Statement by Johann Prader, Alternate Executive Director for Austria
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The Austrian authorities appreciate the Article IV consultation discussions with the Fund staff and commend them for the high quality of the Staff Report. They broadly agree with the staff's assessment of Austria's economic situation and the recommendations on economic and financial policies.

The Staff Report, once again, highlights Austria's historically good economic performance relative to its European peers due to its solid economic policies, structural reforms and wage moderation. They also note the issues raised regarding the Austrian financial system and its engagement in CESE.

Short-term outlook

Towards the end of 2008, the Austrian economy entered a recession, albeit with a lag as compared to its neighbouring countries. In 2009, unemployment has been rising and employment declining, especially in the export sector, which is suffering because of the global economic crisis. So far, the knock-on effects on domestic demand have been muted because of the substantial stimulus measures implemented by the authorities. Since mid-2009, inflation has entered negative territory, but there is no danger of deflation. Given the economy's export orientation and international developments, Austria's economic outlook at present seems unusually uncertain.

Like other developed economies, Austria too has been hit by the global financial crisis. However, in contrast with some other countries, the Austrian economy entered the downturn from a position of strength. The current account balance recorded a significant surplus and the savings ratio of private households is high and has risen in the last several years. Household and corporate balance sheets are relatively healthy as compared to the average of other euro area countries. No overinvestment – as in the run up to the last downturn in 2001 – has been observed and the housing market is stable.

Some imbalances built up only in the stock market, which has witnessed a pronounced boom-bust cycle. Fortunately, wealth effects on consumption have been rather limited in Austria. A risk specific to the Austrian economy is its high exposure to Eastern Europe due to its close trade and financial links. However, after signs of stabilization appeared in Eastern Europe, risks of stronger negative spillovers (at least) via the trade channel declined in the recent months.

In the past few weeks, there have been several green shoots of stabilization in the global economy and a possible - albeit weak - recovery is expected in the second half of the year.

Moreover, what is important for Austria is that the German economy is also showing signs of stabilization.

Although Austrian GDP declined in the second quarter (-0.4 percent), the decline was less than expected. Latest business indicators surprised on the upside. The stress in financial markets is beginning to unwind (CDS spreads dropped from 260 basis points in mid-February to 80 in mid-August and the Austrian stock exchange has gained almost 50 percent since January 2009). And, more recently, even some hard indicators have begun to underpin the – still very weak – recovery. Industrial production rose by 0.6 percent in June (seasonally adjusted, month-on-month). The export indicator – based on road freight data until July – signals that goods exports have started to rebound on a month-to-month basis from May 2009 onwards. Moreover, the situation in the labor market did not deteriorate further. The rise in the number of unemployed seems to have stabilized since February. Subsidized short-term work schemes and active labor-market policies proved to be very effective in helping to normalize the situation in the labor market.

Nevertheless, the evidence from macro indicators is still mixed. Most available indicators have improved but still remain well below historical averages. An internal update of the central bank's economic indicators points towards GDP growth of around ¼ percent both in the third and the fourth quarter of 2009. Thus, we now expect a GDP growth rate for 2009 in the range of -3.5 percent to -3.8 percent. This is slightly more optimistic than the latest central bank forecast of June (-4.2 percent) and the IMF forecast (-4.0 percent).

Given the outcome for the second quarter of 2009 and the brighter prospects for the second half of the year, we are now also more optimistic for 2010 and the coming years.
Overall, a U-shaped recovery is still the most likely scenario. The risks of a double-dip recession seem to be limited and are mainly related to two factors: First, a worsening of the external environment possibly triggered by the phasing out of temporary fiscal stimulus. Second, a lagged and stronger than currently expected impact of the labor market slack with negative consequences for private consumption. Moreover, spending by private households could lose momentum in 2010 as the strong stimulus of tax cuts and substantial wage increases in 2009 will peter out.

Fiscal policy

At 0.4 percent of GDP, the general government deficit for 2008 was somewhat lower than expected. The 2009 budget reflects the biggest stimulus package ever and the automatic stabilizers are set to work fully. We take note of the staff's assessment of a low efficiency of some of the measures in terms of short-term stimulus to growth. Apart from standard Keynesian demand effects, other elements such as ensuring trust in the implementation of the government's economic program should also be taken into account. As Austria has a very comprehensive and generous welfare state, adding transfers in a country with a high tax burden would also have been problematic. The staff rightly notes that considerable amounts will also be spent on infrastructure. However, due to the specific Austrian institutional set-up these are not recorded as public investment. But, it should be noted that so far the construction sector in Austria has not been affected severely by the crisis. Therefore, additional demand might foster a misallocation of resources.

In the medium-term, the Austrian authorities agree that returning to fiscal stability is key for the country. As the 2010 budget includes a further fiscal stimulus of around ½ percent of GDP, fiscal consolidation is not on the immediate agenda but will be addressed as soon as the recovery begins to take hold. It is planned that the fiscal deficit will return to below 3 percent in 2012.

Financial sector

In spring 2008, as a result of the international focus on the CESE region, the spotlight quickly turned to the exposure of Austrian banks in Eastern Europe. The CDS spreads of Austrian banks mirrored the evolution of Eastern European sovereign CDS spreads and rose significantly.

The lack of a housing boom-bust cycle in Austria, the solid deposit base of Austrian banks and the EU-focus of their CESE exposure, as well as the comparatively large size of the Austrian stabilization package helped the Austrian financial sector to cope with the volatility of financial markets in the last couple of quarters.

As of today, it is noteworthy that even in the most difficult markets, Austrian banks have lived up to their commitment as long-term investors in CESE. They were among the most active banks in the European Bank Coordination Initiative and have repeatedly reaffirmed their willingness to maintain their exposure and provide capital.

Notwithstanding the recent calming of international financial markets, the Austrian authorities continue to be mindful of the region's vulnerabilities. FX lending certainly remains one of the top priorities on the authorities' list of concerns.

Against the background of continuing uncertainty about the future evolution of the real economy and its feedback into the banking system, the authorities also take note of the importance of maintaining adequate capitalization levels. They agree with the need to monitor closely both the path of non-performing loans in Austria and CESE, as well as their impact on capital ratios of banks. In this respect, regular stress tests will be conducted to benchmark reality against the stress tests' scenarios and obtain early warning signals for effective contingency planning. The markets reacted positively to the stress tests which were discussed with the Fund staff and published by the authorities at the beginning of July.