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IMF Executive Board Concludes 2012 Article IV Consultation with Austria

On August 27, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

Austria's growth performance was strong in 2011, supported by buoyant employment, and the economy has limited slack. For the year as a whole, growth amounted to 2.7 percent, mainly driven by investment. Employment grew strongly, and unemployment reached 4.2 percent in 2011, the lowest rate in the euro area.

At 3.6 percent in 2011, inflation reached its highest level in decades as excise tax increases and a stronger pass-through of commodity price hikes opened a gap to Germany and the rest of the euro area. In the first half of 2012, these effects subsided and the discrepancy narrowed, and inflation stood at 2.2 percent in June. On the other hand, negotiated wage growth has accelerated to above 3 percent, reflecting the backward-looking wage setting mechanism but also, possibly, tight labor market conditions.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

After peaking in 2008 at 5 percent of GDP, the current account has narrowed, reaching 1.9 percent of GDP in 2011. Imports were boosted by high energy prices, while exports as a share of GDP remained below their 2008 record. Consistent with regional rebalancing, the bulk of the decline in the trade balance in 2011 was against the rest of the euro area. The real and nominal exchange rates were broadly stable in 2011. Unit labor cost growth accelerated, but in line with that in Austria's trading partners, while the global export market share continued its trend decline. Outward FDI and cross-border lending gathered steam, but some of Austrian portfolio investment abroad was withdrawn, even as foreigners resumed portfolio investment in Austria. Capital flows into CESEE remain depressed, with only timid signs of improvement, in part related to Austrian banks' support to their subsidiaries.

The fiscal position has improved but public debt is still rising. In 2011, the deficit fell to 2.6 percent of GDP, but this improvement is likely to be partly reversed to some 3 percent of GDP in 2012, on the back of slowing growth and significantly higher support to troubled medium-sized banks. General government gross debt stood at 72 percent of GDP, up from a pre-crisis level of 60 percent of GDP.

Banks' profitability in 2011 suffered from the continued deterioration of loan quality in several CESEE countries and losses on securities portfolios. Faced with external funding pressures in the second half of 2011, Austrian banks increased their reliance on central bank funding and cut their external positions. These cuts focused on markets other than Austria and the CESEE, most notably the euro area periphery – though exposure to Italy remains significant. The return on assets fell sharply during 2011, including because of losses from the Greek PSI. With the recovery in CESEE sluggish, large write-downs on goodwill for past acquisitions and continued provisioning on the growing stock of NPLs were necessary. In addition, Hungary's scheme to help borrowers indebted in foreign currency caused sizable losses for Austrian banks.

Executive Board Assessment

Executive Directors commended the authorities for their strong economic performance and noted that wage growth and low unemployment continue to support domestic demand, contributing to a welcome rebalancing in growth. As a weaker external environment is now taking a toll on economic activity, Directors concurred that a further intensification of the euro area crisis represents the main risk to the economy. In this context, they agreed that policies should be focused on preserving market confidence, increasing resilience against adverse external spillovers, and boosting long-term growth.

Directors welcomed the adoption of a strong medium-term consolidation strategy, which strikes an appropriate balance between fiscal prudence and growth considerations. They agreed on the need to clearly identify measures that underlie the envisaged structural adjustment, and recommended that the authorities prepare contingency plans in case further support is needed for nationalized or partly nationalized medium-sized banks. In addition, noting the long implementation lags of related reforms, Directors encouraged additional steps to contain aging costs.

Directors welcomed the introduction of fiscal rules, which further strengthen the policy framework. They noted, however, that a comprehensive reform of fiscal federalism is needed to streamline intra-governmental financial arrangements and provide stronger incentives for rule compliance to sub-national governments.

Directors noted that the legacy of an overly ambitious eastward expansion continues to weigh on the banking sector. They welcomed the recent supervisory initiatives leading to an increase in the capital buffer of large banks and looked forward to the prompt definition of a strategy for a more efficient disposal of legacy assets in government-supported medium-sized banks. Directors welcomed the authorities' plans to strengthen early intervention and resolution tools in the banking system in line with international best practices.

Directors saw the new macroprudential guidelines as useful tools to improve financial stability. A capital surcharge, recovery and resolution plans, and greater reliance on local stable funding by foreign subsidiaries should bring about a more solid business model for large and internationally active Austrian banks. Directors also welcomed plans to monitor compliance with the guidelines in close cooperation with host supervisors.

Directors commended the authorities for the steps taken to foster labor market participation by older workers and looked forward to a rapid implementation of these measures. In addition, they encouraged the authorities to explore further reforms to strengthen work incentives, including the equalization of male and female retirement ages and the reduction of the tax burden on labor. Fiscal revenue losses from the latter reforms could be compensated by increasing less distortionary taxes.

Austria: Selected Economic Indicators, 2008–13

Total area	83,850 square kilometers						
Total population (2011)	8.4 million						
GDP per capita (2011)	US$ 49,818 (35,868 Euro)						
	2007	2008	2009	2010	2011	2012	2013
						Projections	
	(change in percent unless indicated otherwise)						
Demand and supply							
GDP	3.7	1.4	-3.8	2.1	2.7	0.8	1.8
Total domestic demand	2.5	0.7	-2.0	1.8	2.5	0.9	1.9
Consumption	1.2	1.6	0.9	1.3	0.5	0.8	1.2
Gross fixed capital formation	3.6	0.7	-7.8	0.8	7.3	1.5	3.2
Net exports (growth contribution in pp)	1.4	0.8	-2.3	0.4	0.4	0.0	0.1
Exports of goods and nonfactor services	8.9	1.4	-15.6	8.7	7.2	2.0	4.0
Imports of goods and nonfactor services	7.1	0.0	-13.3	8.8	7.2	2.1	4.3
Output gap (percent of potential GDP)	3.7	3.3	-2.3	-2.0	-0.8	-1.5	-1.2
Employment and unemployment							
Employment	1.9	1.3	-1.5	0.6	1.8	0.6	0.6
Unemployment rate (in percent)							
Registered (national definition)	6.2	5.8	7.2	6.9	6.7	6.8	6.8
Standardized (Eurostat)	4.4	3.8	4.8	4.4	4.2	4.3	4.3
Prices							
Consumer price index (period average)	2.2	3.2	0.4	1.7	3.6	2.3	1.9
General government finances (percent of GDP)							
Revenue	47.6	48.3	48.5	48.1	48.0	48.6	48.7
Expenditure	48.6	49.3	52.6	52.6	50.6	51.6	50.5
Balance (EDP-definition)	-0.9	-0.9	-4.1	-4.5	-2.6	-3.0	-1.8
Structural Balance	-2.6	-2.4	-3.0	-3.0	-2.0	-1.6	-1.3
Gross debt (end of period)	60.2	63.8	69.2	71.8	72.3	74.6	74.3
Balance of payments							
Trade balance (goods) (in billion euro)	1.3	-0.6	-2.4	-3.2	-7.0	-8.1	-8.5
Current account (in billion euro)	9.6	13.8	7.5	8.6	5.9	5.2	5.3
(In percent of GDP)	3.5	4.9	2.7	3.0	1.9	1.7	1.7

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