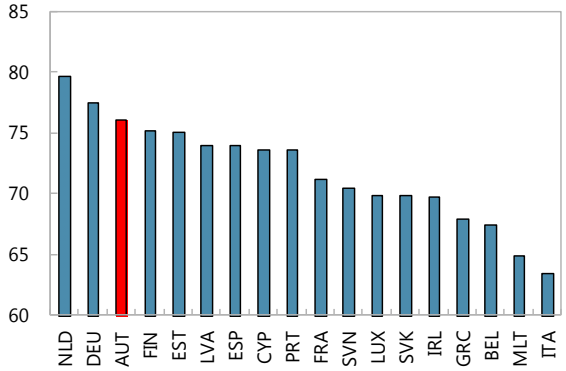
(Percent)



Austria's labor force participation rate also compares favorably within the Euro area...

Labor Force Participation, 2013

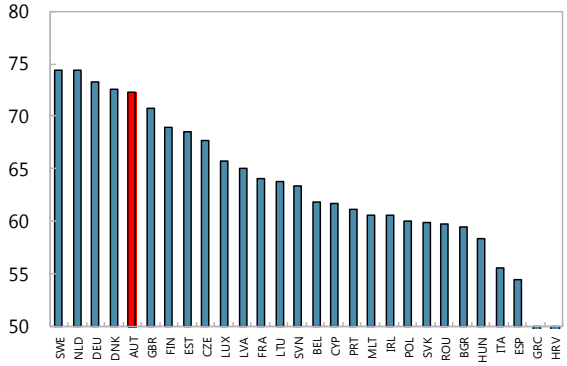
(Percent)



...and so do employment rates.

Employment Rates, 2013

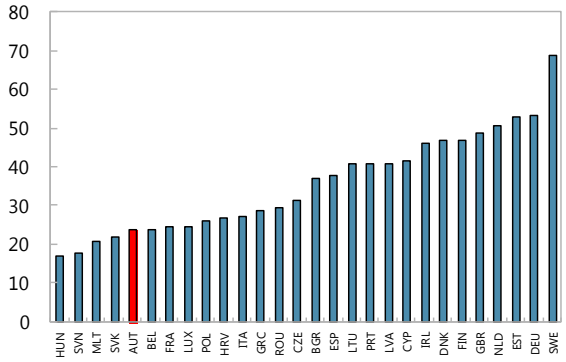
(Percent)



However, labor force participation amongst the elderly is relatively low due to early retirement...

Labor Force Participation of Ages 60-64, 2013

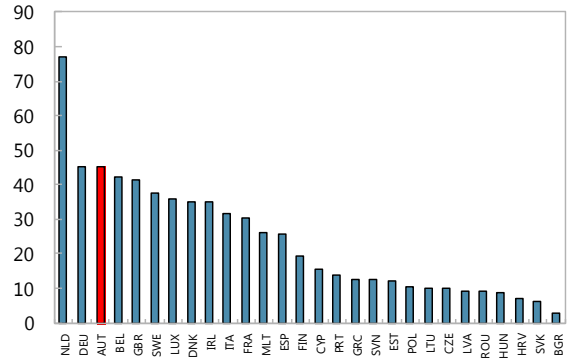
(Percent)



...and the share of women working part time is amongst the highest in the European Union.

Female Part-time Employment, 2013

(Percent of Total Employment)



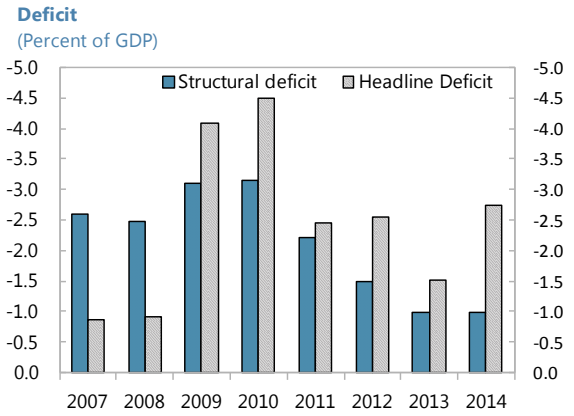
Source: Eurostat.

1/ Data cover ages 15-64.

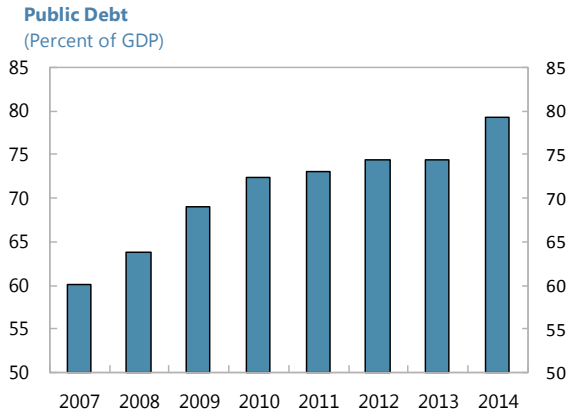
2/ Data cover individuals under 25 years of age.

Figure 12. Austria: Fiscal Developments and Outlook

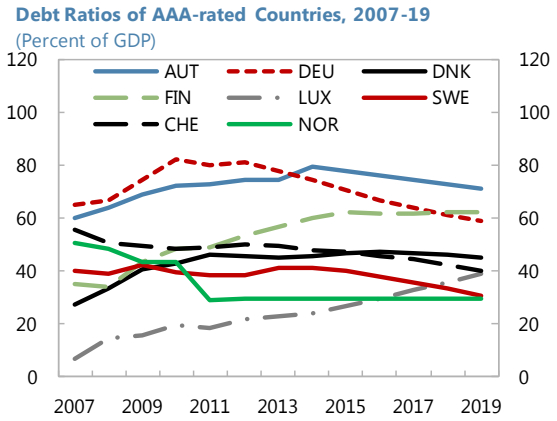
The structural deficit has narrowed...



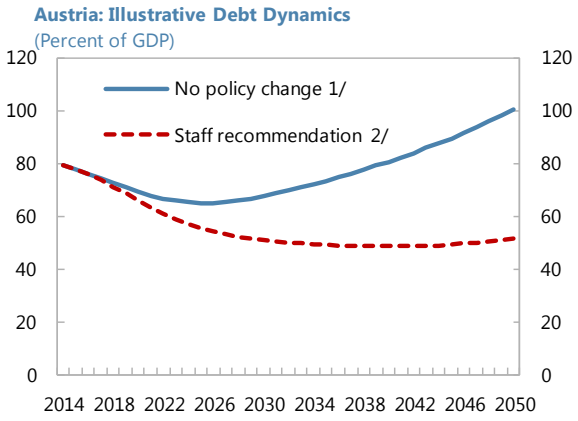
...but debt has increased substantially.



Current fiscal plans leave Austria's debt above AAA peers...



...and more is needed to cope with aging cost.



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

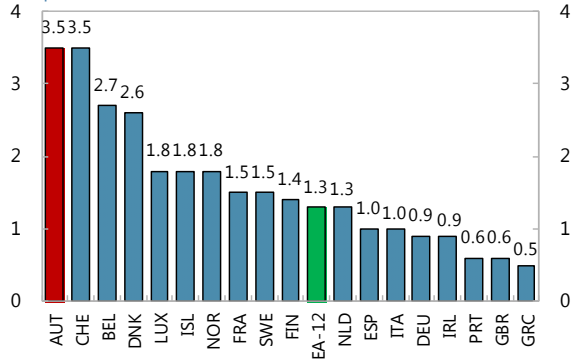
1/ The trajectory "no policy change" illustrates debt dynamics under the assumption that the 1/2 percent of GDP structural deficit target can be maintained from 2016 until 2020 because past reforms show success, aging costs are absorbed through expenditure cuts in other areas, or tax and social security contributions are increased. From 2021 onwards, it is assumed that this is no longer possible and aging cost increases fully impact the deficit.

2/The trajectory "staff recommendation" illustrates debt dynamics under assumption that a structural surplus of 1/2 percent of GDP will be reached by 2018 and maintained until 2022 (when debt has fallen to 60 percent of GDP). From 2023 onwards, it is assumed that this is no longer possible and aging cost increases fully impact the deficit.

Figure 13. Austria: Composition of Government Spending, 2012

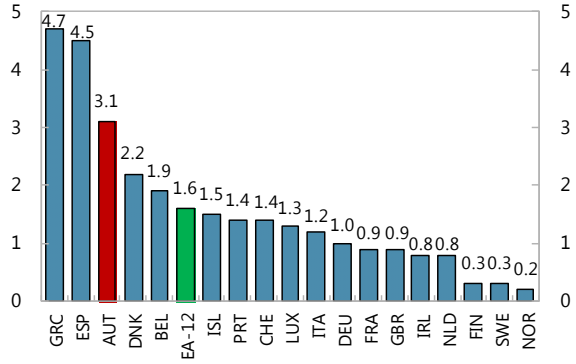
Compared with its peers in the region, Austria's expenditures on subsidies...

Subsidies
(in percent of GDP)



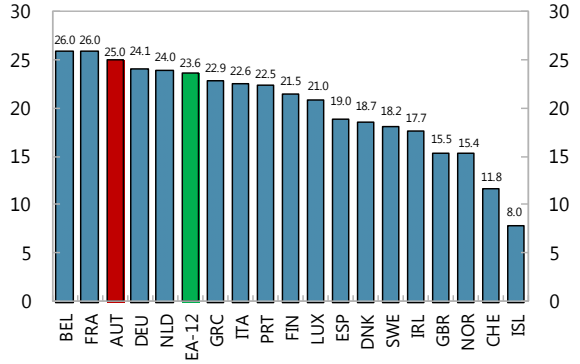
... capital transfers, and...

Capital transfers
(in percent of GDP)



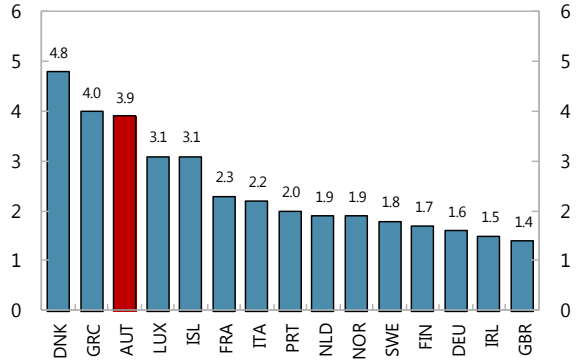
... social benefits and transfers in kind are among the highest.

Social benefits and transfers in kind
(in percent of GDP)



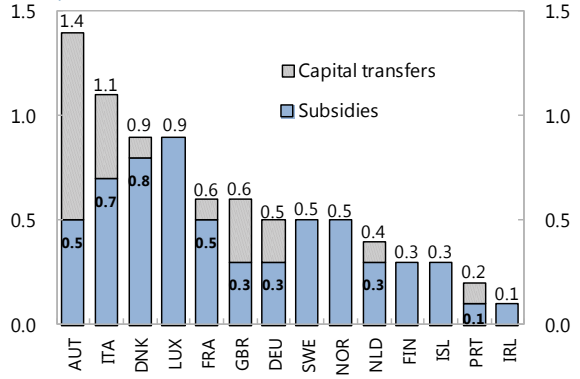
Even abstracting from support to banks and hospitals, Austria's subsidies and capital transfers stand out...

Subsidies in broad sense 1/
(in percent of GDP)



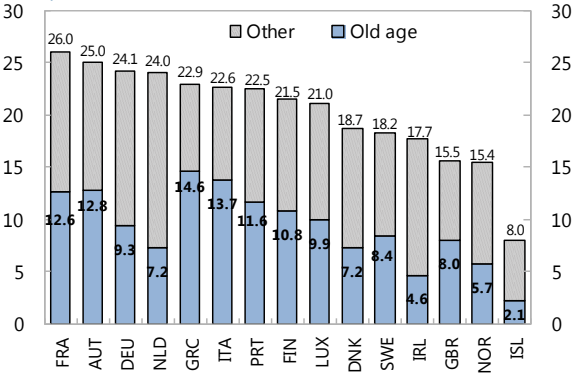
... in particular in the transport sector.

Subsidies and capital transfers in transport sector
(in percent of GDP)



In social benefits, spending for old age is notably high.

Social benefits for old age and other
(in percent of GDP)



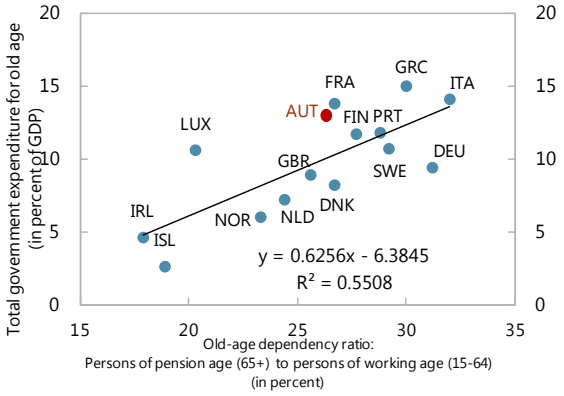
Sources: Eurostat and IMF staff estimates.

1/ Sum of subsidies and capital transfers, excl. subsidies on health and capital transfers in general economic, commercial, and labor affairs and economic affairs n.e.c.

Figure 14. Austria: Comparison of Pension Parameters

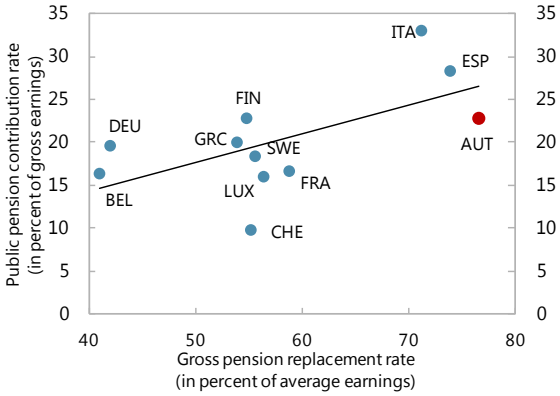
Austria's public pension expenditures are high, despite its relatively favorable old-age dependency ratio.

Old-age Dependency and Expenditure Ratio



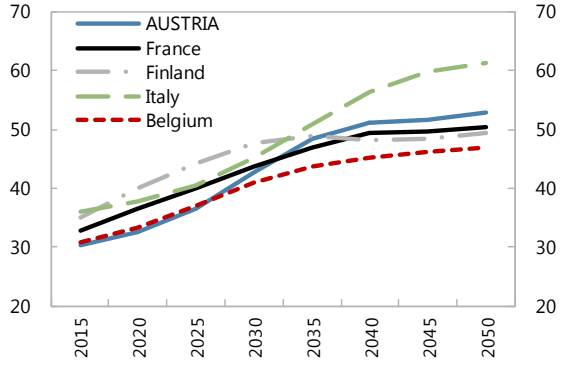
This reflects generosity of the pension system, which requires high contributions.

Public pension contribution vs. gross pension replacement rate, 2012



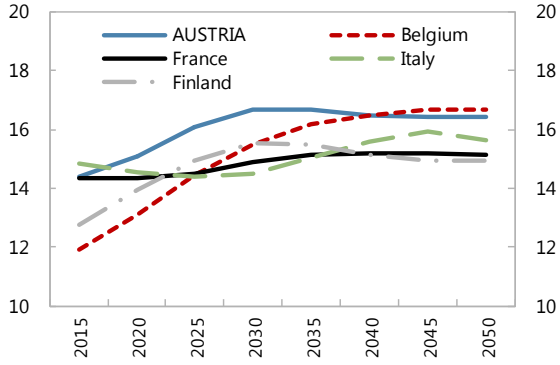
However, there are strong demographic pressures on the pention system...

Old-age dependency ratio: Persons of pension age (65+) to persons of working age (20-64) (in percent of GDP)

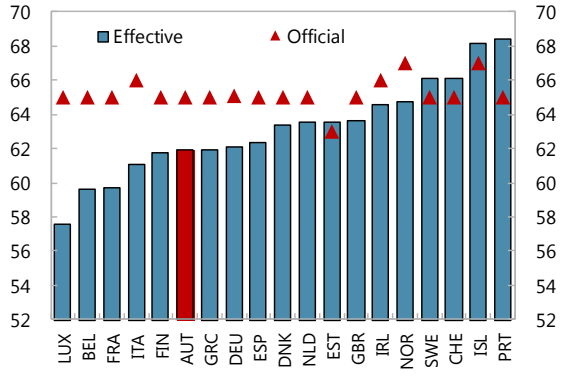


...and public pension spending is projected to rise.

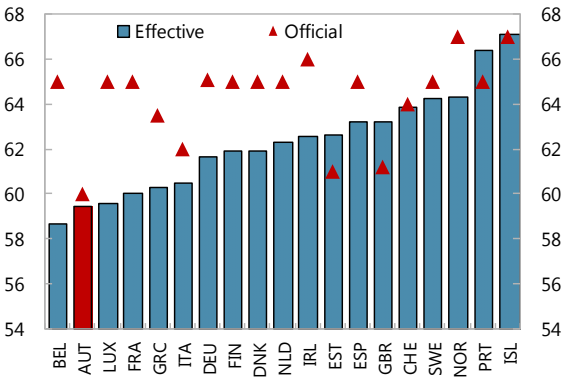
Public pension spending
(in percent of GDP)



An increase of effective retirement age among men...

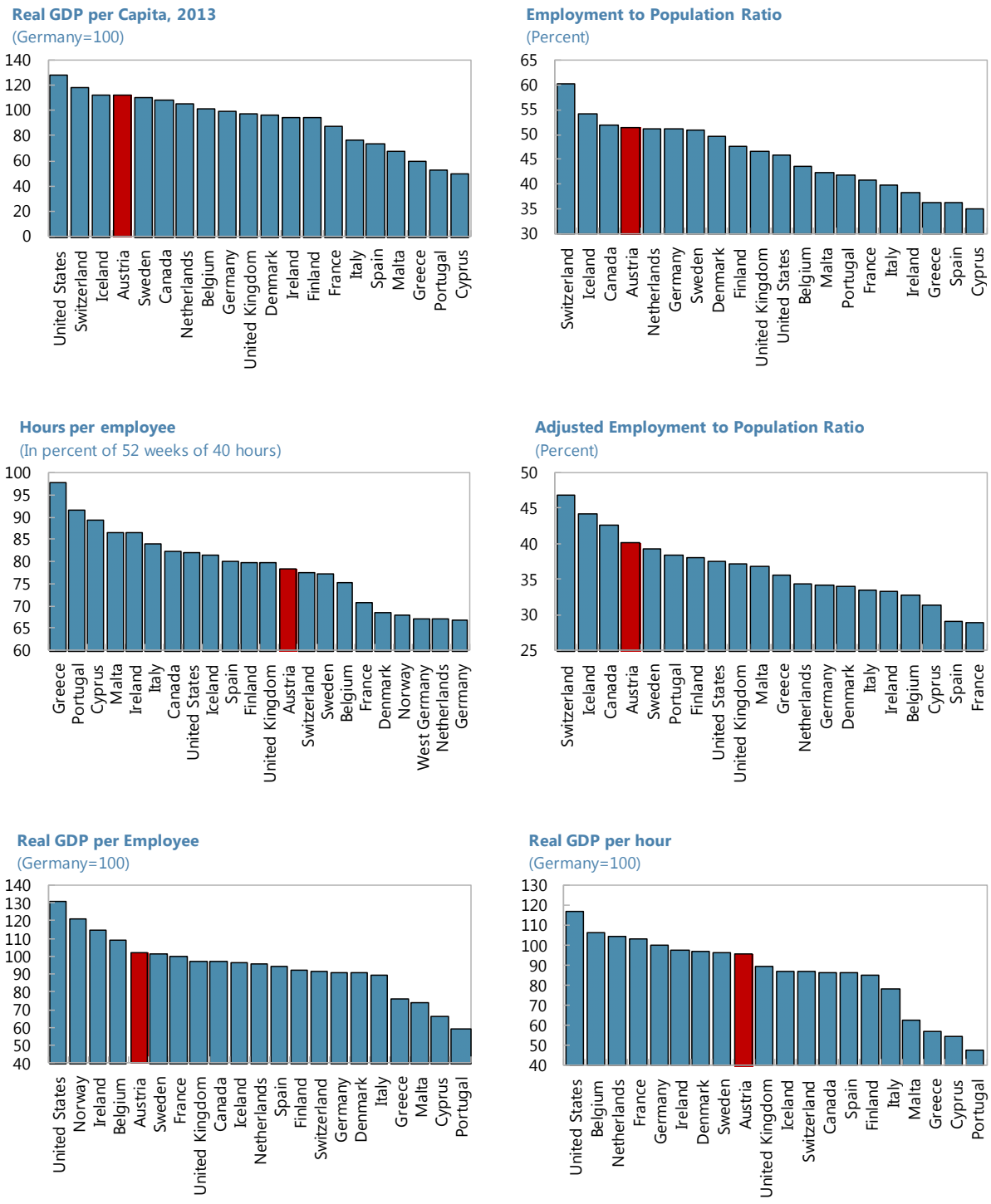


... and a faster increase of statutory retirement age among women would help limit the increase in pension costs.



Sources: European Commission *2012 Ageing Report,* Eurostat, OECD, and IMF staff estimates.

Figure 15. Austria: Real GDP per Capita Comparisons

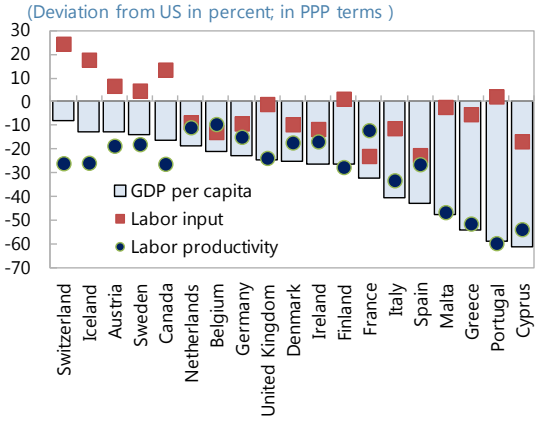


Sources: Conference Board, Total Economy Database.

Figure 16. Austria: Productivity

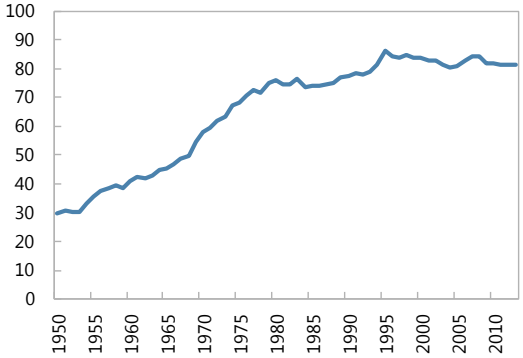
Labor productivity is much lower in Austria than in the US...

Real GDP per Capita and Contributors, 2013
(Deviation from US in percent; in PPP terms)



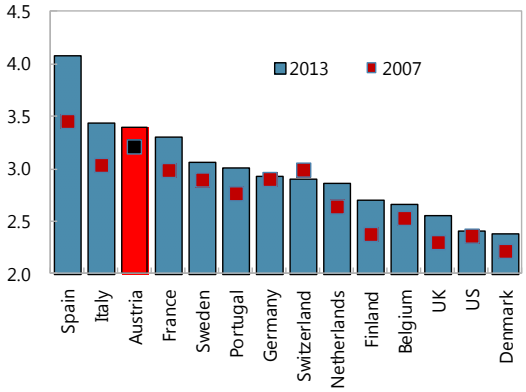
...and has continued to fall behind over time...

Ratio of Labor Productivity in Austria to US



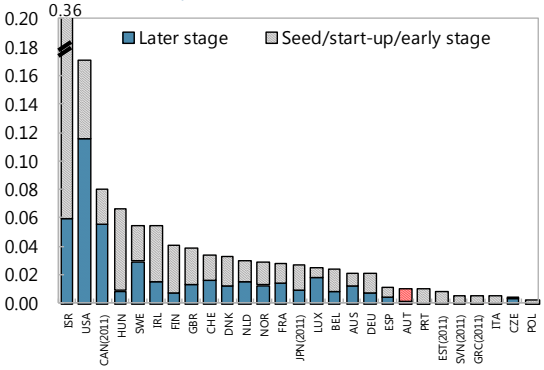
...despite higher capital intensity of production.

Capital-Output Ratio
(Ratio of net capital stock to GDP)



Low venture capital investment may contribute to low levels of productivity.

Venture capital investments as a percentage of GDP
(US dollars current prices)



Sources: Ameco Database, Conference Board, EU, OECD, Total Economy Database.

Average Annual Labor Productivity Growth, 2000 - 2010

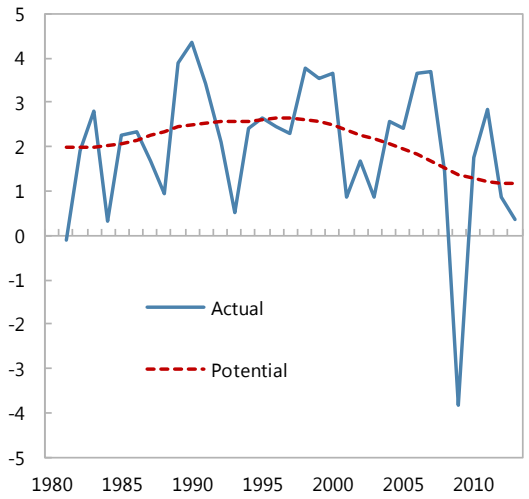
	US	Austria	Netherlands	Germany	UK	France	Spain	Belgium	Italy
Total industries	1.9	1.6	1.4	1.3	1.1	1.0	1.0	0.7	0.1
Agriculture, forestry and fishing	4.1	1.9	3.3	6.4	0.4	2.8	2.1	0.2	0.9
Mining and quarrying	-2.4	6.1	3.5	2.1	-3.1	-2.9	1.6	5.8	-1.3
Total manufacturing	5.7	2.3	2.6	2.4	3.2	2.6	2.7	1.9	0.5
Electricity, gas and water supply	-0.2	1.0	2.1	1.4	-0.3	-0.1	0.2	0.6	0.6
Construction	-1.7	-0.2	-0.9	-0.4	-0.6	-1.7	3.1	1.9	-1.6
Wholesale and retail trade	2.5	1.5	2.4	3.2	2.1	0.6	2.2	1.7	-0.2
Transportation and storage	2.2	0.5	1.6	2.0	-0.8	1.0	-1.2	1.0	-0.1
Accommodation and food service activities	0.8	0.9	-1.9	0.1	1.0	-0.9	-2.3	-0.8	-1.4
Information and communication	7.1	2.5	5.1	2.9	3.2	3.3	1.4	1.7	2.1
Financial and insurance activities	3.3	4.4	4.3	0.0	3.9	1.1	6.4	3.6	2.0
Real estate activities	1.8	0.3	-0.1	1.9	-2.4	1.1	-3.3	-0.9	-1.4
Professional, scientific, technical, administrative and support service activities	1.5	1.7	-0.2	-2.0	0.8	0.1	-3.2	-0.1	-1.7
Community social and personal services	0.1	0.3	0.1	0.4	0.5	0.6	0.5	-0.3	0.4

Source: EU KLEMS database. UK data from 2000-09.

Figure 17. Austria: Cyclical Indicators

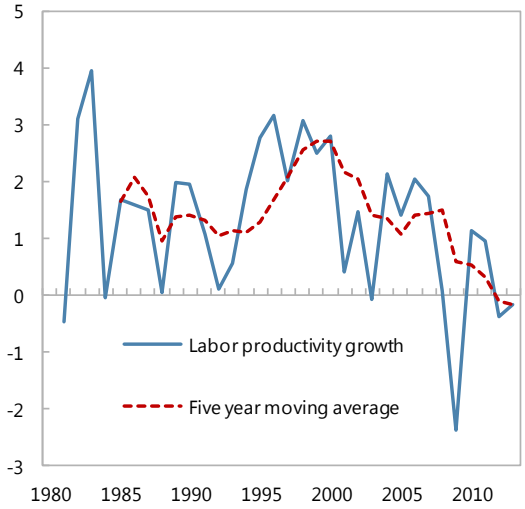
Potential output growth has fallen...

Actual and Potential GDP growth
(Percent)



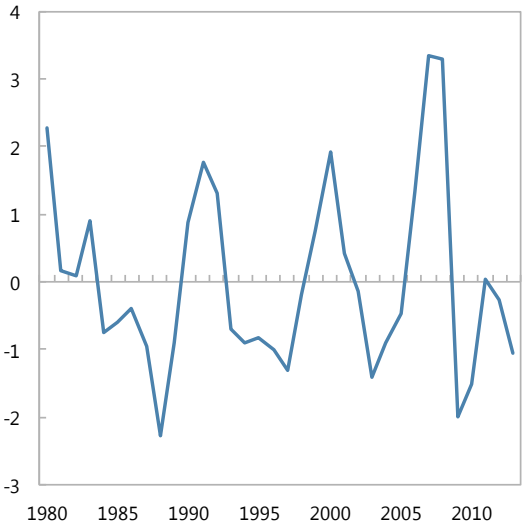
... and so has labor productivity growth.

Labor Productivity Growth
(Percent)



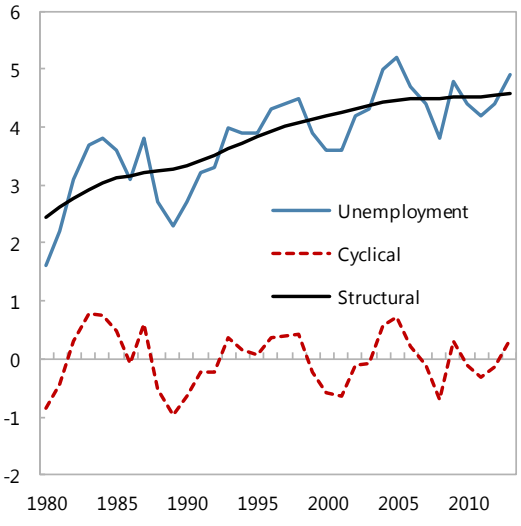
The output gap is small...

Output gap
(Percent)



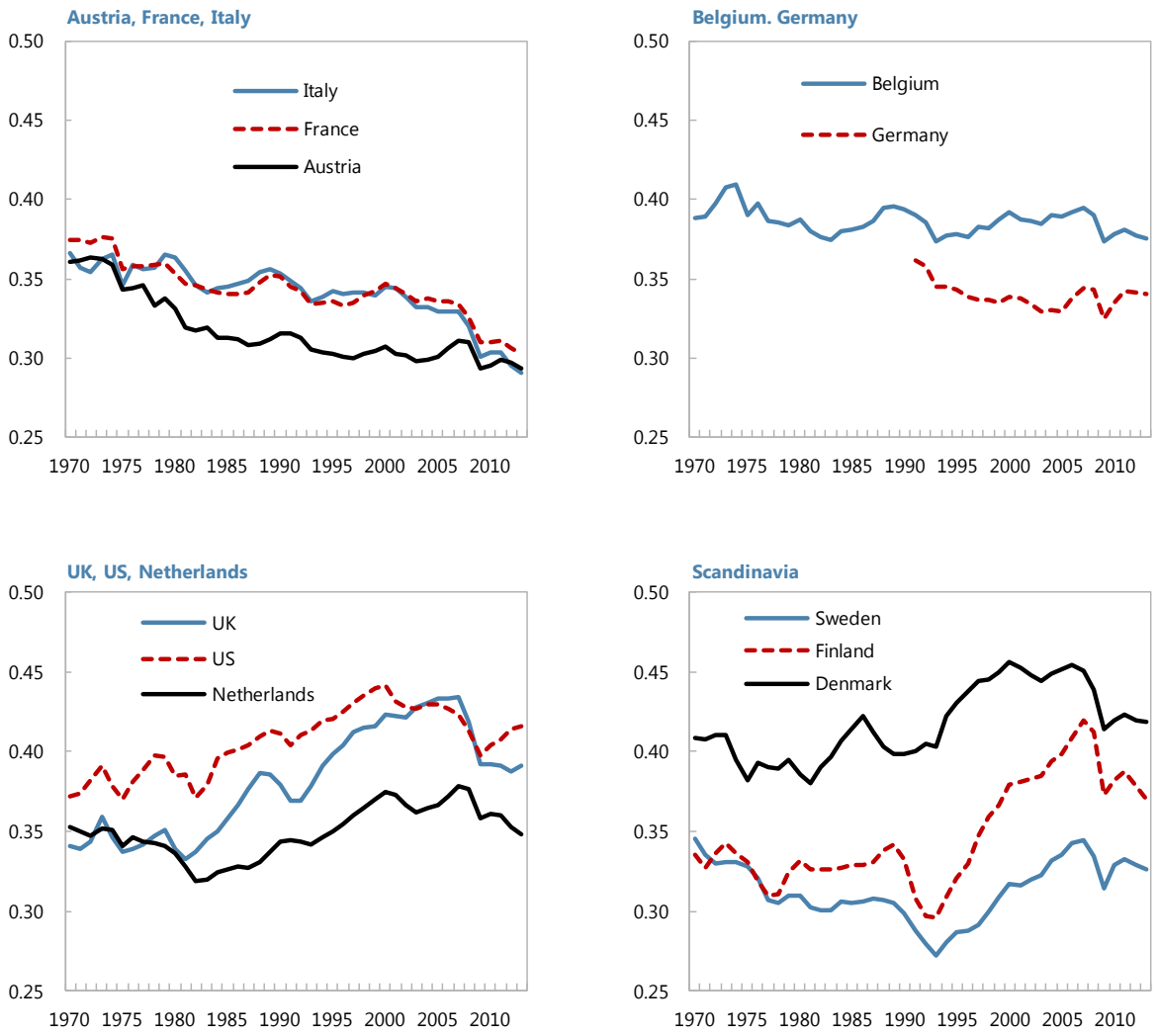
... and the unemployment rate is among the lowest in the euro area.

Unemployment
(Percent)



Sources: IMF, WEO Database; and Staff Calculations
Note: Potential output and structural unemployment were calculated using HP Filter, with a lambda of 100 for annual data.

Figure 18. Austria: Capital Productivity
(GDP per Unit of Net Capital Stock)

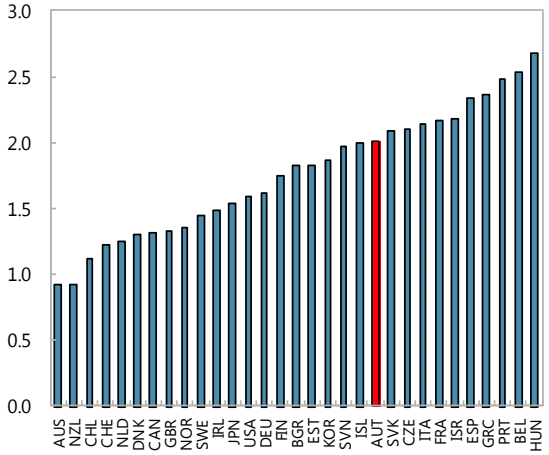


Sources: EU, Ameco Database.

Figure 19. Austria: Structural Indicators

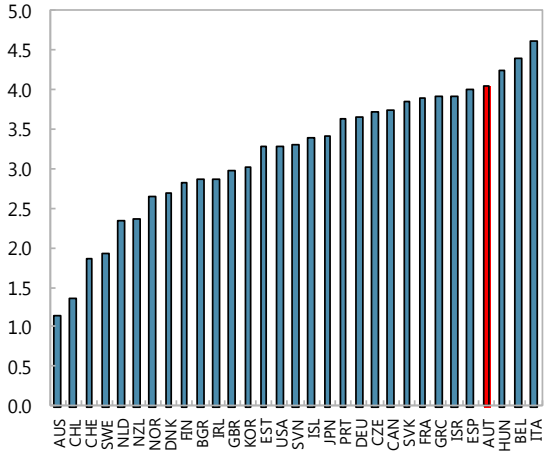
Administrative burdens for startups are relatively high …

Administrative Burden on Startups



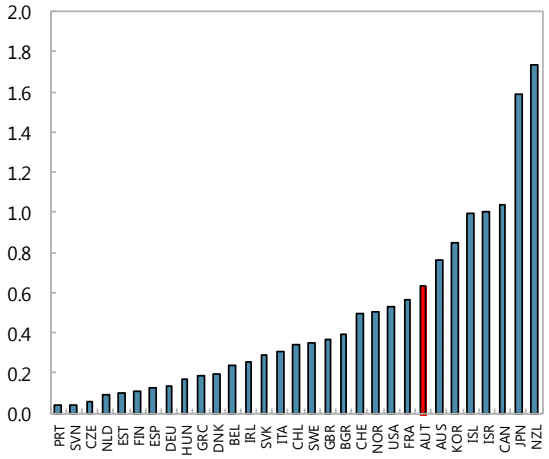
… as are barriers to retail trade and professional services …

Barriers in Services Sectors



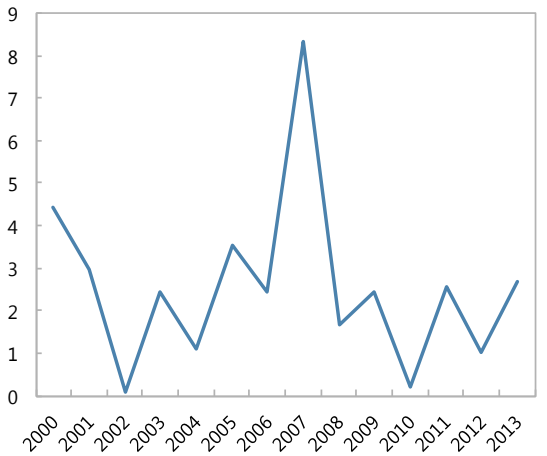
… barriers for foreign investors are high as well …

Barriers to FDI



… and FDI inflows have levelled off.

Foreign Direct Investment Flows into Austria
(Percent of GDP)



Sources: Haver Analytics and OECD Product Market Regulation (PMR) Database.
Note: PMR scale is from zero to six, with zero least restrictive.
Where 2013 USA data are missing, 2008 PMR values are used.
FDI excludes real estate and special purpose entities.

Table 1. Austria: Selected Economic Indicators, 2010–15

Total area	83,850 square kilometers
Total population (2013)	8.5 million
GDP per capita (2013)	US$ 48,957 (36,851 Euro)

	2010	2011	2012	2013	2014	2015
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	1.8	2.8	0.9	0.3	1.5	1.7
Total domestic demand	1.4	3.2	0.1	-1.2	1.0	1.4
Consumption	1.5	0.7	0.4	0.3	1.0	1.1
Gross fixed capital formation	-1.4	8.5	1.6	-0.7	1.3	2.9
Net exports (growth contribution in pp)	0.6	-0.1	0.9	1.3	0.6	0.4
Exports of goods and nonfactor services	9.4	6.6	1.2	2.7	4.4	5.3
Imports of goods and nonfactor services	9.1	7.6	-0.3	0.5	3.9	5.3
Output gap (percent of potential GDP)	-1.5	0.0	-0.4	-1.3	-1.1	-0.7
Unemployment (in percent; Eurostat definition)	4.4	4.2	4.4	4.9	5.0	4.9
Prices						
Consumer price index (period average)	1.7	3.6	2.6	2.1	1.7	1.7
General government finances (percent of GDP)						
Revenue	48.3	48.3	49.1	49.7	49.7	49.6
Expenditure	52.8	50.8	51.6	51.3	52.4	50.9
Balance (EDP-definition)	-4.5	-2.5	-2.6	-1.5	-2.7	-1.3
Structural Balance 1/	-3.2	-2.2	-1.5	-1.0	-1.0	-0.7
Gross debt (end of period)	72.5	73.1	74.4	74.5	79.4	77.9
Balance of payments						
Current account (percent of GDP)	3.4	1.6	2.4	2.7	3.4	3.5

1/ The structural balance excludes the following one-offs: (1) capital transfers to banks (as percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; 0.7 in 2013; 1.4 in 2014; 0.3 in 2015; (2) flood-related expenditure: 0.1 percent of GDP in both 2013 and 2014; (3) revenue from recent tax treaties with Switzerland and Liechtenstein: 0.2 percent of GDP in both 2013 and 2014; (4) revenue from telecom licenses: 0.6 percent of GDP in 2013.

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

Table 2. Austria: Medium-Term Macroeconomic Framework, 2010–19

(in percent of GDP unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projections					
National accounts										
GDP (growth in percent)	1.8	2.8	0.9	0.3	1.5	1.7	1.7	1.5	1.5	1.4
Total domestic demand	1.4	3.2	0.1	-1.2	1.0	1.4	1.3	1.1	1.0	1.0
Consumption	1.5	0.7	0.4	0.3	1.0	1.1	1.1	1.1	1.1	1.1
of which: Private consumption	2.0	0.8	0.5	-0.2	0.8	1.0	1.1	1.1	1.1	1.1
Gross fixed capital formation	-1.4	8.5	1.6	-0.7	1.3	2.9	2.2	1.4	1.0	0.9
Exports of goods and nonfactor services	9.4	6.6	1.2	2.7	4.4	5.3	5.3	5.4	5.8	5.9
Imports of goods and nonfactor services	9.1	7.6	-0.3	0.5	3.9	5.3	5.2	5.4	5.7	5.9
Growth contributions (percentage points)										
Final domestic demand	0.8	2.2	0.7	0.1	1.0	1.4	1.2	1.0	1.0	0.9
Net exports	0.6	-0.1	0.9	1.3	0.6	0.4	0.4	0.4	0.5	0.5
Inventories and statistical discrepancies	0.3	0.8	-0.7	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Prices and unemployment										
CPI inflation (pa; annual percent change)	1.7	3.6	2.6	2.1	1.7	1.7	1.7	1.7	1.7	1.7
Unemployment rate (percent)	4.4	4.2	4.4	4.9	5.0	4.9	4.8	4.6	4.5	4.4
Current account balance	3.4	1.6	2.4	2.7	3.4	3.5	3.5	3.5	3.6	3.5
Goods and services balance	3.5	2.0	2.3	3.7	4.4	4.5	4.5	4.5	4.6	4.6
General government accounts										
Revenue	48.3	48.3	49.1	49.7	49.7	49.6	49.6	49.6	49.6	49.6
Expenditure	52.8	50.8	51.6	51.3	52.4	50.9	50.3	50.2	50.1	50.1
Balance	-4.5	-2.4	-2.6	-1.5	-2.7	-1.3	-0.7	-0.6	-0.5	-0.5
Gross debt	72.5	73.1	74.4	74.5	79.4	77.9	76.2	74.4	72.7	71.1
Structural balance 1/	-3.2	-2.2	-1.5	-1.0	-1.0	-0.7	-0.5	-0.5	-0.5	-0.5
Memorandum items:										
Overall balance (EDP-definition)	-4.5	-2.5	-2.6	-1.5	-2.7	-1.3	-0.7	-0.6	-0.5	-0.5
Gross national saving	24.5	24.7	25.1	23.8	24.4	24.8	25.0	25.1	25.2	25.2
Gross domestic investment	21.1	23.0	22.7	21.1	21.0	21.3	21.5	21.6	21.6	21.6
Potential output (growth in percent)	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4
Output gap (in percent of potential output)	-1.5	0.0	-0.4	-1.3	-1.1	-0.7	-0.4	-0.3	-0.1	0.0
GDP (current prices, in billion euro)	285.2	299.2	307.0	313.1	323.7	334.8	345.6	356.4	367.5	378.3

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

1/ The structural balance excludes the following one-offs: (1) capital transfers to banks (as percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; 0.7 in 2013; 1.4 in 2014; 0.3 in 2015; (2) flood-related expenditure: 0.1 percent of GDP in both 2013 and 2014; (3) revenue from recent tax treaties with Switzerland and Liechtenstein: 0.2 percent of GDP in both 2013 and 2014; (4) revenue from telecom licenses: 0.6 percent of GDP in 2013.

Table 3. Austria: Balance of Payments, 2010–19

(In percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projections					
Current account	3.4	1.6	2.4	2.7	3.4	3.5	3.5	3.5	3.6	3.5
Trade	3.5	2.0	2.3	3.7	4.4	4.5	4.5	4.5	4.6	4.6
Exports	53.5	56.3	56.3	56.3	56.5	57.5	58.9	60.5	62.3	64.4
Imports	50.0	54.2	54.0	52.6	52.1	53.0	54.4	55.9	57.7	59.8
Goods	-1.1	-2.5	-2.3	-1.2	-0.2	-0.1	-0.1	0.0	0.3	0.4
Exports	39.1	41.6	41.0	40.6	40.8	41.3	42.1	43.2	44.6	46.1
Imports	40.2	44.1	43.3	41.8	41.0	41.4	42.2	43.2	44.3	45.7
Nonfactor services	4.6	4.6	4.6	4.9	4.6	4.6	4.6	4.5	4.3	4.1
Exports	14.4	14.7	15.3	15.7	15.7	16.2	16.8	17.3	17.8	18.3
Imports	9.8	10.1	10.7	10.8	11.1	11.6	12.2	12.8	13.4	14.2
Balance on factor income	0.6	0.2	0.8	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Current transfers, net	-0.6	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Capital and financial accounts	-1.1	-1.3	-2.6	-1.9	-3.4	-3.5	-3.5	-3.5	-3.6	-3.5
Capital account, net	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
FDI, net	-2.6	-3.5	-4.1	-0.6	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
Portfolio investment, net	-2.4	5.3	1.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Financial derivatives	-0.1	0.3	0.8	1.2	0.6	0.6	0.6	0.6	0.6	0.6
Other	4.3	-3.1	-0.7	-3.0	-4.0	-4.2	-4.2	-4.2	-4.4	-4.3
Reserve assets	-0.4	-0.2	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-2.3	-0.3	0.2	-0.8	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. Austria: General Government Operations, 2010–19

(In percent of GDP, unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projections					
Revenue	48.3	48.3	49.1	49.7	49.7	49.6	49.6	49.6	49.6	49.6
Taxes	27.3	27.4	28.0	28.2	28.4	28.5	28.7	28.8	28.9	28.9
Indirect taxes	14.5	14.4	14.6	14.5	14.5	14.4	14.3	14.2	14.1	14.0
Direct taxes	12.8	13.0	13.4	13.7	14.0	14.2	14.4	14.6	14.8	15.0
Social contributions	16.3	16.3	16.4	16.7	16.7	16.6	16.5	16.4	16.4	16.3
Other current revenue	4.7	4.6	4.6	4.8	4.6	4.4	4.4	4.4	4.3	4.4
Expense	52.8	50.8	51.7	51.9	52.4	50.9	50.3	50.2	50.1	50.1
Compensation of employees	9.8	9.5	9.5	9.4	9.3	9.2	9.2	9.1	9.1	9.1
Goods and services	4.5	4.3	4.4	4.4	4.4	4.3	4.3	4.3	4.3	4.3
Interest	2.7	2.6	2.6	2.5	2.6	2.6	2.5	2.5	2.5	2.5
Subsidies	3.5	3.4	3.6	3.4	3.3	3.2	3.1	3.0	2.9	2.9
Social benefits	25.5	24.7	25.0	25.4	25.4	25.3	25.2	25.3	25.3	25.3
Other expense	7.0	6.2	6.7	6.8	7.5	6.3	6.0	6.0	6.0	6.0
Net operating balance	-4.5	-2.5	-2.6	-2.2	-2.7	-1.3	-0.7	-0.6	-0.5	-0.5
Net acquisition of non-financial assets	0.0	0.0	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / Net borrowing	-4.5	-2.4	-2.6	-1.5	-2.7	-1.3	-0.7	-0.6	-0.5	-0.5
Net acquisition of financial assets	0.6	1.6	1.1	...	...	...	...	...	...	...
Net incurrence of liabilities	5.4	4.1	3.5	...	...	...	...	...	...	...
Statistical Discrepancy	0.3	0.1	-0.1	...	...	...	...	...	...	...
Memorandum item:										
Overall balance (EDP-definition)	-4.5	-2.5	-2.6	-1.5	-2.7	-1.3	-0.7	-0.6	-0.5	-0.5
Primary balance	-1.8	0.2	0.0	1.0	-0.2	1.2	1.8	1.9	2.0	2.0
Structural balance 1/	-3.2	-2.2	-1.5	-1.0	-1.0	-0.7	-0.5	-0.5	-0.5	-0.5
Change in structural balance	0.0	0.9	0.7	0.5	0.0	0.3	0.2	0.1	0.0	0.0
Public debt	72.5	73.1	74.4	74.5	79.4	77.9	76.2	74.4	72.7	71.1

Sources: Authorities, Eurostat, and IMF staff projections.

1/ The structural balance excludes the following one-offs: (1) capital transfers to banks (as percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; 0.7 in 2013; 1.4 in 2014; 0.3 in 2015; (2) flood-related expenditure: 0.1 percent of GDP in both 2013 and 2014; (3) revenue from recent tax treaties with Switzerland and Liechtenstein: 0.2 percent of GDP in both 2013 and 2014; (4) revenue from telecom licenses: 0.6 percent of GDP in 2013.

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

(In billions of Euro)

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

Sources: Statistical Office of Austria and Eurostat.
1/ At market value

Table 6. Austria: Financial Soundness Indicators, 2009–13

(Percent)

	2009	2010	2011	2012	2013
Capital adequacy					
Regulatory capital to risk-weighted assets 1/	15.0	15.4	15.8	17.0	18.0
Regulatory Tier I capital to risk-weighted assets 1/	11.1	11.7	12.0	12.9	13.7
Capital to assets (percent) 2/	7.0	7.5	7.2	7.8	8.0
Large exposures to capital 2/	55.5	64.8	62.9	59.1	52.6
Nonperforming loans net of loan-loss provisions to capital 2/	6.3	8.2	8.0	6.9	5.8
Asset quality					
Nonperforming loans to total gross loans 2/	2.3	2.8	2.7	2.8	2.9
Sectoral distribution of loans to total loans 3/					
Residents	68.7	70.0	70.0	70.5	70.2
Deposit-takers	27.7	25.2	25.4	23.6	22.6
Central bank	1.4	1.4	2.0	2.6	1.7
Other financial corporations	3.2	3.2	2.9	2.8	2.7
General government	3.4	3.8	4.0	4.0	3.9
Nonfinancial corporations	16.9	18.4	18.1	18.9	19.8
Other domestic sectors	16.2	18.1	17.7	18.6	19.6
Nonresidents	31.3	30.0	30.0	29.5	29.8
Geographical distribution of loans to total loans 2,3/					
Domestic economy	68.7	70.0	70.0	70.5	70.2
Advanced economies, excluding China	15.4	13.7	14.5	14.6	14.6
Emerging market and developing countries, including China	15.9	16.3	15.6	14.9	15.2
Africa	0.1	0.1	0.1	0.1	0.1
of which: Sub-Sahara Africa	0.1	0.1	0.1	0.1	0.1
Central and Eastern Europe	13.0	13.2	12.6	12.2	12.3
Commonwealth of Independent States and Mongolia	2.0	2.1	2.0	1.9	2.1
Developing Asia, including China	0.4	0.4	0.4	0.5	0.5
Middle East	0.4	0.4	0.3	0.1	0.1
Western Hemisphere	0.1	0.1	0.1	0.1	0.1
Earnings and profitability 1/					
Return on assets	0.1	0.5	0.1	0.3	0.1
Return on equity	1.5	7.9	1.4	5.5	1.6
Net interest income to gross income	69.7	67.4	63.3	59.3	65.2
Noninterest expenses as a percentage of gross income	86.0	83.0	87.4	84.4	95.5
Liquidity 2/					
Liquid assets to total assets	26.1	23.5	25.4	24.8	24.5
Liquid assets to short-term liabilities	76.2	68.0	71.6	73.4	68.9
Net open position in foreign exchange to capital	0.6	0.3	0.1	0.4	0.2
Other FSIs 2/					
Trading income as a percentage of gross income	2.8	3.4	1.7	3.3	2.6
Personnel expenses as a percentage of noninterest expenses	51.4	50.2	51.2	51.2	50.7
Spread between reference lending and deposit rates (basis points)	191.0	197.0	208.0	180.0	181.0
Foreign currency-denominated loans to total loans	22.4	22.1	21.4	19.7	18.8
Foreign currency-denominated liabilities to total liabilities	14.4	11.3	12.0	10.6	10.0

Sources: OeNB; and fsi.imf.org.

1/ Domestically controlled, cross-border and cross sector consolidation basis

2/ Domestic consolidation basis

3/ Total loans include loans to financial institutions

Table 7. Austria: Authorities' Response to Past IMF Policy Recommendations	
IMF 2013 Article IV Recommendations	**Authorities' Response**
Fiscal policy I Fiscal cost from medium-sized banks under restructuring should be compensated with additional gradual fiscal adjustment, with a view to bringing public debt down to its pre-crisis level in the first years of the next decade.	No gradual strengthening of fiscal adjustment beyond the 2016 structural deficit target in the fiscal planning for 2014-18.
Fiscal policy II Decide on further expenditure reforms to anchor sustainability in the medium and long run.	No further significant reform plans at the moment.
Fiscal policy III Streamline intergovernmental fiscal relations and create stronger nexus between spending and financing responsibilities at the subnational level, including by introducing meaningful tax autonomy for states.	No significant progress.
Fiscal policy IV Generate and use expenditure savings to finance a comprehensive reform of labor taxation and social and family benefits to foster labor supply and potential growth.	No significant progress.
Financial sector policy I Dispose more efficiently of legacy assets in restructuring banks and downsize these banks faster to contain final fiscal cost.	Strategy for main problem bank has been decided; further progress in the troubled apex institution of one banking group; however, one bad bank still has banking license.
Financial sector policy II Create comprehensive framework for bank resolution.	Preparations for the transposition of the new EU Bank Recovery and Resolution Directive are on-going.
Financial sector policy III Strengthen the macroprudential framework by giving the OeNB a decisive role in the new macroprudential committee, broadening the set of macroprudential tools, and improving the statistical information base.	Committee has not yet started to work, OeNB role could be stronger, macroprudential tools still need to be broadened.
Financial sector policy IV Unify deposit insurance system and create bank resolution fund.	No progress on plans for unifying the deposit insurance system.

Annex. Austria: Public Debt Sustainability Analysis (DSA)

Debt is sustainable within the DSA medium-term projection horizon, but aging cost pressures are looming in the longer term. In 2014–19, debt will gradually fall from currently around 80 percent of GDP to slightly above 70 percent of GDP in the baseline.[1] A relatively high share of public debt held by non-residents could increase volatility in times of heightened CESEE concerns. Lower growth and a contingent liability shock could shift up debt significantly but would leave it on a downward trajectory. In the longer term and barring policy measures, aging cost pressures would reverse the debt path.[2]

Baseline

Growth is accelerating, and fiscal consolidation is on track. The overall structural adjustment of around ½ percentage point of GDP between 2014 and 2016 assumed in the baseline is well within reach.[3] Against this backdrop, the debt-to-GDP ratio will peak at almost 80 percent of GDP in 2014, propped up by the creation of a defeasance structure for Hypo Alpe Adria bank, and gradually fall to slightly above 70 percent of GDP by 2019. Gross financing needs are moderate.

The standard DSA heat map indicates a high share of public debt held by non-residents as the main vulnerability. In principle, this should not be a source of concern as long as Austria is perceived a safe-haven euro area core country. However, it could lead to higher volatility in spreads as a function of developments in CESEE and residual risks from banks' CESEE exposure.

Stress Tests

Standardized macro-fiscal stress tests reveal lower growth and the realization of contingent liabilities as main factors that could shift the debt-to-GDP ratio upwards, even though debt remains on a downward trajectory.

The standardized low-growth scenario assumes that, in 2015 and 2016, growth is reduced by one standard deviation of the historical growth outturn and amounts to a negative ½ percent.[4] In this case, the debt-to-GDP ratio would increase by 5 percentage points to a peak of 84 percentage points in 2016 and follow a downward trend to 79 percentage points in 2019. A purely illustrative contingent liability shock of 10 percentage points of GDP, about the size of the overall debt effect of

[1] Forthcoming revisions to GDP and the perimeter of general government, due to new ESA rules effective as of September 2014, are not yet included.

[2] See figure 12 in main document.

[3] The structural balance excludes various one-offs, in particular bank restructuring cost (see table 1 of main document). Looking at the purely cyclically-adjusted primary balance confirms that the baseline scenario is realistic (see panel "Austria Public DSA – Realism of Baseline Assumptions", part one, bottom lhs chart).

[4] The scenario also assumes that lower growth induces a reduction in the inflation rate by some ¼ percentage points, while interest rates are assumed to increase by ½ percentage point (with concurrent effects on the primary balance).

bank support during the crisis, would prop up the debt-to-GDP to some 90 percent before a very gradual reduction to some 86 percent towards the end of the decade.

The other standardized macro shocks will not lead to significant deviations from the baseline debt path. These shocks are the primary balance shock, the real exchange rate shock, and the real interest rate shock.[5] A "combined shock" for all variables is driven by assumed lower growth and leads to a similar debt path as in the low-growth scenario.

[5] Compared to baseline, the primary balance shock assumes a deterioration of the balance in 2015 and 2016 by half of the 10-year historical standard deviation; the real exchange rate shock assumes a depreciation of 13.1 percent in 2015 (largest historical depreciation over the last ten years); and the real interest rate shock assumes a spread increase of 200 bp.

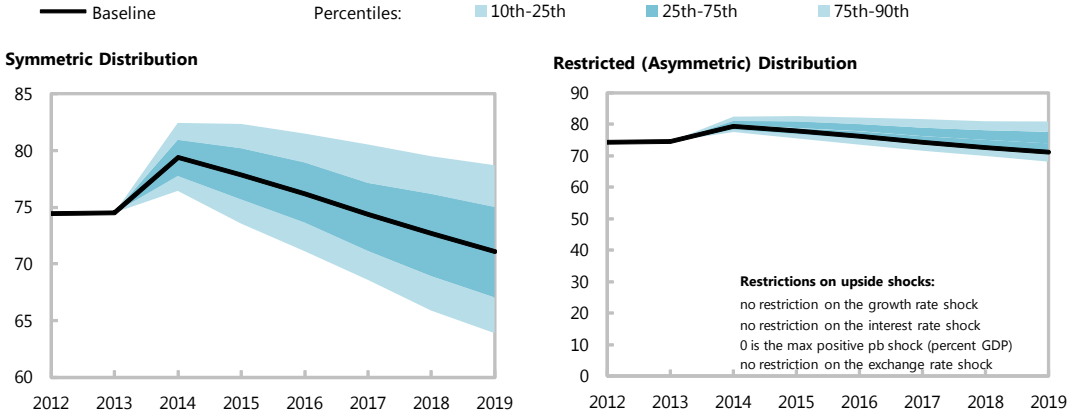
Austria: Public DSA—Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

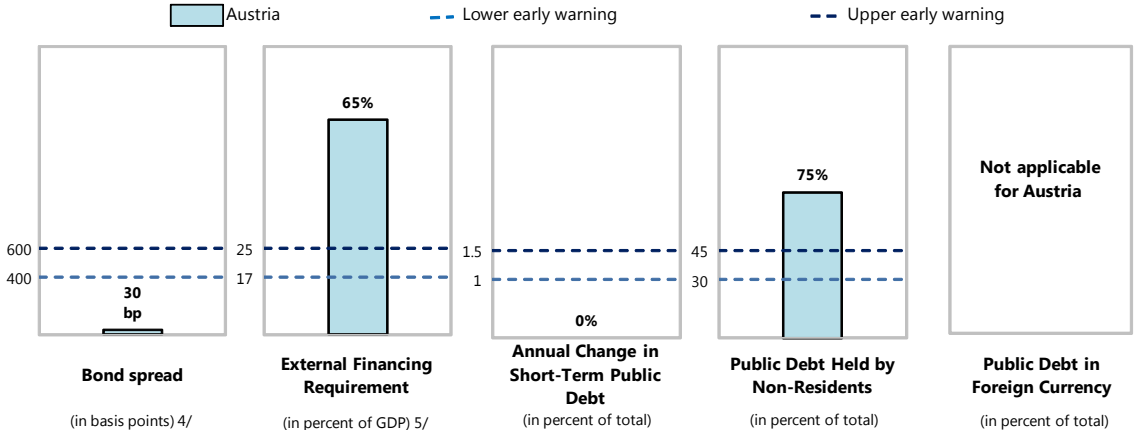
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 08-Apr-14 through 07-Jul-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Austria: Public DSA—Realism of Baseline Assumptions

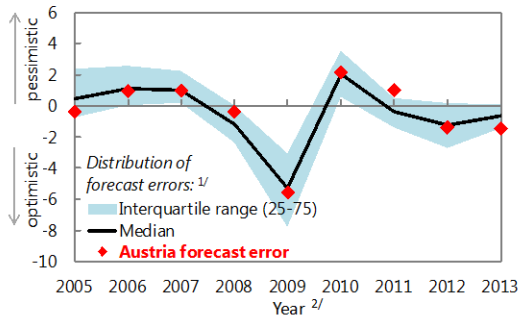
Forecast Track Record, versus surveillance countries

Real GDP Growth

(in percent, actual-projection)

Austria median forecast error, 2005-2013: -0.37

Has a percentile rank of: 46%

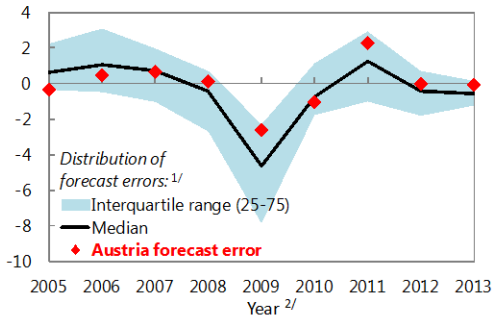


Primary Balance

(in percent of GDP, actual-projection)

Austria median forecast error, 2005-2013: 0.00

Has a percentile rank of: 56%

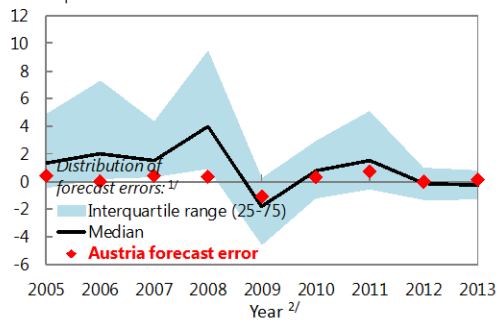


Inflation (Deflator)

(in percent, actual-projection)

Austria median forecast error, 2005-2013: 0.28

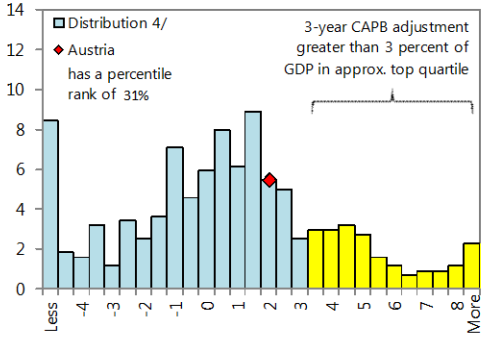
Has a percentile rank of: 30%



Assessing the Realism of Projected Fiscal Adjustment

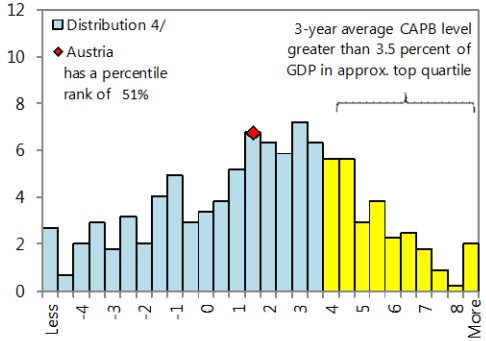
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)

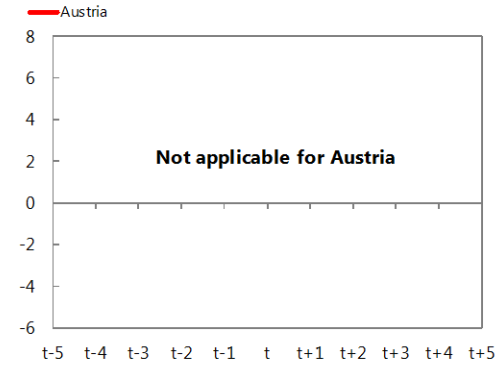
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth

(in percent)



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Austria, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Austria: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

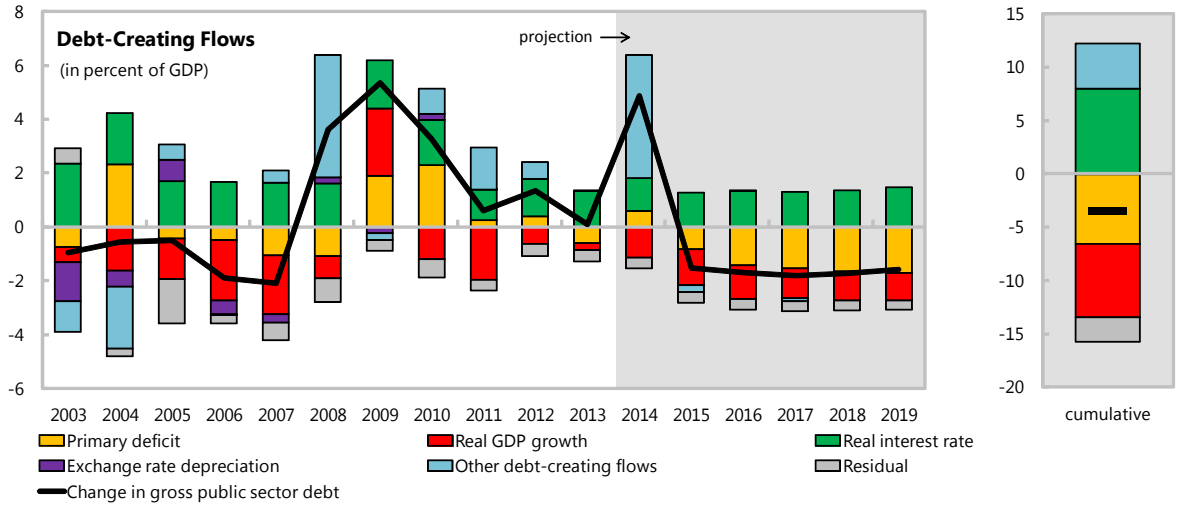
	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	66.1	74.4	74.5	79.4	77.9	76.2	74.4	72.7	71.1
Public gross financing needs	...	10.2	9.4	11.7	7.7	6.3	11.3	7.6	9.5
Real GDP growth (in percent)	1.7	0.9	0.3	1.5	1.7	1.7	1.5	1.5	1.4
Inflation (GDP deflator, in percent)	1.7	1.7	1.7	1.8	1.6	1.6	1.6	1.6	1.5
Nominal GDP growth (in percent)	3.5	2.6	2.0	3.4	3.4	3.2	3.1	3.1	2.9
Effective interest rate (in percent) [4/]	4.5	3.7	3.5	3.6	3.3	3.4	3.4	3.5	3.6

As of July 07, 2014

Sovereign Spreads		
EMBIG (bp) 3/		27
5Y CDS (bp)		31
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AA+	AA+
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.8	1.4	0.1	4.9	-1.5	-1.7	-1.8	-1.7	-1.6	-3.5	
Identified debt-creating flows	1.3	1.8	0.5	5.3	-1.1	-1.3	-1.4	-1.3	-1.2	-1.2	
Primary deficit	0.3	0.4	-0.6	0.6	-0.8	-1.4	-1.5	-1.6	-1.7	-6.5	0.5
Primary (noninterest) revenue and grant	47.7	48.6	49.3	49.3	49.2	49.2	49.2	49.2	49.3	295.3	
Primary (noninterest) expenditure	48.1	49.0	48.7	49.9	48.3	47.8	47.7	47.6	47.6	288.8	
Automatic debt dynamics [5/]	0.5	0.8	1.1	0.1	-0.1	0.1	0.2	0.3	0.5	1.1	
Interest rate/growth differential [6/]	0.7	0.8	1.1	0.1	-0.1	0.1	0.2	0.3	0.5	1.1	
Of which: real interest rate	1.7	1.4	1.3	1.2	1.3	1.3	1.3	1.4	1.5	8.0	
Of which: real GDP growth	-1.1	-0.6	-0.2	-1.1	-1.3	-1.2	-1.1	-1.1	-1.0	-6.9	
Exchange rate depreciation [7/]	-0.2	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.5	0.6	0.0	4.6	-0.2	0.0	-0.1	0.0	0.0	4.2	
SFA (incl. 2014 HAA defeasance structu	0.5	0.6	0.0	4.6	-0.2	0.0	-0.1	0.0	0.0	4.2	
Residual, including asset changes [8/]	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-2.3	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

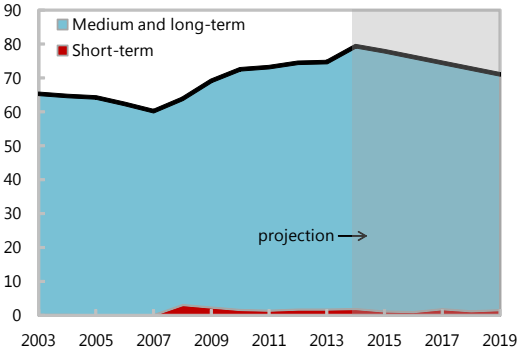
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Austria: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

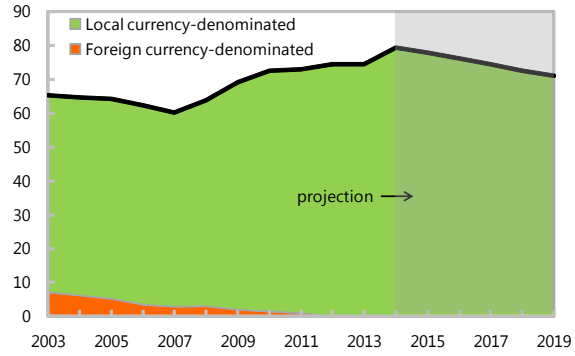
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

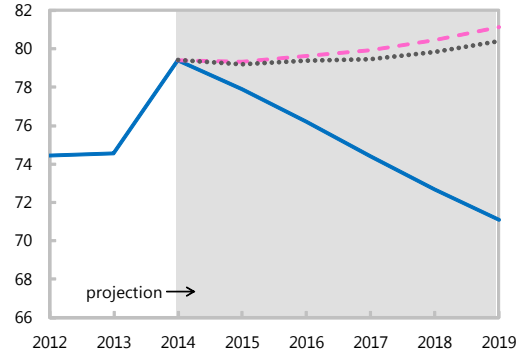


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

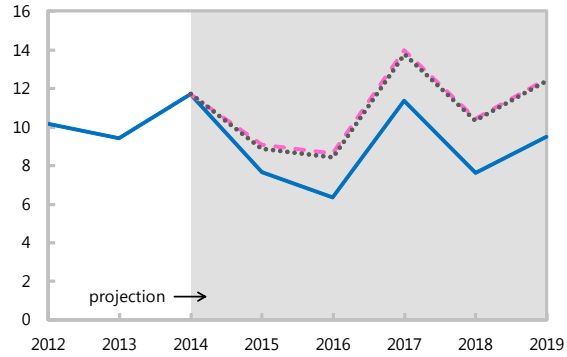
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

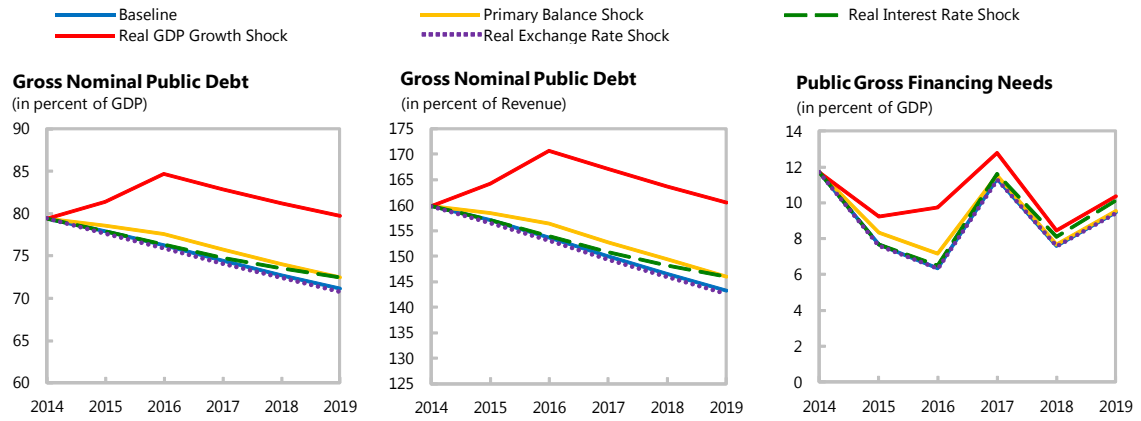
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.5	1.7	1.7	1.5	1.5	1.4
Inflation	1.8	1.6	1.6	1.6	1.6	1.5
Primary Balance	-0.6	0.8	1.4	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.4	3.4	3.5	3.6
Constant Primary Balance Scenario						
Real GDP growth	1.5	1.7	1.7	1.5	1.5	1.4
Inflation	1.8	1.6	1.6	1.6	1.6	1.5
Primary Balance	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	3.6	3.3	3.3	3.4	3.5	3.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.5	1.6	1.6	1.6	1.6	1.6
Inflation	1.8	1.6	1.6	1.6	1.6	1.5
Primary Balance	-0.6	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	3.6	3.3	3.4	3.5	3.7	3.8

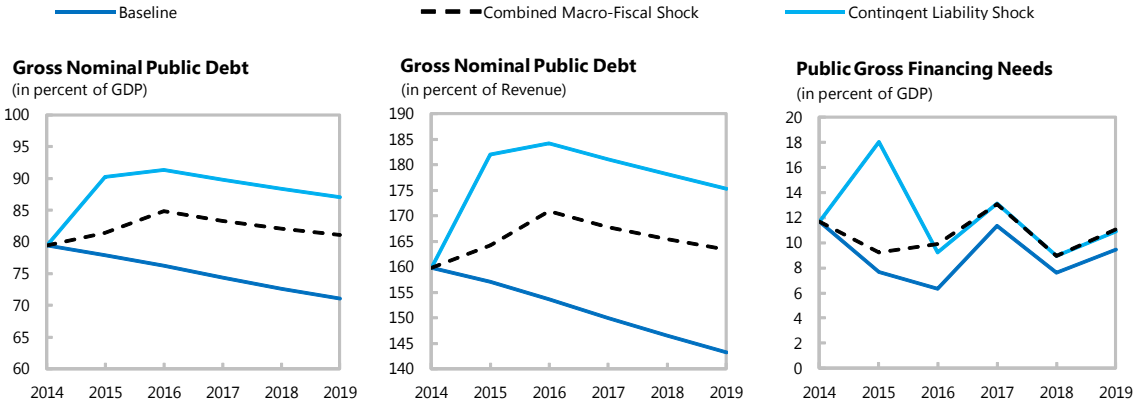
Source: IMF staff.

Austria: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.5	1.7	1.7	1.5	1.5	1.4
Inflation	1.8	1.6	1.6	1.6	1.6	1.5
Primary balance	-0.6	0.1	0.7	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.4	3.4	3.5	3.6
Real Interest Rate Shock						
Real GDP growth	1.5	1.7	1.7	1.5	1.5	1.4
Inflation	1.8	1.6	1.6	1.6	1.6	1.5
Primary balance	-0.6	0.8	1.4	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.6	3.8	4.1	4.3
Combined Shock						
Real GDP growth	1.5	-0.5	-0.5	1.5	1.5	1.4
Inflation	1.8	1.1	1.0	1.6	1.6	1.5
Primary balance	-0.6	-0.5	-1.3	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.6	3.8	4.1	4.4

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.5	-0.5	-0.5	1.5	1.5	1.4
Inflation	1.8	1.1	1.0	1.6	1.6	1.5
Primary balance	-0.6	-0.5	-1.3	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.4	3.5	3.6	3.6
Real Exchange Rate Shock						
Real GDP growth	1.5	1.7	1.7	1.5	1.5	1.4
Inflation	1.8	2.0	1.6	1.6	1.6	1.5
Primary balance	-0.6	0.8	1.4	1.5	1.6	1.7
Effective interest rate	3.6	3.3	3.4	3.4	3.5	3.6
Contingent Liability Shock						
Real GDP growth	1.5	-0.5	-0.5	1.5	1.5	1.4
Inflation	1.8	1.1	1.0	1.6	1.6	1.5
Primary balance	-0.6	-9.2	1.4	1.5	1.6	1.7
Effective interest rate	3.6	3.5	3.7	3.7	3.8	3.9

Source: IMF staff.

INTERNATIONAL MONETARY FUND

AUSTRIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 31, 2014

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of June 30, 2014)

Mission: Consultation discussions were held in Vienna from June 20 to July 1, 2014. The authorities released the mission's concluding statement, which is available at: http://www.imf.org/external/np/ms/2014/070114.htm

Staff team: Mr. Bakker (head), Ms. Buzaushina, and Messrs. Steinlein and Thegeya (all EUR). Mr. Prader, Executive Director for Austria, and Mr. Just (OED) attended the meetings.

Country interlocutors: Vice-Chancellor and Minister of Finance Spindelegger, OeNB Governor Nowotny, Labor Minister Hundstorfer, other senior officials, parliamentarians, and representatives of the social partners, the banking sector, and think tanks.

Fund relations: Austria is on a 12-month consultation cycle. The last consultations were held June 21-July 1, 2013, and the staff report is available at: http://www.imf.org/external/pubs/cat/longres.aspx?sk=40929.0

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

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	2,113.90	100.00
Fund holdings of currency	1,606.24	75.98
Reserve position in Fund	507.67	24.02
Lending to the Fund:		
New Arrangements to Borrow	492.10	

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	1,736.31	100.00
Holdings	1,658.83	95.54

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund:

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

	Forthcoming				
	2014	**2015**	**2016**	**2017**	**2018**
Principal	--	--	--	--	--
Charges/Interest	0.03	0.07	0.07	0.07	0.07
Total	0.03	0.07	0.07	0.07	0.07

Implementation of HIPC Initiative: Not Applicable

Exchange System:

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

STATISTICAL ISSUES

1. **Macroeconomic statistics are adequate for surveillance.** Austria subscribed to the Fund's Special Data Dissemination Standard (SDDS) in 1996, and its metadata are available on the Fund's electronic Dissemination Standards Bulletin Board. Austria is availing itself of the SDDS flexibility option on the timeliness of the industrial production index and the merchandise trade data.

2. **The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB.** The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the IFS and IFS Supplement.

Austria: Table of Common Indicators
(as of July 30, 2014)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	07/29/14	07/30/14	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	June 2014	07/20/14	Monthly	Monthly	Monthly
Reserve/Base Money	June 2014	07/30/14	Monthly	Monthly	Monthly
Broad Money	June 2014	07/30/14	Monthly	Monthly	Monthly
Central Bank Balance Sheet	June 2014	07/15/14	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	June 2014	07/30/14	Monthly	Monthly	Monthly
Interest Rates[2]	07/29/14	07/30/14	Daily	Daily	Daily
Consumer Price Index	June 2014	07/14/14	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2014:Q1	06/30/14	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	June 2014	07/30/14	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	June 2014	07/30/14	Monthly	Monthly	Monthly
External Current Account Balance	2014:Q1	06/30/14	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	2014:Q1	06/30/14	Quarterly	Quarterly	Quarterly
GDP/GNP	2014:Q1	06/06/14	Quarterly	Quarterly	Quarterly
Gross External Debt[5]	2014:Q1	06/30/14	Quarterly	Quarterly	Quarterly
International Investment Position	2014:Q1	06/30/14	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.

INTERNATIONAL MONETARY FUND

AUSTRIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

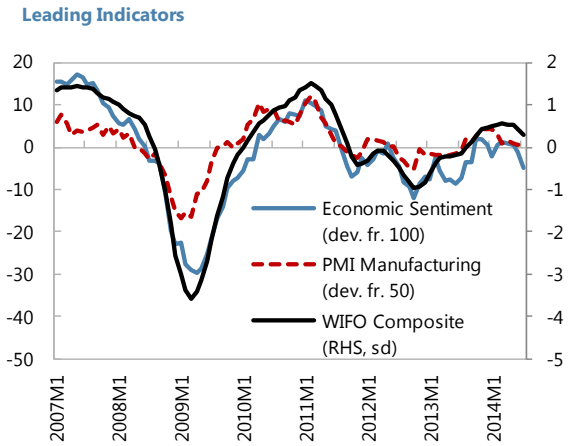
September 2, 2014

Approved By | Philip Gerson and Tamim Bayoumi

This supplement provides information that has become available since the Staff Report (SM/14/238) was circulated to the Executive Board on August 5, 2014. The information does not alter the thrust of the staff appraisal.

Economic Developments and Prospects

1. As in other euro area countries, growth in Q2 was weaker than expected, while growth in Q1 was revised down. Q1 growth was revised down from 0.2 to 0.1 percent (qoq), mainly due to weaker exports than originally estimated. The flash release for Q2 points to only a slight growth acceleration to 0.2 percent (qoq). Export growth picked up, but private consumption continued to grow only marginally at 0.1 percent (qoq), and gross fixed capital formation declined by 0.3 percent, compared with an expansion of 0.6 percent in Q1.



2. At the same time, forward looking indicators have deteriorated. Sentiment has been affected by geopolitical turmoil, but also by the weaker-than-expected economy in the euro area.

3. Staff now expects annual GDP growth in 2014 to be about ½ percentage points lower. The new baseline is growth of 1.0 percent in 2014, compared with 1.5 percent in the staff report.

4. A strengthening of the economy is now projected for 2015, but downside risks remain significant. With GDP starting from a lower level, the growth

rate (1.9 percent) is projected to be slightly faster than in the staff report (1.7 percent), which would imply that about 40 percent of the growth shortfall this year would be made up in 2015. However, the strength of the euro area recovery and the impact of the geopolitical turmoil remain uncertain at this stage and constitute important downside risks.

5. Weaker growth is not expected to have much impact on the structural deficit in 2014. The headline deficit is likely to be ¼ percentage points higher than was expected in the staff report.

6. Financial market conditions have remained stable. Sovereign bond yields notched further down, although the spread vis-à-vis German Bunds remained steady. The stock market seems to have stabilized, although bank equities remain fragile. Bank bond yields have remained flat and banks' CDS spreads seem to have retreated from a recent peak.

7. Inflation has recently risen again and stood at 1.7 percent in both June and July (yoy) up from 1.5 percent in May, with the services sector continuing to be a major driver. This deviates from the trend in the euro area and Germany, where inflation has declined to 0.4 and 0.8 percent.

New Finance Minister

8. Austrian Finance Minister, Vice Chancellor, and conservative People's Party (OeVP) leader Mr. Michael Spindelegger resigned on August 26 from all his political posts, citing differences within his party on tax reform. The resignation highlights the differences of view in Austria on how an income tax cut should be financed (¶32 of the Staff Report). The Social Democrats have advocated a revenue-neutral tax reform, with a lower income tax financed by higher property and inheritance/gift taxes. So far, the OeVP had argued that tax reductions should be funded through expenditure cuts, but calls within the party had been increasing to compromise.

9. On September 1, Mr. Hans Joerg Schelling, also a member of the conservative party, was appointed as new Finance Minister. Unlike his predecessor, Schelling will not take on the positions of party chairman and vice-chancellor—these will go to Economy Minister Reinhold Mitterlehner. Mr. Schelling held several managerial positions in the private and public sectors, including as chairman of the supervisory board of the restructuring apex institution of the Austrian Volksbanken sector. The appointment of a new OeVP finance minister and party chairman have made an agreement on tax reform more likely. Expectations are that the coalition will continue until the next regular national elections in 2018.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/xx
FOR IMMEDIATE RELEASE
[Month, dd, yyyy]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Austria

On September 8, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Austria.

Austria came through the global economic and financial crisis relatively well, reflecting the absence of large pre-crisis domestic imbalances. The main impact of the crisis was on the internationally active banking system and public debt. Before the crisis, Austrian banks had expanded rapidly in Central, Eastern and Southeastern Europe (CESEE). As their funding dried up post-Lehman, and their assets suffered from the end of the credit boom in CESEE, Austrian banks came under pressure and needed government support.

After a new slowdown in 2012 and 2013, a recovery is now taking hold. GDP is currently projected to grow at about 1.5 percent in 2014 and 1.7 percent in 2015, compared with 0.3 percent in 2013. Inflation has fallen from near 4 percent in late 2011 to 1.5 percent in May, but the risk of deflation remains low, as a tight labor market keeps services inflation elevated. (The unemployment rate is the lowest in the EU. Austria's current account and real effective exchange rate are broadly in line with fundamentals. Risks are mainly geopolitical, and include spillovers from Ukraine and Russia. Other risk factors include the European Central Bank (ECB)'s comprehensive balance sheet assessment and lower-than-expected growth in emerging markets and the euro area. Funding shocks for Austrian banks could give rise to spillovers to CESEE.

Austria's public expenditure-to-GDP ratio is high. The counterpart is a high tax burden, especially on labor. With 1 percent of GDP in 2013, Austria's structural deficit is not high. However, due to bank support, debt dynamics are not as favorable, and the public debt-to-GDP ratio will reach about 80 percent of GDP in 2014 and become higher than in any other European AAA country.

[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.

The restructuring of fully or partly nationalized banks has made progress, but challenges remain. The restructuring law for Hypo Alpe Adria includes a bail-in of €890 million in subordinated debt guaranteed by the state of Carinthia and an effective wipe-out of the underlying guarantee. The internationally active Austrian banks have been shifting to a new model, in which credit of their CESEE subsidiaries is, to a much larger extent, funded by local deposits rather than by parents. These large banks have strengthened their capital position, but capital gaps with peers remain. Neither the non-financial corporate sector nor the household sector is overleveraged, but housing prices warrant monitoring.

Executive Board Assessment[2]

Executive Directors commended the authorities for their sound macroeconomic management, which has helped weather the global financial crisis and deliver stable growth and low unemployment. Directors noted that, while Austria's economic outlook remains positive, geopolitical developments could pose risks, especially to the financial sector given its exposure to Central, Eastern, and Southeastern Europe. They agreed that policy priorities ahead should continue to focus on preserving financial stability by completing bank restructuring and further strengthening macro-financial stability. Efforts should also continue to address long-standing structural issues to bring down the high debt and boost labor productivity and potential output growth.

Directors welcomed the reduction in the fiscal deficit and the authorities' commitment to achieve a structurally balanced budget by 2016. They generally saw scope for more decisive expenditure and fiscal federalism reforms to make room for faster debt reduction and tax cuts, including from social security contributions. These steps would create buffers for absorbing aging costs, potential additional bank restructuring outlays, and other contingent liabilities. Directors highlighted the need for greater public spending efficiency by reforming public pensions and health care, better targeting subsidies, and by linking more closely expenditure and revenue responsibilities in the federal system.

Directors welcomed the recent progress in the restructuring of fully or partly nationalized banks, in particular Hypo Alpe Adria Group. They encouraged timely completion of the sale of Hypo's Southeastern European subsidiaries while ensuring measures to avoid disruptive effects in host countries. Directors recognized that the recent bail-in of subordinated debt is in line with the European framework. They noted, however, that the retroactive effective voiding of a guarantee of the Austrian state of Carinthia, while designed and intended as an isolated case, could risk undermining the credibility of similar guarantees in the future. For the Volksbanken sector, Directors underscored that, given the structurally low profitability of the domestic banking market, speedy asset disposal in the apex institution and the rapid implementation of a streamlined association structure remain essential.

[2] 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.

Directors acknowledged that the transition to a new funding model and stronger capital positions have reduced vulnerabilities of internationally active banks. They encouraged the authorities to continue to strengthen banks' capital buffers and to accelerate the implementation of the EU banking union framework. Directors also highlighted the need for further refinement of the macroprudential framework.

Directors underscored that raising labor productivity and increasing labor force participation would improve longer-term economic prospects by boosting potential growth and mitigating the impact of aging. The enhancement of IT adaptation, better access to financing for start-ups, and the reduction of administrative barriers for new business could help expand the economy's production frontier. Increasing the labor force by reducing the tax burden on labor and raising the effective retirement age would further boost economic potential.

Austria: Selected Economic Indicators, 2010–15

	2010	2011	2012	2013	2014	2015
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	1.8	2.8	0.9	0.3	1.5	1.7
Total domestic demand	1.4	3.2	0.1	-1.2	1.0	1.4
Consumption	1.5	0.7	0.4	0.3	1.0	1.1
Gross fixed capital formation	-1.4	8.5	1.6	-0.7	1.3	2.9
Net exports (growth contribution in pp)	0.6	-0.1	0.9	1.3	0.6	0.4
Exports of goods and nonfactor services	9.4	6.6	1.2	2.7	4.4	5.3
Imports of goods and nonfactor services	9.1	7.6	-0.3	0.5	3.9	5.3
Output gap (percent of potential GDP)	-1.5	0.0	-0.4	-1.3	-1.1	-0.7
Unemployment (in percent; Eurostat definition)	4.4	4.2	4.4	4.9	5.0	4.9
Prices						
Consumer price index (period average)	1.7	3.6	2.6	2.1	1.7	1.7
General government finances (percent of GDP)						
Revenue	48.3	48.3	49.1	49.7	49.7	49.6
Expenditure	52.8	50.8	51.6	51.3	52.4	50.9
Balance (EDP-definition)	-4.5	-2.5	-2.6	-1.5	-2.7	-1.3
Structural Balance 1/	-3.2	-2.2	-1.5	-1.0	-1.0	-0.7
Gross debt (end of period)	72.5	73.1	74.4	74.5	79.4	77.9
Balance of payments						
Current account (percent of GDP)	3.4	1.6	2.4	2.7	3.4	3.5

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

1/ The structural balance excludes the following one-offs: (1) capital transfers to banks (as percent of GDP): 0.6 in 2010; 0.2 in 2011; 0.9 in 2012; 0.7 in 2013; 1.4 in 2014; 0.3 in 2015; (2) flood-related expenditure: 0.1 percent of GDP in both 2013 and 2014; (3) revenue from recent tax treaties with Switzerland and Liechtenstein: 0.2 percent of GDP in both 2013 and 2014; (4) revenue from telecom licenses: 0.6 percent of GDP in 2013.

Statement by Johann Prader, Executive Director for Austria
September 8, 2014

The Austrian authorities welcome the consultations with the Fund and thank staff for the high-quality report. They broadly agree with the assessment of Austria's economic and financial situation and the recommendations on economic and financial policies.

The Austrian economy has weathered the global economic and financial crisis relatively well, with current employment and GDP above their pre-crisis levels and an increase of the public expenditure ratio smaller than in most other euro area countries. Against the background of hesitant investment activity, cautious private consumption and somewhat less dynamic external demand, Austria's economic recovery follows the general international pattern in that its speed and its amplitude are decelerating. At the same time, the financial sector is proceeding with the repair of balance sheets but with so far only limited impact on domestic real activity. The rise of the public debt level relates primarily to Austrian government support for the banking sector throughout the crisis, which has also been helpful in avoiding credit growth being unduly restrained in the emerging economies of the region. The authorities agree that policy needs to focus on reducing the tax burden, in particular on labor, while further improving the sustainability of public finances through a prudent review of revenues and expenditures, including transfers and subsidies, and adequate measures aimed at increasing the potential of long-term economic growth and strengthening the domestic banking sector.

Macroeconomic outlook

Since passing the trough of the business cycle in the first half of 2013, the Austrian economy has embarked on a moderate recovery path in the second half of 2013. **But against the background of weak euro area growth and high geopolitical risks, growth of real GDP in Austria turned out to be significantly lower than expected in the first half of 2014. Given latest information from conjunctural indicators the authorities expect real GDP growth to remain below potential for the rest of 2014.** Despite very favorable financing conditions, investment is expected to accelerate only moderately in the months to come. Enterprises postpone investment projects given the highly uncertain external business environment. The authorities share staff's view that the geopolitical situation in Ukraine and Russia poses a substantial downward risk to the outlook, with possible ramifications for the financial sector and the investment climate going forward.

Consumer price inflation in Austria has been among the highest in the euro area as of late as housing, restaurants, and the prices for other services have been the main drivers. In contrast, producer prices and the relative evolution of the GDP-deflator suggest that a negative

transmission to external price competitiveness has not materialized, even though vigilance in terms of price competitiveness is warranted. Against the background of relatively sluggish growth, employment growth has held up quite well with positive side effects for public finances. Since a substantial part of the rising supply of labor has been coming from abroad, wage pressure is expected to remain subdued. Even if the recent acceleration of housing prices has not been accompanied by any corresponding acceleration of leverage in the private sector, the authorities agree with staff that the situation in the housing market needs close monitoring for a macro-prudential toolkit to be applied if the need arises.

The authorities welcome the staff analysis on the deceleration of productivity. However, this deceleration does not appear to be a specific Austrian feature, but rather a euro area-wide phenomenon. One also needs to be mindful of a whole range of technical statistical factors that may explain the non-convergence to the productivity level of the United States. The difference in the production structure in terms of the distribution between higher and lower value-added sectors – perhaps more so than between higher- and lower-tech sectors – in the economy may be among the main economic factors explaining the said productivity gap. Staff's claim is relatively strong that lower IT penetration in the Austrian economy may be the main reason; some more empirical evidence from staff would be helpful to substantiate this assertion.

Fiscal policy

The Austrian government pursues the goal to achieve a structurally balanced budget by 2016. The government also remains committed to the additional fiscal measures as formulated in a letter to the European Commission of May 12, 2014 in order to avoid a significant deviation from the adjustment path to the Medium-Term Objective as defined by the rules of the European fiscal surveillance mechanism.

The authorities agree with staff's analysis that a large part of the recent increase of the public debt ratio has been due to government support for the financial sector in response to the economic and financial crisis as well as soon also to the ongoing revision of the ESA 2010 rules for national accounting. The authorities further agree with the assessment that the tax burden in general and on labor (including via social security contributions) in particular is very high. Staff's recommendations for reform are useful.

Since the room for maneuver for raising other taxes to finance the tax reform is rather limited in the current context, more focus will indeed have to be put on reviewing the expenditure side. In that respect, the authorities welcome the staff's elaboration on the differences of the Austrian expenditure system from peer countries like Germany, in particular in areas such as health, subsidies and capital transfers as well as pensions. For this latter expenditure item, from an economic point of view, the three main calibration areas are effective retirement age, current and future contributions and current and future benefits; putting the

national public pension system on a sustainable footing may require *all* of these elements to be addressed.

Financial Sector Issues

The relatively good performance of Austria in the global and financial crisis is partly due to the absence of pre-crisis domestic financial imbalances. However, vulnerabilities which stemmed from the international exposure of Austrian banks in Central Eastern and Southeastern Europe (CESEE) materialized in the aftermath of 2008. During the past years, the build-up of capital buffers, progress in bank restructuring and the sound macroeconomic environment in Austria have been important pillars of financial stability in Austria. However, there is no room for complacency.

The Austrian authorities concur with the staff that the loss absorbing capacity of Austrian banks has to be further strengthened through the continuous build-up of additional capital. Although banks have strengthened their capital positions in recent years, they continue to be lower than those of their international peers. Leverage ratios are yet more favorable compared to the peer group, reflecting the banks' focus on a more traditional loan business. A main challenge remains the persistent pressure on banks' profitability in their domestic market. They should thus strive to address structural issues and improve their cost efficiency.

In CESEE, asset quality remains a challenge for the Austrian banks' subsidiaries abroad. A potential increase in geopolitical tensions surrounding Russia and Ukraine could affect asset quality and also profitability. The Austrian authorities thus continuously encourage risk-adequate provisioning and coverage policies to deal with credit quality issues. In this context, the European Central Bank's comprehensive assessment is a useful exercise to further increase the transparency of the banks' balance sheets, to quantify known weaknesses and to support corrective actions to address them.

With respect to concerns that funding pressures on internationally active banks could constrain credit supply to the real sector in the CESEE host economies, the Austrian authorities' assessment is as follows:

- First, the **liquidity position** of Austrian banks is **comfortable** with low dependence on wholesale funding. The **funding mix of the banks' subsidiaries** has **changed** towards more local stable sources of funding as acknowledged by the staff. This shift was guided by a set of macroprudential guidelines ("Sustainability Package" as of 2012). It was a decisive move to encourage banks to further improve their liquidity situation and strengthen their capital base.

- Second, the Austrian authorities are closely monitoring the **international exposure** of Austrian banks, which **has remained broadly stable** during the past years, while the CESEE region has become increasingly heterogeneous. Banks have thus adjusted their regional portfolios and reduced their business in countries which display macroeconomic and/or political vulnerabilities (e.g. Ukraine). Such shifts should be regarded as a standard business procedure in a changing market environment, but warrant caution if they lead to a higher concentration of profits and banks' risk exposure to individual countries.

From a general macroprudential perspective, a gradual reduction in leverage is a welcome development. It helps adapting banks' balance sheets to the post-crisis environment. In contrast, high loan growth at interest rates that do not cover credit, liquidity, and systemic risk costs is not a sustainable policy objective. It leads to the misallocation of capital and risk in the economy, which are both disruptive to financial stability and sustainable economic growth.

The Austrian authorities concur with the report that the completion of bank restructuring and a firm institutional setup is crucial for financial stability. In particular, the implementation of the European Banking Union framework should proceed swiftly, with the establishment of the national resolution agency and the pre-funding of the deposit guarantee scheme.

As regards macroprudential policy in Austria, the responsible authority, the Financial Market Stability Board, has been established. It aims at fostering cooperation among the Austrian authorities and mitigating systemic and cyclical risks. Since the IMF team's visit end of June, the Board's members have been appointed and first meetings are scheduled in autumn 2014.