



OESTERREICHISCHE NATIONALBANK

Stability and Security.

ANNUAL REPORT 2004

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REPORT
ON THE FINANCIAL YEAR 2004
WITH FINANCIAL STATEMENTS
FOR THE YEAR 2004

Submitted to the General Meeting on May 24, 2005



Six years after the beginning of Stage Three of Economic and Monetary Union (EMU), the Eurosystem may look back on the successful introduction of the common currency. Continuing European integration and EU enlargement pose new challenges, which will also require adjustments within the European System of Central Banks (ESCB).

Historically low interest rates and the ongoing strong appreciation of the euro against the U.S. dollar have created a difficult operational environment for Eurosystem central banks. Despite these demanding conditions, the Oesterreichische Nationalbank (OeNB) managed to achieve profits close to the long-term average in 2004. This is particularly remarkable given the significant revenue shortfalls of other national central banks (NCBs). The record profits following the establishment of the monetary union as well as the high risk provisions of recent years, however, have put a cap on future profit potential. In this context it is important to call to mind the NCBs' obligation within the ESCB to hold sufficient reserves to fulfill their tasks and to make risk provisions. Compliance with this obligation is a prerequisite for Eurosystem credibility.

In addition to fulfilling a wide range of responsibilities in the field of monetary policy implementation, the OeNB also contributed significantly to the ESCB's activities in 2004. Special emphasis was placed on the communication of monetary policy objectives, the promotion of financial stability and the preparations for a Single Euro Payments Area (SEPA). Once more, the OeNB's subsidiaries were key for the efficient provision of means of payment which meet the highest security requirements.

Looking at the challenges that lie ahead, cooperation with Central and Southeastern European countries will take on an important role in the future, and the OeNB's expertise in this area will prove very valuable for the Eurosystem.

Efficient performance is crucial for longer-term corporate success, in particular for a small NCB. Thus, it is of great importance for the OeNB to continue optimizing its business processes, to make effective use of synergies and to promote cooperation. The high degree of trust the OeNB enjoys as a monetary institution is an acknowledgement of its performance and a mandate for the future.

Herbert Schimetschek
President

In 2004 the global economy expanded by more than 4% in real terms. The euro area also saw an economic recovery, recording a growth rate of 1.8% (seasonally and working-day adjusted), which was well above the levels of previous years. However, from the spring of 2004 the global upturn lost momentum, mainly because of a surge in oil and commodity prices, a slowdown in export activity and monetary policy tightening in several countries induced by inflationary pressures.

As in the previous year, inflation in the euro area as measured by the Harmonised Index of Consumer Prices (HICP) stood at 2.1% in 2004, driven largely by energy prices. In view of a favorable medium-term outlook for price developments, however, the Governing Council of the ECB decided to leave key interest rates unchanged at their historically low level. Inflation expectations in 2004 were stable and in line with the Governing Council's medium-term HICP inflation target for the euro area of below, but close to, 2%. The Eurosystem's monetary policy continued to enjoy a high degree of credibility.

By contrast, the credibility of the sustainability and soundness of fiscal policy in the euro area was put to the test in 2004. Half of the euro area countries recorded deficit ratios of around or above 3%, and debt ratios exceeded 60% in eight countries. In March 2005 the reform of the Stability and Growth Pact led to changes in, and a weakening of, EMU's fiscal policy framework, the consequences of which are not yet foreseeable. Greater scope for discretionary decision-making entails an even higher degree of responsibility for policymakers in safeguarding the sustainability and long-term growth orientation of fiscal policy. The Governing Council of the ECB is firmly convinced that sound public finances are indispensable for sustainable economic development in the euro area.

2004 was also marked by the mid-term review of the Lisbon strategy, which revealed that – while some progress has been made with regard to employment, the network industries and the financial services sector – European research, innovation and education systems still require reform. Member States should swiftly implement further reforms at the national level within the framework of national growth strategies or action plans.

Economic policymaking in Austria was characterized by further reforms in 2004: The reform of the Austrian pension system will render pension schemes more sustainable and will contribute to safeguarding their long-term financing. The corporate tax and income tax

reforms will strengthen both Austria's position as a business location and real disposable income. The IMF and the OECD have acknowledged these reform efforts. The reform process needs to be continued to guarantee Austria's competitiveness and prosperity.

Austria's economy gathered considerable steam in the first half of 2004, mainly driven by booming external trade. At 2%, economic growth in 2004 clearly exceeded the levels of the previous two years and was also slightly higher than the euro area average. While the deceleration of economic growth in the euro area toward the end of 2004 also affected Austria, investment remained lively. At 2%, Austria's inflation rate stood slightly below the euro area average in the reporting year.

Austria's deficit ratio according to the Maastricht definition came to 1.3% of GDP in 2004, which was less than half of the euro area average. The government's 2005 tax reform is going to raise the deficit ratio to 1.9%. Under its stability program, Austria is to achieve a balanced budget and a debt ratio of below 60% of GDP by 2008. The OeNB welcomes the plans to reduce the tax-to-GDP ratio to around 40% as early as in 2006; at the same time, however, the reduction of the government spending ratio should be speeded up.

The accession of ten new Member States to the European Union on May 1 was a landmark achievement in 2004. EU enlargement fosters Austria's economic potential, as Austrian businesses have already been actively expanding into, and cooperating with, Austria's neighboring countries in Eastern Europe. Enlargement has validated the OeNB's decision to put a special focus on Eastern European issues, which was taken many years ago.

The IMF's Financial Sector Assessment Program confirmed the high resilience of the Austrian financial system to shocks and the excellent cooperation between the OeNB and the Austrian Financial Market Authority (FMA).

The OeNB has redesigned its website (www.oenb.at) and relaunched several of its macroeconomic and statistical publications, namely *Monetary Policy & the Economy*, the *Workshop* series, *Focus on European Economic Integration* as well as its exclusively German publication *Statistiken – Daten & Analysen* to further improve the quality, scope and accessibility of the analyses and data it provides in the service of economic policy and the Austrian public.

Klaus Liebscher
Governor



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**REPORT OF THE GENERAL COUNCIL (GENERALRAT)
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Editorial close: April 14, 2005.





General Council (Generalrat),
State Commissioner,
Governing Board (Direktorium)
and Personnel Changes,
Organizational Structure of the Bank

General Council (Generalrat), State Commissioner

on December 31, 2004

Herbert Schimetschek

President
Chairman of the Board
of Austria Versicherungsverein
auf Gegenseitigkeit

Manfred Frey

Vice President
retired President of the regional
finance authority of Vienna,
Lower Austria and Burgenland

August Astl

Secretary General of the Board of Presidents
of the Austrian Chamber of Agriculture

Christian Domany

Member of the Management Board
of Flughafen Wien AG

Bernhard Felderer

Director
of the Institute for Advanced Studies (IHS)

Philip Göth

Certified public accountant/tax consultant
Partner of Deloitte Austria

Elisabeth Gürtler-Mauthner

Managing Director
of Sacher Hotels Betriebsges.m.b.H.
and Vice President
of the Österreichische Hoteliersvereinigung

Herbert Kofler

Independent accountant/tax consultant
Head of the Section
Financial Accounting and the Tax System
of the University of Klagenfurt

Georg Kovarik

Head of the Economics Division
of the Austrian Trade Union Federation

Johann Marihart

Chief Executive Director
of Agrana Beteiligungs-AG

Werner Muhm

Chief of the Chamber
of Labor of Vienna

Gerhard Randa

Chairman of the Supervision Board
of Bank Austria Creditanstalt AG
and Member of the Board of
Managing Directors of Bayerische
Hypo- und Vereinsbank AG

Walter Rothensteiner

Chief Executive Director
of Raiffeisen Zentralbank Österreich AG

Johann Zwettler

Chief Executive Director
of Bank für Arbeit und Wirtschaft AG

Representatives delegated by the Staff Council to attend proceedings
that deal with personnel matters pursuant to Article 22 paragraph 5 of the
Oesterreichische Nationalbank Act:

Thomas Reindl

Staff Council Chair

Martina Gerharter

Staff Council Deputy Chair

State Commissioner

Thomas Wieser

Director General at the Austrian Federal
Ministry of Finance

Deputy State Commissioner

Heinz Handler

Austrian Institute
of Economic Research (WIFO)

Governing Board (Direktorium)

on December 31, 2004



Klaus Liebscher
Governor

Wolfgang Duchatzek
Vice Governor

Peter Zöllner
Executive Director

Josef Christl
Executive Director

Personnel Changes

between April 19, 2004, and April 14, 2005

The ordinary General Meeting of May 13, 2004, marked the end of the term of office of General Council member R. Engelbert *Wenckheim*. Christian *Domany*, then Secretary-General of the Austrian Federal Economic Chamber and since October 1, 2004, Member of the Management Board of Flughafen Wien AG, was appointed as his successor.

At its session of July 6, 2004, the federal government decided to appoint Philip *Göth*, certified public accountant, tax consultant and partner of Deloitte Austria, and to reappoint Johann *Marihart* as members of the General Council, both with effect from August 1, 2004. The term of office of General Council member Karl Werner *Rüsch* ended on July 31, 2004.

Richard *Leutner* and Lorenz *Fritz* resigned from their seats in the General Council with effect from July 1, 2004, and August 13, 2004, respectively. Georg *Kovarik*, Head of the Austrian Trade Union Federation's Economics Division, and Elisabeth *Gürtler-Mauthner*, Managing Director of Sacher Hotels Betriebsges.m.b.H. and Vice President of the Österreichische Hoteliersvereinigung, were appointed as their successors at the extraordinary General Meeting of September 9, 2004.

ORGANIZATION CHART

President
Herbert Schimetschek

Office of the General Council
Richard Mader, Head

Vice President
Manfred Frey

Governing Board (Direktorium)

Central Bank Policy Department
Klaus Liebscher, Governor

Office of the Governor
Wolfgang Ippisch, Head

Internal Audit Division
Wolfgang Winter, Head

Secretariat of the Governing Board and Public Relations
Günther Thonabauer, Head

Planning and Controlling Division
Gerhard Hohäuser, Head

Anniversary Fund
Wolfgang Höritsch, Head

Personnel Division
Axel Aspetsberger, Head

Unit

Future Unit
Peter Achleitner, Director

Money, Payment Systems, Accounting
and IT Department
Wolfgang Duchatzcek, Vice Governor

Legal Division
Hubert Mölzer, Head

Section

Payment Systems and Information Technology
Wolfgang Pernkopf, Director

Information Technology and Payment Systems Strategy Division
Walter Hoffenberg, Head

IT Development Division
Reinhard Auer, Head

IT Operations Division
Erich Schütz, Head

Payment Systems Division
Andreas Dostal, Head

Section

Cashier's Division and Branch Offices
Stefan Augustin, Director

Printing Office
Gerhard Habitzl, Technical Manager

Cashier's Division
Gerhard Schulz, Head

Northern Austria Branch Office
Josef Kienbauer, Branch Manager

Southern Austria Branch Office
Friedrich Fasching, Branch Manager

Western Austria Branch Office
Armin Schneider, Branch Manager

Section

Accounting
Michael Wolf, Director

Financial Statements Division
Friedrich Karrer, Head

Accounts Division
Herbert Domes, Head

Economics and Financial Markets Department
Josef Christl, Executive Director

Section

Economic Analysis and Research
Peter Mooslechner, Director

Economic Analysis Division
Ernest Gnan, Head

Economic Studies Division
Eduard Hochreiter, Head

European Affairs and International Financial Organizations Division
Franz Nauschnigg, Head

Foreign Research Division
Doris Ritzberger-Grünwald, Head

Brussels Representative Office
Marlies Stubits, Chief Representative

Paris Representative Office
Andreas Breitenfellner, Chief Representative

Section

Financial Institutions and Markets
Andreas Ittner, Director

Financial Markets Analysis and Surveillance Division
Michael Würz, Head

Banking Analysis and Inspections Division
Helmut Ettl, Head

Credit Division
Franz Richter, Head

Investment Policy, Internal Services and Statistics Department
Peter Zöllner, Executive Director

Equity Interest Management Division
Franz Partsch, Head

Section

Treasury
Rudolf Trink, Director

Treasury – Strategy Division
Walter Sevcik, Head

Treasury – Front Office
Rudolf Kreuz, Head

Treasury – Back Office
Gerhard Bertagnoli, Head

London Representative Office
Doris Kutalek, Chief Representative

New York Representative Office
Gerald Fiala, Chief Representative

Section

Organization and Internal Services
Albert Slavik, Director

Organization Division¹
Wolfgang Ruland, Head

Administration Division
Roland Kontrus, Head

Security Division
Gerhard Valenta, Head

Documentation Management and Communications Services
Alfred Tomek, Head

Section

Statistics
Aurel Schubert, Director

Banking Statistics and Minimum Reserve Division
Gerhard Kaltenbeck, Head

Balance of Payments Division
Eva-Maria Nesvadba, Head

¹ Environmental Officer Johann Jachs.

As of April 14, 2005.





Report of the
Governing Board (Direktorium)
on the Financial Year 2004

The Eurosystem Secures Price Stability

Euro Area Key Interest Rates Unchanged in 2004

Following two years of subdued growth (2002: 0.9%; 2003: 0.5%), euro area GDP expanded by 2.1% in 2004. The growth momentum that gained a foothold in the second half of 2003 was maintained at the beginning of 2004 but subsequently dampened by surging oil prices in the second half. Investment remained moderate throughout 2004. Despite low interest rates and a pickup in profitability, investment in plant and equipment merely edged up. Construction investment, in fact, even diminished marginally. While consumer spending picked up somewhat toward the end of the year, it provided hardly any impulses. The revival in world trade lifted Austria's current account surplus slightly compared with 2003, bringing it to 0.5% of GDP. The upturn hardly had a perceptible impact on the labor market yet in 2004: Employment rose by 0.5% and unemployment persisted at 8.9% in 2004.

Euro area inflationary pressure remained subdued even though demand recovered in the first half of 2004, above all because wage in-

creases were modest and the impact of the appreciation of the euro was delayed. From May 2004, the rate of inflation as measured by the HICP topped 2%, which may be traced to the hike in indirect taxes and administered prices as well as the gain in oil prices. In the second quarter of 2004, the *energy* component accounted for as much as 20% of the price growth. Yet in its judgment of the medium-term risks to price stability, the Governing Council of the ECB assessed inflationary pressures to remain limited, above all because the labor market was weak and wage adjustments would thus remain moderate. The inflation projections of the Eurosystem of June 2004 put inflation at between 1.9% and 2.3% for 2004 and at 1.1% to 2.3% for 2005.

These developments brought inflation to an average of 2.1% in 2004, the same level as in 2003. Against this background of only slight price pressures and a positive medium-term outlook for prices, the Governing Council left the key Eurosystem interest rates unchanged at a historically low level. Throughout 2004, the minimum bid rate for main refinancing operations (MROs) thus

Strong euro and oil price surge dampen economic recovery in the euro area

Inflationary pressure moderate – key interest rates unaltered

Euro Area Interest Rates



Source: ECB.

stood at 2.0%, the interest rate for the deposit facility at 1.0%, and the interest rate for the marginal lending

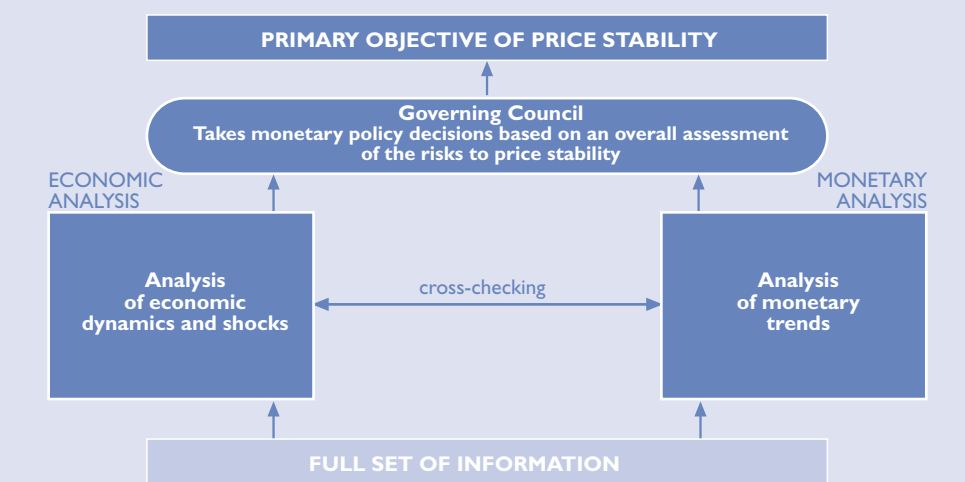
facility at 3.0%. These interest rates have in fact remained unaltered since June 2003.

Box 1

The Monetary Policy Strategy of the Eurosystem: An Overview

The primary goal of the Eurosystem's monetary policy is to maintain price stability. Monetary policy decisions are thus taken with inflationary expectations in mind, as guided by the underlying monetary policy strategy. This strategy provides a framework that structures all information relevant to monetary policymaking and thus assists the Governing Council of the ECB in taking interest rate decisions and clearly communicating them to the general public.

The Stability-Oriented Monetary Policy Strategy of the Eurosystem



Source: ECB, 2004. *The Monetary Policy of the ECB*, 66.

To this end, the monetary policy strategy of the Eurosystem consists of three elements. The key element is a quantitative definition of price stability, which aims at inflation rates of below, but close to, 2% over the medium term. This measure is complemented by a framework for assessing the risks to price stability that consists of two pillars. The first pillar, economic analysis, contains those indicators which provide information about the factors determining price developments over the short to medium term. The second pillar, monetary analysis, draws on monetary indicators; these serve as a means of cross-checking, from a medium- to long-term perspective, the short- to medium-term indications from the economic analysis.

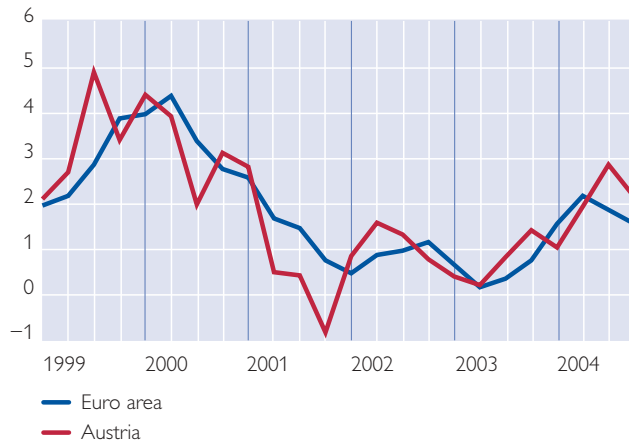
Economy recovers gradually in the first half of 2004

At the beginning of 2004, data corroborated the progressive revival of business activity in the euro area, and leading indicators confirmed the staying power of the rebound. In the first quarter of 2004, real GDP expanded by 0.7% against the preceding quarter, with exports benefiting most from robust global growth. Fairly powerful consumer spending advances (+0.7% against the previous quarter) registered as a favorable surprise and also signaled a continuation of the recovery. In the sec-

ond quarter, however, oil prices burgeoned to just under USD 40 per barrel (Brent), posing a risk to prospects for the expansion. For the time being, though, the positive effect of rapid global economic growth appeared to prevail. Forecasters expected the upswing to accelerate in the second half and revised estimates upward. The Eurosystem's projections of June 2004 pegged real GDP growth at between 1.4% and 2.0% in 2004, with an increase to 1.7% to 2.7% in 2005.

**Economic Growth
in the Euro Area and in Austria**

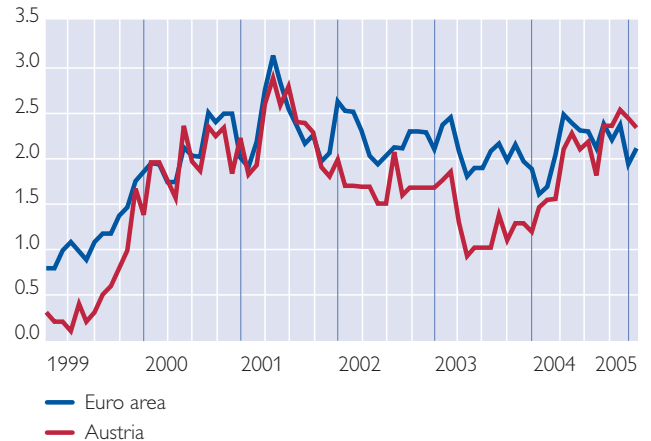
Annual change in real GDP in %



Source: WIFO, Eurostat.

**HICP-Inflation
in the Euro Area and in Austria**

Annual change in the HICP in %



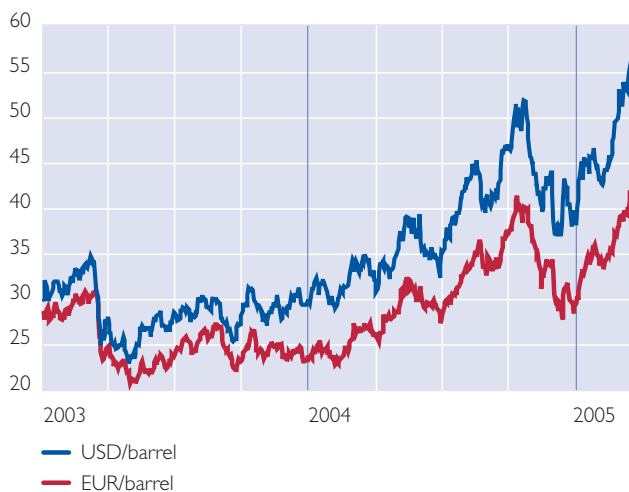
Source: Eurostat.

In the second half of the review year, three key factors influenced cyclical developments: World economic growth lost some speed, oil prices surged further to top USD 50 per barrel (Brent) in the summer of 2004, and the euro continued to appreciate, especially in the fourth quarter. Available indicators increasingly confirmed that oil price developments were dampening growth in the euro area and beyond. As a result,

euro area quarter-on-quarter growth contracted to just 0.3% in the third and 0.2% in the fourth quarter. In view of these developments, forecasters revised their outlooks for growth downward; the Eurosystem's economic projections of December 2004 pegged the expansion of real GDP at 1.4% to 2.4% in 2005 and 1.7% to 2.7% in 2006. The experts underlined the downside risks of oil prices for economic activity.

Upswing slows noticeably in the second half of 2004

Crude Oil Price Developments (Brent)



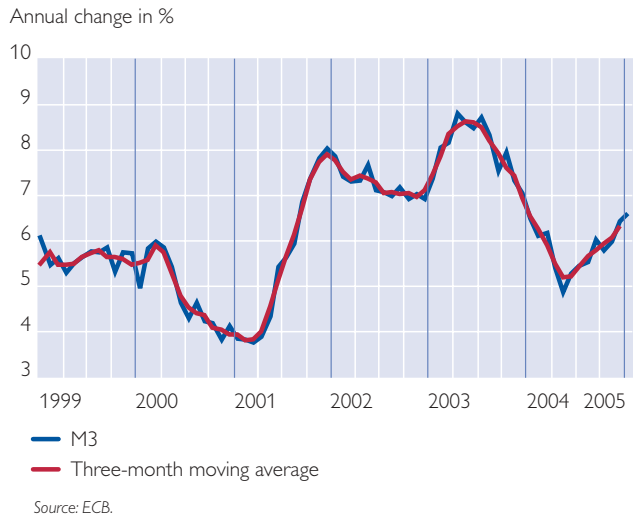
Source: Thomson Financial.

U.S. Dollar/Euro Exchange Rate

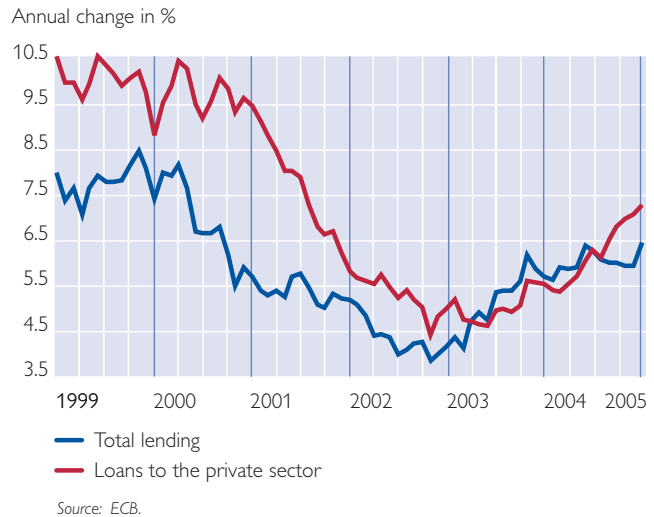


Source: Thomson Financial.

M3 Growth in the Euro Area



Euro Area Credit Growth



**Oil prices
fuel inflation**

In the second half of 2004, inflation came in at over 2% every month. The contribution of the component *energy* to inflation widened from 0.5 percentage point at mid-year to 0.8 percentage point in October 2004. However, no price pressures emanated from developments within the euro area itself, as wage increases were still moderate and as the oil price rise had not produced second-round effects; moreover, given dampened growth, this pattern was expected to persist. Against this background, the Eurosystem's inflation projections of December 2004 put

**M3 growth sags
at the beginning
of 2004, quickens
from mid-2004**

inflation at between 1.5% and 2.5% for 2005 and at 1.0% to 2.2% for 2006.

The expansion of M3 slowed from 6.5% at the beginning of 2004 to 4.9% in May 2004, reflecting above all the normalization of investors' marked preference for liquid assets as a result of their cautiousness from 2001 through 2003. Economic agents regained market confidence and began to reinvest in longer-term and riskier assets. On the back of low interest rates, M3 growth reaccelerated from 5.3% in June 2004 to 6.4% in December 2004. The low interest rate level also boosted credit demand, in particular for mortgage loans, which is indicative of the real estate price boom in some euro area countries. In view of these developments, the Governing Council of the ECB cautioned that the stock of excess liquidity and strong credit growth represented not only a risk to price stability, but could also entail an excessive rise in asset prices.



The Links between the Balance of Payments and

Monetary Developments in the Euro Area

The Role of the Balance of Payments

The theoretical literature widely recognizes that cross-border transactions have an impact on the monetary dynamics of a currency area. Classical economic theory provides insights into the link between monetary developments and the balance of payments; at the same time, this connection is also a fundamental proposition of international macroeconomics. Against the background of globally linked financial and capital markets, model-based analyses provide topical evidence for monetary policymaking. For the euro area, research undertaken by the ECB implies that the dynamics of the broad monetary aggregate M3 since 2001 have been associated in large part with transactions involving nonresidents. Thus, the observation of cross-border capital flows has become an important element in euro area monetary analysis.

Conceptual Framework and Statistics

For the euro area institutional analysis, the ECB compiles a monetary presentation of the euro area balance of payments in close cooperation with the NCBs of the ESCB. The OeNB has presented the new conceptual framework to the interested public and has explained the statistical and analytical principles on which it is based.¹ Because of their principle of balance sheet identity and because balance of payments statistics are harmonized with monetary statistics (the consolidated MFI balance sheet) it is possible to use balance of payments data to derive structural information about the development of the external counterpart of M3 (the MFIs' net external assets). The monetary presentation of the euro area balance of payments shows net capital flows between the resident money-holding (non-MFI) sector and the rest of the world.

Changes in International Capital Flows – From Net Inflows to Net Outflows

During a first phase after the introduction of the euro, from 1999 to mid-2001, the euro area recorded substantial net capital exports, which exerted a restrictive effect on monetary growth. In this period companies in the euro area were diversifying abroad under the impact of globalization, and euro area investors had a preference for investment in equities in the rest of the world, among other things for reasons of diversification. Nonbanks borrowed cheap in the euro area and invested these funds abroad, especially in the U.S.A., at higher yields. During the second phase, from 2001 to 2003, net capital flows switched and capital was repatriated to Europe in the wake of the bursting of the technology bubble and crumbling stock prices as well as the market repercussions of the 9/11 terrorist attacks, which sent investors on a search for safe havens. Hence, external transactions contributed to the acceleration of M3 growth observed in the euro area during this period.

Developments in 2004

In 2004, the expansionary impact of transactions with euro area nonresidents on M3 growth increased further. Higher net capital imports to the euro area are the result both of real transactions with the rest of the world, in particular lower net income outflows, and of financial transactions, i.e. investment on international capital markets and external lending and deposits of the money-holding (nonbank) sector. For example, euro area investors placed fewer funds in foreign equities and mutual fund shares whereas foreign investment in euro area securities rose. Cross-border investment in bonds developed along the same lines. Conversely, investment in money markets produced net capital outflows, and net exports in direct investment expanded, causing the euro area to be harder hit by the persistent reduction in foreign direct investment than the rest of the world.

¹ See: OeNB. 2003. *Understanding the Impact of External Trade and International Capital Flows on Euro Area Monetary Growth and Austria's Contribution from 1999 to 2002: The Monetary Presentation of the Balance of Payments*. In: *Focus on Austria 3/2003*. OeNB. 76–94.

Monetary policy
framework adjusted

To ensure the smooth implementation of monetary policy operations, the Governing Council of the ECB introduced two changes to the monetary policy framework in March 2004. In a first step, the timing of the reserve maintenance periods was adjusted to start on the settlement day of the main refinancing operation (MRO) following the first Governing Council meeting of a given month. This aligned the reserve maintenance period with the cycle for interest rate decision making, ensuring that changes in key interest rates always take effect at the beginning of a minimum reserve period. This measure eliminated expectations of changes in key interest rates within a minimum reserve period and their destabilizing impact on counterparties' bidding behavior in the MRO.

In a second step, the maturity of the MROs was shortened from two weeks to one week. Thus, MROs settled in one reserve period no longer extend into the subsequent reserve maintenance period. The implementation of both changes was smooth. Halving the MRO maturity to one week led to a doubling in the size of each MRO.

Austria – Export-Led Recovery

Powerful export demand buoyed economic activity in Austria in the first half of 2004. Despite dampening effects induced by the appreciation of the euro, Austrian exporters succeeded in boosting deliveries abroad significantly. Domestic demand, by contrast, was sluggish. With disposable income making little headway and energy prices high, consumer spending did not take off. In the first half of 2004, investment did not pick up speed either, but the pronounced improvement of capacity utilization and the results of the Investment Survey conducted by WIFO, the Austrian Institute of Economic Research, signaled a growing propensity to invest toward the end of the year. Moreover, the expiration of the special investment tax credit at the end of 2004 may have prompted investors to frontload investment. Investment became noticeably more animated in the second half of 2004. GDP growth surged from 0.8% in 2003 to 2.0% in 2004.

Real Gross Domestic Product and Its Components in Austria

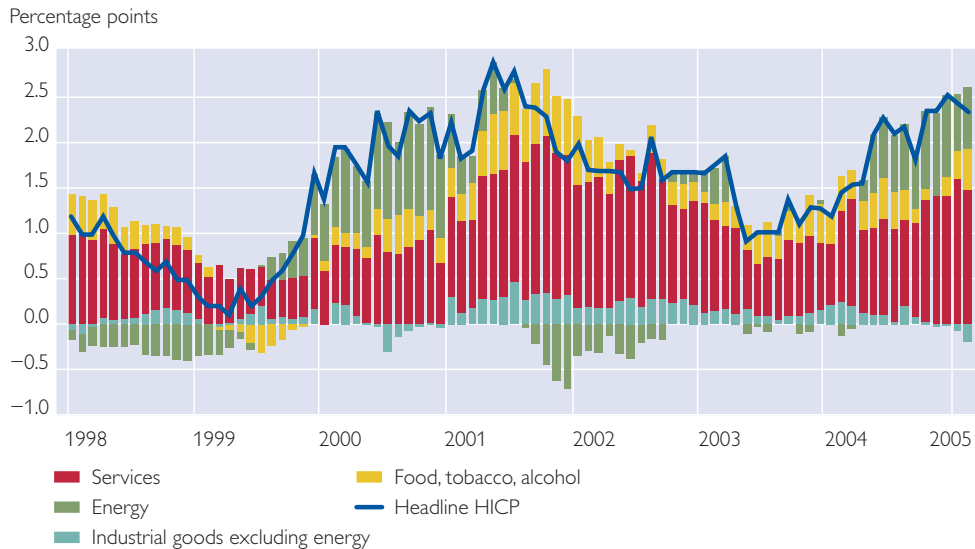
(seasonally adjusted)

Chained volume measures (reference year = 2000)

	2002	2003	2004	Q1 04	Q2 04	Q3 04	Q4 04
	Annual change in %			Quarterly change in %			
Real GDP	1.2	0.8	2.0	0.6	0.8	0.8	0.3
Contributions to GDP growth	Percentage points						
Private consumption	0.0	0.4	0.8	0.2	0.2	0.1	0.2
Government consumption	0.2	0.1	0.2	0.0	0.1	0.1	0.0
Gross capital formation	-0.8	0.9	0.8	0.0	0.3	0.6	0.4
Net exports	1.5	-1.0	1.8	0.8	1.1	0.3	-0.8
Statistical discrepancy	0.3	0.4	-1.6	-0.5	-0.9	-0.3	0.5

Source: WIFO, OeNB.

HICP for Austria: Inflation Rate and Contributions to Inflation



Inflation rose in Austria in the course of 2004. HICP inflation ran to 2.0%; core inflation – defined as inflation exclusive of the components *energy* and *unprocessed food* – stood at 1.6%. Therefore, the annual average HICP for Austria in 2004 was within the definition of price stability formulated by the Governing Council of the ECB. The rise in the rate of price increase stems largely from the contribution of two categories: *energy* (+6.9%) and *housing, water, electricity, gas and other fuels* (+4.2%). By contrast, wage moderation – the wage settlements for 2004 provided for increases of 2.1% – was instrumental for price stability.

The defining trends on the labor market were the rise in the number of reported vacancies and above all the surge in labor supply as a result of the boom in labor from abroad and of the pension reforms implemented in the past few years. Employment advanced by 0.5% in 2004, with most of the new positions created in the service sector. More recently, job shedding in manufactur-

ing and construction also came to a halt. Nevertheless, the accelerating recovery failed to offset the above-average gain in labor supply and hence to reduce unemployment. The unemployment rate (Eurostat definition) came to 4.5% in 2004, somewhat more than in 2003 (4.3%), despite substantially higher economic growth.

The current account closed the year 2004 with a surplus of EUR 0.8 billion (+0.3% of GDP). Animated export growth (+13.0% in nominal terms in 2004) shored up the merchandise and services balances substantially, which had a surplus of EUR 4.8 billion, nearly twice that recorded in 2003. Austria's healthy export performance hence counteracted a more pronounced slippage into deficit of the current account caused by marginally rising shortfalls on incomes and transfers. The financial account posted a surplus of EUR 1.1 billion in 2004; net capital inflows on other investment compared with net capital outflows on all other subbalances (direct invest-

High energy prices
add most to inflation

Marked enlargement
of labor supply

Vigorous export
growth compensates
for pronounced shift
of the current
account into deficit

U.S. economy
remains dynamic

ment, portfolio investment, financial derivatives). Both inward and outward direct investment contracted perceptibly against the 2003 values, partly on account of extraordinarily high direct investment as a result of restructuring measures.

Powerful Global Economic Growth in 2004

2004 marked the highest real-term world economic growth in 20 years – more than 5.1% (IMF, April 2005). The growth powerhouses were the U.S.A., China and the East Asian emerging economies. The global recovery was to a good extent propelled by expansionary economic policy impulses, but began to lose momentum from the spring of 2004. This weakening, albeit at a high level, stemmed from a more restrictive economic policy stance, above all in the U.S.A. and in China, coupled with burgeoning oil prices and the resulting decline in consumer spending as well as the boost in commodity prices in the wake of

the Chinese industrial sector's high demand for raw materials.

Real economic growth was fast-paced in the U.S.A., coming to 4.4% in 2004. However, the upswing lost some momentum in the course of the year; especially export growth slipped despite the weak dollar. Conversely, import growth was far livelier, causing net exports to tone down growth and the current account deficit to augment to 5.4% of GDP. Furthermore, household consumption decelerated temporarily in the second and third quarters, remaining animated overall, however (2004: +3.8% in real terms). The dip in spending growth may be traced to the petering out of the impulse provided by expansionary fiscal policy, mounting prices and the U.S. Federal Reserve System's tightening of the monetary reins with higher interest rates from June 2004. By contrast, investment growth was unabated throughout 2004. Investment in equipment and software as well as expenditure on housing posted solid

Key Figures for Selected Regions

	EU-12	EU-15	EU-25	U.K.	U.S.A.	Japan	China
Annual change in % GDP (real)							
2002	0.9	1.0	1.1	1.8	1.9	-0.3	8.0
2003	0.5	0.8	0.9	2.2	3.0	1.4	9.3
2004	2.1	2.3	2.4	3.1	4.4	2.7	9.5
Inflation rate							
2002	2.3	2.1	2.1	1.3	1.6	-0.9	-0.8
2003	2.1	2.0	1.9	1.4	2.3	-0.3	1.2
2004	2.1	2.0	2.1	1.3	2.7	0.0	3.9
% Unemployment rate (Eurostat definition)							
2002	8.4	7.7	8.9	5.1	5.8	5.4	x
2003	8.9	8.1	9.1	4.9	6.0	5.3	x
2004	8.9	8.1	9.0	4.7	5.5	4.7	x
% of GDP Net deficit							
2002	-2.4	-2.2	-2.3	-1.7	-3.8	-7.9	-3.3
2003	-2.8	-2.8	-2.9	-3.4	-4.6	-7.7	-2.8
2004	-2.7	-2.6	-2.6	-3.2	-4.4	-7.0	-2.4
Current account surplus/deficit							
2002	1.0	0.7	x	-1.7	-4.4	2.8	2.8
2003	0.5	0.3	x	-1.8	-4.7	3.2	3.2
2004	0.6	0.4	-0.2	-1.9	-5.4	3.7	4.2

Source: Eurostat, European Commission; China: IMF

gains on the back of high domestic demand, sound profit margins and favorable financing conditions. The gain in oil prices was instrumental in driving up inflation from 2.3% in 2003 to 2.7% in 2004. At 4.4% of GDP, the U.S. budget deficit stayed

high in 2004. The U.S. twin (budget and current account) deficit was partly responsible for the U.S. dollar's weakness in 2004 (see box 3) and weighs on medium-term U.S. growth prospects.

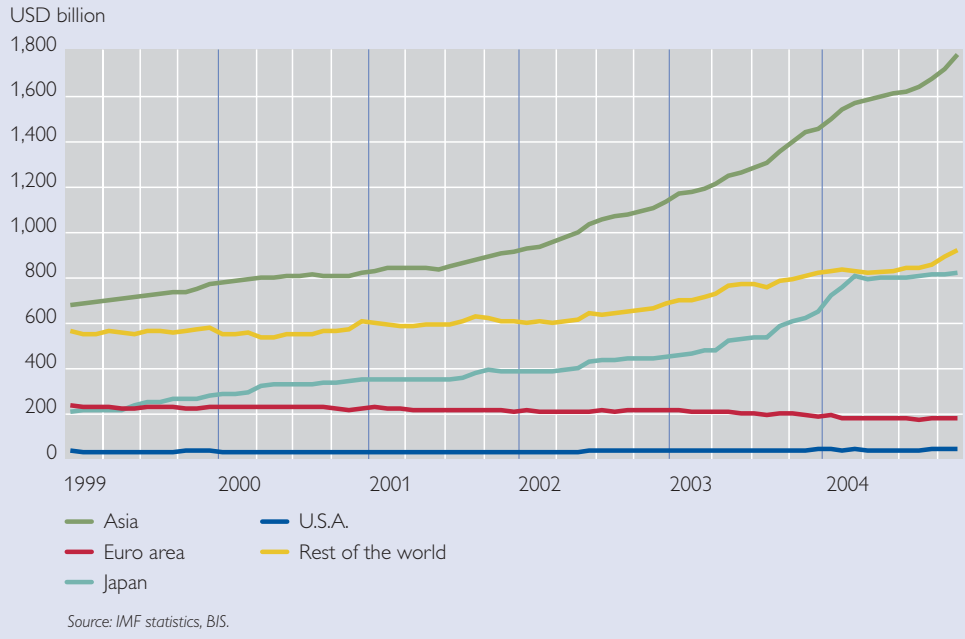
Box 3

International Exchange Rates, Foreign Exchange Reserves and Gold Reserves

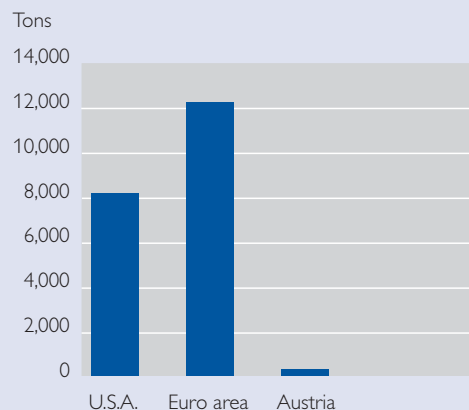
International Exchange Rates and Foreign Exchange Reserves

The U.S. currency's continued downtrend against the euro since 2001 remained more or less unbroken throughout 2004. Whereas the U.S. dollar strengthened substantially until the end of May – on May 13, 2004, it stood at USD 1.18 to the euro – the dollar started to slip again in fits and starts during the summer and depreciated considerably during the fourth quarter of 2004.

Foreign Exchange Reserves



Central Bank Gold Reserves



Source: IMF statistics, BIS.

With market participants paying close attention to the issue of the sustainability of external imbalances, reports about the enlargement of the twin deficit – the shortfalls on the U.S. current account and the budget – also acted as a damper on the dollar's value. Yet until the late summer, the data signaled that net U.S. liabilities did not represent a major financing burden. Expected and actual interest rate hikes by the U.S. Federal Reserve System secured the attractiveness of the U.S. markets for investment compared with other financial centers.¹ Even when private sector capital flows began to shrink as investors were reassessing the profitability of holding dollar-denominated investments, the principal Asian monetary authorities still hoarded substantial

amounts of U.S. dollars in an effort to uphold their currencies' parities to the U.S. dollar, thus financing the U.S.A.² The rapid slide in the value of the U.S. dollar against the euro in the fourth quarter of 2004 was set off above all by expectations that U.S. business activity was letting up, as reflected by flagging industrial output, disappointing labor market data and deteriorating consumer confidence. Moreover, the persistently high oil price stoked fears that the economy would suffer.

New Central Bank Gold Agreement

The gold price broadly mirrored the USD/EUR exchange rate changes in 2004, bottoming out on May 5, 2004, at around USD 372 per fine ounce and then rising gradually to about USD 457 per fine ounce by the end of November.

The OeNB has been able to pursue a profitable, active gold policy, using e.g. gold leasing transactions within the framework of the Central Bank Gold Agreement. On March 8, 2004, 15 European central banks issued a joint statement on gold by which they renewed the gold agreement that expired on September 26, 2004, for another five years. The Bank of England left the agreement whereas the Bank of Greece joined. The gold sales already decided and to be decided by the undersigned institutions will be achieved through a concerted program of sales over a period of five years. Annual sales will not exceed 500 tons, and total sales over this period will not exceed 2,500 tons (previously: 2,000 tons). The participating central banks also agreed that the total amount of their gold leasings and the total amount of their use of gold futures and options would not exceed the amounts prevailing at the date of the signature of the previous agreement.

¹ The Federal Reserve System raised the federal funds target rate step by step from 1.00% to 2.25% in the course of 2004 (measures taken at the Federal Open Market Committee meetings of June 30, August 10, September 21, November 10 and December 14). Market players had anticipated each of the 25 basis point hikes months in advance, and each move was discounted in the yield curves.

² According to IMF statistics, Asia's net currency reserves (excluding gold) alone widened from some USD 1.500 trillion to USD 1.787 trillion from the beginning of 2004 to November 2004. In the meantime, these countries' foreign exchange reserves have attained such a large volume that even minor portfolio shifts have an impact on the exchange rate.

Japanese output expanded by some 4% in 2004, mainly on the back of very vigorous growth until spring 2004. However, the Japanese economy – especially gross fixed capital formation – slowed down perceptibly thereafter. Furthermore, Japan's exports lost momentum when Chinese demand slackened. Additionally, the decline in public investment weighed on growth. Conversely, with employment growth boosting consumer confidence, household spending was healthy even though real incomes rose only moderately. Japan could still not shake loose deflation in 2004. Despite fairly animated output growth and the surge in oil prices, consumer prices persisted at the year-earlier level. Consequently, the Bank of Japan stayed its monetary policy course with interest rates near 0% since 2001.

At the beginning of 2004, China's economy showed signs of overheating, such as capacity constraints of the energy and transport infrastructures and quickening inflation. But from mid-2004, above all because policymakers steered a more restrictive course, the pace of economic growth eased in China, too, though it remained at a high level. As a case in point, minimum reserve rates for commercial banks were raised and standards for investment lending were tightened. These measures brought the growth in loans to the nonbank sector to a standstill at mid-year. Furthermore, public-sector infrastructure investment was scaled back. Finally, the surge in commodity and oil prices also tempered growth. Yet despite all these restraints, Chinese economic activity shot up by about 9.5% in 2004. High growth in tandem with soaring commodity prices pushed up inflation considerably to a yearly rate of almost 4%.

Russia chalked up continued solid economic growth of 6.6% in 2004. This expansion was sustained by a massive boost in investment drawing on quickly rising profits and a notable increase in consumer spending fueled by rapid gains in real wages. As an exporter of oil and commodities, Russia benefited from the high prices of these goods. The country again concluded the year with a large current account surplus thanks to the pronounced improvement of the terms of trade. The budget closed with a surplus as a result of substantial tax receipts in connection with expensive oil. While inflation came down somewhat from 2003 levels, it remained high at 10,7%.

The eight new Member States located in Central and Eastern Europe (CEEC-8) showed a fairly solid growth performance in 2004, as did Southeastern Europe (with the exception of the Former Yugoslav Republic of Macedonia), Ukraine and Belarus. The upswing in these countries was buoyed mainly by strengthening private investment and household spending alongside healthy exports stimulated by the revival in the remainder of the EU. Consumer price inflation also picked up in 2004, with the outcomes spanning a large range among countries: Infla-

Japanese economy posts robust growth – deflation persists

Russia – high growth, high inflation

Robust growth in the Central and Eastern European new Member States

Chinese business activity overheats



United Kingdom –
pronounced upturn

tion was lowest in Lithuania at 1.1% and highest in Slovakia at 7.4%. Despite animated economic growth, the unemployment rate averaged 15% across the CEEC-8.

The upswing in the United Kingdom that had begun in 2003 continued until mid-2004, sustained largely by domestic demand. In particular consumer spending advanced at a lively pace, drawing on the marked increase in real disposable incomes, favorable employment prospects and hefty asset price gains linked to the boom in real estate prices. However, growth abated noticeably in the third quarter of 2004, as manufacturing output and retail sales declined and as the situation on the real estate market eased, which dampened household spending. The British economy expanded by 3.1% in real terms in 2004. The revival reduced the unemployment rate to 4.7%, and despite high growth, inflation remained low at 1.3%.



The Stability and Growth Pact – A Key Pillar of EMU's Stability Architecture

Euro area budget deficit remains high in 2004

The slowness of the recovery in the euro area kept the aggregate budget deficit at the previous year's level of 2.7% of GDP in 2004. The positive

impact of moderate primary expenditure growth and of a slight drop in interest expenditure was offset by the gradual disappearance of deficit-decreasing temporary measures and the decline in revenue following tax reform. Adjusted for the effects of temporary measures, the euro area budget deficit would have run to approximately 3.0% of GDP.

Germany, France and Greece closed the year with deficits in excess of 3% of GDP; Italy posted a 3% deficit. Looking ahead, in their spring 2005 excessive deficit procedure (EDP) reports all three countries committed themselves to reducing their deficits to below the Maastricht reference value of 3% of GDP in 2005; success will, however, be contingent on a considerable improvement of the economic framework and on expenditure restraint.

In this respect it is worth noting that on July 13, 2004, the European Court of Justice annulled Ecofin's decision to put into abeyance the EDP for Germany and France. To prevent a stalemate, the Ecofin Council, on recommendation of the European Commission, gave both countries until 2005 to bring their deficit ratios back under the 3% limit, in recognition of their firm commitment to reduce their budget deficits. Greece, however, was found not to have taken effective action to avoid an (excessive) deficit, prompting the European Commission to recommend that the Ecofin Council give notice to Greece.

All euro area countries except Spain, Luxembourg, Ireland, the Netherlands and Finland still posted debt ratios that surpassed the 60% reference value in 2004.

According to the national convergence programs, among the non-euro area Member States, the Czech Republic, Cyprus, Hungary, Malta,

Poland and Slovakia posted excessive deficits in 2004. In all cases but Cyprus, the Council decisions allow for the correction of these excessive deficits in a medium-term framework rather than already in 2005 given the existence of special circumstances, namely continuing structural adjustment. The debt ratios of the new Member States – except for those of Cyprus and Malta – are, incidentally, below the euro area average.

In 2004, the European Commission made proposals to reform the Stability and Growth Pact. The changes agreed by the Ecofin Council on March 20, 2005, and adopted by the European Council on March 22, 2005, include the commitment to improve the coordination of national budgetary policies with the stability and convergence programs, statistical governance and forecast reliability.

The preventive arm of the Stability and Growth Pact was altered to take into account in the definition of the medium-term objective of a budgetary position “close to balance or in surplus” factors such as potential growth, debt ratios and certain structural reforms. Moreover, the European Council Presidency conclusions stressed the importance of using periods of growth above trend more effectively for budgetary consolidation.

As to the corrective aspects of the Stability and Growth Pact, it was agreed that in addition to an increased focus on debt and the long-term sustainability of public finances in establishing whether an excessive deficit exists, systemic pension reforms and “other relevant factors,” such as costs associated with the unification of Europe, should be given due consideration. The deadlines for correcting an excessive deficit were extended, and the definition of “se-

vere economic downturn” was eased. The reference values for the deficit-to-GDP ratio and the debt-to-GDP ratio remained unchanged at 3% and 60%, respectively.

The Governing Council of the ECB expressed serious concern that the changes to the Stability and Growth Pact could reduce the effectiveness of the EDP. It must be avoided that changes in the corrective arm undermine confidence in the sustainability of public finances in the euro area countries. The Governing Council also took note of some proposed changes which are in line with the possible strengthening of the preventive arm of the Stability and Growth Pact.

Reform of the
Stability and
Growth Pact



Sound fiscal policies and a monetary policy geared to price stability are fundamental for EMU's success. They are prerequisites for macroeconomic stability, growth and cohesion in the euro area. The Governing Council underlined that it was imperative that the Member States, the European Commission and the Council of the European Union implement the revised framework in a rigorous and consistent manner conducive to prudent fiscal policies. Without transparent fiscal rules, the financial markets play a greater role in imposing discipline.

Austrian general government deficit comes to 1.3% in 2004

Update of the Austrian stability program

Budgetary developments in Austria

Based on the figures provided by Statistics Austria (March 2005), the general government deficit (Maastricht definition) came to 1.3% of GDP in 2004, substantially below the euro area average of 2.7% of GDP. The public deficit rose by 0.2 percentage point of GDP from the 2003 result.¹ Expenditure cuts did not suffice to offset the decline in the revenue ratio that was triggered, above all, by shrinking income and wealth tax revenues (which reflect, inter alia, the effects of the first stage of tax reform and anticipation effects of the second part of the tax reform scheduled for 2005) and contracting value added tax receipts. Expenditure growth

slowed mainly as a result of the pension reform already implemented and the administrative reform measures taken so far (including personnel reductions). However, the effect of these consolidation measures was dampened by the residual effects of child-care benefit payments and higher social security spending (automatic stabilizers).²

The update of the Austrian stability program for 2004 to 2008 of November 30, 2004, has three aims: First, achieving a general government budgetary position which is in balance over the business cycle; second, reducing the tax-to-GDP ratio to 40% by 2010; and third, boosting growth potential by investing in research, education and infrastructure.

Fiscal Convergence Criteria for Austria

% of GDP	2003	2004	2005	2006	2007	2008
	Final Budget Account	Outturn	Stability program ¹			
Receipts ²	49.5	49.4	47.5	46.2	46.0	45.8
Expenditure ²	50.6	50.5	49.5	48.0	46.7	45.8
Budget balance²	-1.1	-1.2	-1.9	-1.7	-0.8	0.0
Interest expenditure (net)	3.2	3.2	3.1	3.1	3.0	2.9
Primary expenditure	47.4	47.3	46.4	44.9	43.7	42.9
Primary surplus	2.1	2.0	1.2	1.3	2.2	2.9
Cyclically adjusted budget balance	-0.4	-0.5	-1.5	-1.5	-0.7	0.0
Cyclically adjusted primary surplus	2.8	2.7	1.6	1.6	2.3	2.9
Debt ratio	64.7	64.2	63.6	63.1	61.6	59.1
Tax ratio ³	42.8	42.8	41.6	40.5	40.3	40.0

Source: Federal Ministry of Finance, Statistics Austria.

Note: Discrepancies may arise from rounding.

¹ Update of November 30, 2004.

² Swaps shown net.

³ Direct taxes, indirect taxes, social security contributions excluding imputed contributions, inheritance taxes.

The goal is a balanced budget in 2008. Especially in 2005 and 2006, fiscal stimulus packages, a “growth and location package” and most of all tax reform will cause the deficit

ratios to swell. Nevertheless, these measures will not jeopardize the 3% deficit target at any time. From 2006, the reduction in the general government deficit will result nearly

¹ The value for 2003 was revised downward from 1.3% to 1.1%.

² Automatic stabilizers are cyclical changes in tax revenues (especially income tax revenues) and public spending (mainly on unemployment insurance) which have a positive impact on GDP.

exclusively from structural improvements. Under the stability program, the tax ratio of 40% of GDP is to be attained already in 2006.

Along with a new fiscal sharing scheme for the years 2005 through 2008, a new Austrian stability pact was adopted to support budget coordination. Within the framework of fiscal sharing, further improvements (above all for local government) and simplification measures as well as the further procedure for the second stage of the administrative reform package were agreed. Moreover, the three levels of government agreed on introducing additional revenue-raising measures worth 0.12% of GDP to finance the health care deficit (posted by the social security and hospital sectors) and on drawing up an expenditure cut package of the same magnitude.

The debt ratio is projected to decline by 5.1 percentage points from 2004 and thus fall below the limit of 60% of GDP by 2008, among other things thanks to rebounding primary surpluses and contracting positive interest rate/growth differentials.

Mid-Term Review – Further Massive Reforms Required to Implement Lisbon Strategy

In 2004, a high-level group headed by Wim Kok performed a mid-term review of the Lisbon strategy,³ the reform program aimed at making Europe the most dynamic and competitive knowledge-based economy

in the world. The strategy defines employment, research, internal market, environmental sustainability and social goals to be reached by 2010. The Kok report⁴ criticizes the disappointing delivery of the Lisbon goals of growth and employment. While some progress was observable and Europe's social model had a much better record than its U.S. counterpart in important areas (poverty, infant mortality rates, life expectancy), productivity growth in Europe had declined and so far, the political will to implement reforms was lacking. Overall, there was little improvement in many areas, such as employment or research. Some areas in some countries represented exceptions, e.g. achievements toward the knowledge society in Finland and Sweden, the reduction of unemployment in Italy and productivity gains in Ireland. The unfavorable framework conditions of economic stagnation and global political uncertainty represented obstacles to reaching the Lisbon goals. Moreover, the EU's focus was on enlargement and the Constitution for Europe.

The EU scored some progress in reaching the employment rate target of 70%. Despite economic stagnation, Italy succeeded in lowering unemployment from nearly 12% to 8%; the employment rate for Europe as a whole advanced by 1 percentage point to just under 65% from 2000. Liberalization has made strides in most European network industries, such as telecommunications, energy (gas and electricity), the postal serv-

Kok Report is critical

Progress in employment, network industries and financial services

³ The 32nd Economics Conference of the OeNB on May 27 and 28, 2004, also dealt with this topic: "Growth and Stability in the EU: Perspectives from the Lisbon Agenda." (The conference proceedings may be found on the OeNB's website at www.oenb.at.)

⁴ See: *Facing the challenge. The Lisbon strategy for growth and employment. Report from the High Level Group chaired by Wim Kok. Luxembourg: Office for Official Publications of the European Communities. November 2004.*

Little progress in research and innovation systems; Austrian R&D indicators near EU-15 average

ice and the railroad sector, albeit to different degrees in different countries. In its tenth Progress Report on the Financial Services Action Plan, the European Commission observes that nearly all legislative measures had been completed on schedule. The successful implementation of the Financial Services Action Plan is attributed to a good extent to the Lamfalussy procedure. According to this procedure, EU bodies to which representatives of national regulatory and supervisory authorities (and central banks) are appointed are involved in the legislative process and in the consistent transposition of Community law in the Member States. This reduces the burden on the European Commission. Moreover, the classification of legislation into basic legislation requiring a political decision and detailed provisions to be passed at the technical level provides for speedy decision making. Full integration of the internal market for services will have to be preceded by a thorough debate about the services directive of the European Commission, as the draft still requires fundamental changes according to the European Council of March 22 and 23, 2005.

Improving implementation



Europe's research, innovation and education systems appear to have a long way to go toward becoming competitive. The discussion surrounding the single European patent is typical of the failure to push through reforms. The EU's R&D ratio merely edged up from 1.93% in 2000 to 1.99% in 2002 (Austria: 2.27% in 2004). The Kok and Sapir⁵ reports both urge the authorities to implement research promotion and university reforms.

To speed up implementation, the Kok report recommends a greater emphasis on the national level via "partnerships for reform" and national action programs subject to debate within national parliaments. The report proposes that the EU budget be reshaped to reflect the Lisbon priorities of R&D and education expenditure, that communication be improved and that a European Research Council be created. The strategy is to be focused on fewer targets overall. European Commission President José Manuel Barroso has already called for a relaunch of the Lisbon strategy as a "partnership for growth and employment."

Implementation may be improving for a number of reasons. In the past, efforts have typically been redoubled when a deadline drew near. Furthermore, the European Commission and the Member State governments should invest more political energy in the Lisbon process from 2005 to 2010. Economic stagnation has prompted many member countries to begin to tackle reforms. If the Lisbon agenda is to be transposed into a "national growth strategy" or a partnership for reform and brought to the attention of Europe's citizens

⁵ Sapir, A., P. Aghion, G. Bertola, M. Hellwig, J. Pisani-Ferry, D. Rosati, J. Viñals und H. Wallace. 2003. *Agenda for a Growing Europe: Making the EU Economic System Deliver*. Brussels.

more effectively, the chance of at least getting decisively closer to attaining the Lisbon goals by 2010 will be much better, which will revitalize enthusiasm.

The European Council of March 22 and 23, 2005, agreed to reform the Lisbon strategy and to refocus it on the priorities of growth and employment. Knowledge and innovation were designated as vital strands of the relaunch. Furthermore, the European Council confirmed the three (economic, social and environmental) dimensions of the strategy. Streamlining the various governance processes represents a further key priority of the mid-term review.

Crucial structural reforms implemented in Austria in 2004⁶

In 2004, the Austrian Research Promotion Agency was founded through a merger of four previously independent research companies. The merger did not include the Austrian Science Fund. This reform is targeted at boosting the efficiency of public R&D promotion. In a few years, an evaluation will be able to show whether this step has improved performance.

Austria has succeeded in accelerating implementation of Internal Market directives, and after establishing an implementation watchdog now ranks among the top third of countries in terms of implementation speed. Moreover, under the new minimum acceptance provisions for job seekers, the protection unemployed persons used to have from being obligated to accept a job outside their former industry (Beruf-

schutz) has been replaced by a minimum pay guarantee (Entgeltsschutz). Hence, jobless persons turning down jobs unrelated to their qualification after being unemployed for 100 days will lose their entitlement to unemployment benefits. However, the income of the new job must not fall below 75% of job seekers' last salaries. The new acceptance conditions for the first time stipulate commuting time limits (no more than a quarter of the working hours). Moreover, the government made further progress on the Administrative Reform Program, the electronic filing system ELAK has been in use since 2004, and headway was made on paperless government initiatives, such as public e-procurement (e-government legislation, simplification of electronic communications with public authorities).

Implementing health care reform and the results of the Constitutional Convention, whose objective is more efficient governance relations between the central, regional and local government, is still on the Austrian government's agenda. A first draft Federal Constitution was presented



⁶ Issue Q2/2005 of the OeNB's publication *Geldpolitik & Wirtschaft* (published in English as *Monetary Policy & the Economy*), scheduled to appear at the end of June 2005, will cover the topic "10 Years of Austrian EU Membership," presenting studies on structural reforms from a variety of angles.



The Convergence Reports of the ECB and the European Commission

The EU expands to become the EU-25

at the beginning of 2005, but it does not take into account a number of objectives. Also, in a European comparison, rules governing the liberal professions are far more stringent in Austria. The results of the OECD's PISA⁷ survey assessing students' knowledge and skills have triggered lively discussions about educational reform in 2005.

European Integration Makes Headway

By concluding the accession negotiations with ten countries, the Copenhagen European Council of December 12 and 13, 2002, laid the foundation for the accession of the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia to the EU. After the Accession Treaty was signed in Athens in April 2003, the historical enlargement of the EU by these ten Member States was celebrated on May 1, 2004.

As part and parcel of their EU accession, the new Member States became members of the ESCB, and their central bank presidents became members of the General Council of the ECB. Likewise, their NCBs' experts in the ESCB committees now

have full member status whenever the committees meet in ESCB composition, i.e. with representatives from all EU NCBs.

EU enlargement automatically entailed an increase in the ECB's subscribed capital to EUR 5.565 billion on May 1, 2004. The 12 Eurosystem NCBs have paid up their subscribed capital in full. The 10 new non-euro area NCBs are required to pay up a minimal percentage of their subscribed capital (7% as at May 1, 2004) as a contribution to the operational costs of the ECB. At the same time, the paid-up shares of the nonparticipating NCBs (Bank of England, Denmark's Nationalbank and Sveriges Riksbank) in the ECB's subscribed capital increased from 5% to 7%.

The European Commission and the ECB published their Convergence Reports 2004 on October 20, 2004. They conclude that at the moment of examination neither the new Member States nor Sweden fulfilled all the criteria needed to introduce the euro.

To measure the countries' compliance with the inflation criterion, the August 2004 reference value of 2.4% was used. The Czech Republic, Estonia, Cyprus, Lithuania and Sweden had inflation rates below the reference value. Five countries – Estonia, Latvia, Lithuania, Slovenia and Sweden – fulfilled the criterion on the government budgetary position, with fiscal deficits below the 3% of GDP reference value and debt ratios below the 60% of GDP reference value. None of these Member States participated in the exchange rate mechanism ERM II for the full two-year reference period. To determine compliance with the long-term interest rate criterion, a reference

⁷ Programme for International Student Assessment.

value of 6.4% over the 12 months ending in August 2004 was chosen. The Czech Republic, Cyprus, Latvia, Lithuania, Malta, Slovenia, Slovakia and Sweden fulfilled this criterion. A harmonized long-term interest rate to examine the degree of convergence was not available for Estonia, which has no long-term government bonds or similar securities, but no indications suggested a negative assessment. The Convergence Reports also included an examination of the

compatibility of national legislation with the Treaty, notably the compatibility of the statutes of the countries' NCBs with the Treaty and with the ESCB Statute. None of the countries fulfill the necessary legal conditions. Hence, the status of the 11 countries (the ten new Member States and Sweden) as Member States with a derogation remains in force. The next Convergence Reports are expected for 2006.

Box 4

Milestones of European Integration in 2004

- On May 1, 2004, the biggest enlargement in the EU's history became reality. The EU expanded to include 25 countries. The accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia (in protocol order) boosted the population of the EU from some 370 million to about 455 million people.
- On June 18, 2004, the European Council meeting in Brussels reached an agreement on the Treaty establishing a Constitution for Europe (Constitutional Treaty). The Constitutional Treaty is set to replace all current European treaties by a single legal act with the intention of making the EU more democratic, transparent and efficient; it is currently expected to enter into force on November 1, 2006.
- Estonia, Lithuania and Slovenia took a major step toward introducing the euro by joining ERM II on June 28, 2004. The central parities against the euro were set at EEK/EUR 15.6466, LTL/EUR 3.45280 and SIT/EUR 239.640. Participation in ERM II for at least two years without severe tensions is one of the convergence criteria a country has to fulfill to introduce the euro.
- On December 14, 2004, the accession negotiations with Bulgaria and Romania were formally concluded. Both countries are scheduled to become EU members on January 1, 2007.
- At its meeting on December 16 and 17, 2004, the European Council agreed to open accession negotiations with Turkey and Croatia. As a prerequisite for the opening of accession talks, Turkey is committed to signing the protocol on the adaptation of the Ankara Agreement (a free-trade agreement between the EU and Turkey, which has to be extended to the ten new EU members). The negotiation framework for Turkey is to be based on the following principles, which may be considered: long transitional periods, derogations, specific arrangements or permanent safeguard clauses for areas such as freedom of movement of persons, structural policies or agriculture. The opening of accession negotiations with Croatia is conditional on full cooperation with the International Criminal Tribunal for the former Yugoslavia.

The Intergovernmental Conference started its proceedings on October 4, 2003, and at the Brussels European Council on June 18, 2004, reached an agreement on the Treaty establishing a Constitution for Europe (Constitutional Treaty). The final draft of the Constitutional Treaty has been submitted to the Member

States for ratification and is currently expected to enter into force on November 1, 2006.

The Constitutional Treaty reaffirms the framework conditions for monetary union as embodied in the Treaty on European Union; all amendments are purely technical. The legal and institutional framework

Treaty establishing
a Constitution for
Europe

for the ESCB and ECB as well as for the single monetary policy is defined in both the constitutional provisions (Part I) and the policy areas (Part III) of the Constitutional Treaty. The ESCB Statute is annexed to the Constitutional Treaty as a Protocol.

The constitutional provisions (Part I) not only define the price stability goal as one of the EU's general objectives, but also confirms the sui generis nature of the ECB as enshrined in the Treaty on European Union. The draft Constitution integrates the "Eurosistem" concept and incorporates into primary legislation that the euro be defined as currency

unit and symbol of the Union. The part pertaining to monetary union (Part III) embodies a number of new provisions applicable exclusively to euro area member countries.

On November 5, 2004, the OeNB held a workshop on the Constitutional Treaty.⁸ This meeting provided experts from Austria and abroad with an opportunity to discuss the economic and monetary policy aspects of the Constitutional Treaty and to probe its possible impact on future developments of EMU.



⁸ See also: *A Constitutional Treaty for an Enlarged Europe: Institutional and Economic Implications for Economic and Monetary Union. Workshops – Proceedings of OeNB Workshops No. 4. February 2005.*

The OeNB as a Competent Partner in Ensuring Financial Stability

Promoting financial stability in Austria is a key priority for the OeNB. Since the OeNB aims at detecting potential risks for the domestic financial market as early as possible, a substantial proportion of its activities in 2004 was dedicated to conducting audits, drawing up comprehensive analyses and regularly monitoring the financial market. In the course of off-site surveillance, the OeNB continuously monitored the developments, and potential risks, in the Austrian financial market with the help of prudential data Austrian banks reported on a regular basis.

Austrian Financial Sector Posts Improved Results

After 2002 had been characterized by economic difficulties and 2003 had marked the beginning of an upswing, the year 2004 saw further improvements in the Austrian financial market: banks, insurance companies, investment funds and pension funds were able to expand their business activities and achieve – in part considerable – improvements in their profitability and performance.

In December 2004, Austrian banks' total assets amounted to EUR 653 billion, up 7.9% against December 2003, which means that the growth rate of banks' total assets was significantly higher than both the 2003 rate (+5.5%) and the average growth rate of the past ten years (+5.9%). This uptrend mainly resulted from more animated external business and domestic interbank operations; domestic retail banking also increased in 2004. Loans to domestic customers picked up (+4.7%), and customer deposits augmented again

(+4.9%) after subdued growth between end-2002 and mid-2003. Savings deposits, and especially deposits under a savings and loan contract, continued to be very popular among investors. On average, every Austrian holds savings deposits worth EUR 16,700.

The significance of foreign currency loans in lending to households remained high: The share of foreign currency loans in total loans to households peaked at a new high of 29.1% in December 2004, whereas their share in total loans to domestic non-banks remained at a relatively stable value of approximately 19%. Since mid-2000, the share of foreign currency loans in total loans to nonfinancial corporations has declined steadily, amounting to a mere 14.8% in December 2004.¹ The share of foreign currency loans denominated in Japanese yen declined further in 2004, coming to no more than 5.6% of all foreign currency loans at end-2004, whereas loans denominated in Swiss francs had risen to more than 90%. From the point of view of financial stability, this currency shift is welcome, as the Swiss franc fluctuated against the euro within a much smaller range than the Japanese yen did. The high share of foreign currency loans in total lending is a distinctively Austrian feature within the euro area: While accounting for only 3% of total euro area loans, Austrian borrowers held 20% of all yen-denominated loans and 42% of all Swiss franc-denominated loans. These proportions indicate that foreign currency lending will still need to be closely monitored in the interest of financial stability.

Banks expand their business activities

¹ As no information is available on repayment vehicles accumulated for paying back these loans, these figures represent an upper limit.

Austrian banking
sector stability has
strengthened further

Business in CEECs
contributes
significantly to banks'
income

The quality of loans granted by Austrian banks remained stable in 2004. At end-2004, the ratio of specific loan loss provisions to claims on nonbanks for the entire banking sector stood at 3.3%, thus corresponding to the values recorded in the two previous years. The analysis of nonaccrual and nonearning assets and of nonperforming and irrevocable loans did not show any worrying developments, and market risk remained limited. Regulatory capital requirements for interest rate risk and equity price risk picked up somewhat but stayed well below the historical peak levels, whereas capital requirements for open foreign exchange positions declined slightly toward the end of 2004. Austrian banks' interest rate risk exposure resulting from maturity transformation occurred mainly in euro and did not pose a major risk.



The results of the stress tests (carried out by the OeNB on a regular basis) confirmed these data; they did not indicate any threats to financial stability in Austria. The effects of market risk shocks on the capital ratio remained constant, whereas those of credit risk shocks increased slightly; this rise was more than compensated by the higher capital ratio. At 14.7% by end-2004, the unconso-

lidated capital ratio of Austrian banks remained well above the 8% level required as a minimum by the Austrian Banking Act. The core capital ratio of 10% was higher than the long-term average, too.

In 2004, Austrian banking groups' business in the Central and Eastern European countries (CEECs) continued to boom, which resulted in substantial growth rates in total assets and profits. The dividends of their subsidiaries in this region sharply boosted income from equity shares in affiliated enterprises abroad and constituted a key factor in their improved profitability.

The CEEC subsidiaries contributed approximately one eighth to Austrian banks' total assets and almost one quarter to total annual profits. As for banking services, market penetration in the CEECs is still low compared with that in the EU-15, which means that there is additional growth potential. Competition is expected to augment, however, which will reduce the margins in these markets.

Profit growth in the Austrian banking sector continued to accelerate in 2004, with operating profit expanding 7.7% (year on year) in the fourth quarter of 2004 on the back of the stronger increase in income levels than in expenses. Operating income rose by 4.3%, whereas operating expenses went up by only 2.7%. The increase in operating income was primarily fueled by income from securities and participating interests as well as fee-based income from securities transactions. However, net interest income, which makes up half of operating income, also picked up again in 2004 after a longer period of decline. Operating expenses edged up after having decreased between the first quarters of 2003 and 2004.

While staff costs and income developments seem to have shown a higher correlation recently, staff costs increased more significantly (+2.5% per annum in the fourth quarter of 2004) than operating expenses.

Austrian banks continued their consolidation efforts by further reducing the number of banking offices and staff: Between end-1997 and December 2004, the number of banking offices (head offices and branches) was cut by 7.7% from 5,686 to 5,248, and the number of credit institutions went down from 995 to 882. A similar development may be reported for staff numbers. During the period under review, the number of employees² declined from 70,967 to 65,615 (-7.5%). However, banks still ensured a high degree of banking service coverage: Banking density in Austria remained well above the European average, and the demand for traditional bank services diminished as more and more customers opted for alternative distribution channels (especially Internet banking).

Operating business is improving and the impact of provisioning is expected to decrease further. Banks operating in Austria expect profits to amount to EUR 2.98 billion for the year 2004, which is considerably higher (+44%) than the actual profit for the year 2003. Return on assets (ROA)³ is expected to rise to 0.46% after climbing from 0.24% in 2002 to 0.34% in 2003. The profitability of Austrian banks remained weak compared with those of other EU countries despite strong domestic profit growth, high margins from business activities in the CEECs and continued consolidation efforts. This



tepid performance may be attributed to strong competition, which resulted in low interest margins, as well as high staff costs (by international standards) and the high cost of maintaining an extensive banking offices network.

2004 was a good year also for other financial intermediaries. Insurance companies, for example, considerably expanded their total assets and improved their profits mainly on grounds of better financial results, a strong performance in the Central and Eastern European (CEE) markets as well as tighter cost management.

The assets held by Austrian investment funds enlarged by 12.9% to EUR 125 billion between December 2003 and December 2004, with debt securities making up the largest part of invested capital (70%). Stocks and equity securities accounted for 17%; the remaining capital was invested in other assets and mutual fund shares. With assets to the tune of EUR 456 million, the significance of real estate funds (which have been in the market since end-2003) was still low despite strong capital inflows. The total performance (realized yields) of all Austrian investment

Positive trends for
other financial
intermediaries

² These figures refer to actual staff capacities, i.e. excluding staff on paid paternal leave or unpaid sabbaticals.

³ Annual profits relative to total assets.

funds between January and December 2004 came to 6.0%, up from 5.5% in 2003.

Pension funds' assets amounted to EUR 10.1 billion at end-December 2004, with most investment decisions being outsourced to investment funds: 94% of total assets were invested in mutual fund shares. In 2004, the annual performance of all pension funds stood at 7.3%, up significantly from the results recorded in previous years.



IMF Gives Positive Assessment of Austrian Financial Market

Between June 2003 and August 2004, the Austrian financial sector was subject to a voluntary evaluation within the framework of the Financial Sector Assessment Program (FSAP) conducted by the International Monetary Fund (IMF). FSAPs aim to identify the vulnerabilities of a country's financial system both to prevent crises and determine priorities for the future development of the financial sector as well as to enhance financial system efficiency. In the course of the FSAP, IMF representatives spent several weeks on working visits in Vienna. These visits were dedicated to reviewing the financial market reforms that had been implemented

over the past few years and to assessing the compliance of both the new supervisory structures and supervisory legislation with internationally recognized principles and standards (principles of efficient banking, insurance and securities supervision, combating money laundering and the financing of terrorism).

The OeNB and the IMF devised and conducted stress tests to assess the impact of exogenous shocks on the Austrian banking sector with a view to determining financial stability in Austria. These stress tests combined scenarios of extreme (but still plausible) changes in one or more risk factors (e.g. waning economic growth, crash of the Austrian stock market, increasing interest rates, appreciation of the Swiss franc, etc.) with information on banks' exposures (e.g. loan portfolio, equity exposure, interest rate-sensitive position, open foreign exchange position, etc.) and measured the resulting loss (or profit) that subsequently changes banks' capital ratios. Stress tests were carried out for individual institutions and for entire banking sectors with a special focus on credit risk, market risk (interest rate risk, exchange rate risk and equity price risk) and contagion risk in the Austrian banking sector.

A key result of the stress tests was that the Austrian banking system is resilient to external shocks thanks to its high degree of capitalization: The unconsolidated capital ratio of the Austrian banking sector stood at 14.8% in mid-2004. The stress tests did not suggest any systemic impacts of external shocks for the entire Austrian banking sector. As expected, two factors had the strongest impact on the capital ratio: credit risk (domestic credit risk, credit risk in the CEECs, indirect credit risk of foreign

Stress test results
prove shock
resilience of the
Austrian banking
system

currency loans) and interest rate risk in euro. Even a combination of several shocks reduced the capital ratio to no less than 13.2%.

In addition to confirming the shock resilience and stability of the Austrian financial sector, the IMF noted in its findings that

- the establishment of an integrated supervisory approach and in this connection the consolidation of supervision competence within the Financial Market Authority (FMA) is in line with high international standards and that cooperation between the FMA and the OeNB is working well;
- the level of compliance with international standards in banking, insurance and securities supervision and anti-money laundering is generally very high;
- the banking sector is profitable, banks' capital adequacy is good and the banking sector has undergone a large-scale restructuring and consolidation process in recent years;
- the financial sector has been developing well despite the difficult economic environment; and
- the early expansion of Austrian credit institutions in CEE has contributed significantly to strengthening profitability.

In its assessment, the IMF concluded that Austrian banks need to take further action to sustain their current performance, which has been supported mainly by profits from the new EU Member States in CEE, and to increase profitability in the home market (e.g. by additional restructuring and consolidation measures). Furthermore, the report recommends reviewing the deposit insurance system in the light of the restructuring process and further improving corporate governance. Finally, the IMF ad-

vocated intensifying the supervision of insurance companies and pension funds and continuing the regular monitoring of potential risks arising from foreign currency loans for both lenders and borrowers. The annual Article IV Consultation in May 2004 marked the preliminary conclusion of the FSAP mission. After having been discussed by the IMF board, the final report was published on the IMF website in August 2004.



The Austrian legislator reacted to the recommendations voiced in the IMF report by having an amendment to the Austrian Banking Act drafted; it comprises the requirement to define consistent provisions on official liability, the expansion of the FMA's scope of regulatory power, the further development of corporate governance and an adaptation of the respective supervisory legislation. The FMA and the OeNB have already taken action to implement several IMF recommendations, e.g. by increasing the number of on-site examinations and focusing their examination activities on systemically relevant institutions.

In the course of the FSAP review, the IMF's experts underscored the significance of a high-profit banking system for medium- and long-term financial stability. An analysis of the

IMF assesses
Austrian banks'
profitability

cost and profit efficiency of Austria's 100 largest banks, initiated by the OeNB and based on the stochastic frontier approach as well as the distribution free approach, produced the following results: The level of profit efficiency is much lower than that of cost efficiency, which indicates a satisfactory homogeneity of the cost efficiency factor and an insufficient average utilization of the profit potential. Therefore, Austrian banks need to concentrate their efforts on expanding existing profit potentials to comply with the focus on long-term financial stability called upon by the IMF. Given the strong connection of cost and profit efficiency, banks will also need to maintain tight cost management policies, as banks with a high level of cost efficiency also ranked high in terms of profit efficiency. Furthermore, the FSAP clearly showed that effective risk management and especially risk-adjusted lending conditions constitute key factors in increasing banks' profitability.

The OeNB Supports Implementation of Basel II

On June 26, 2004, the Basel Committee on Banking Supervision published the new Basel II framework.⁴ By agreeing on the new framework after five years of negotiations at the international level, the G-10 central bank governors and heads of banking supervision authorities defined the key principles of the new capital adequacy requirements for banks. While this essentially concludes the Basel II process itself, it is now up to the EU Member States to implement Basel II by reaching agreement on a new capital adequacy directive,

which will have to be transposed into national law as a next step.

Concurrent to the proposals of the Basel Committee, the European Commission took measures to ensure the timely implementation of Basel II. Thus, the European Commission's Member States' Expert Group (MSEG) worked on preparing the draft directive in the first half of 2004. Austria was represented in the MSEG meetings by experts of the OeNB, the Federal Ministry of Finance and the FMA. On July 14, 2004, shortly after the Basel Committee on Banking Supervision published the new capital accord, the European Commission presented its Basel II draft directive⁵, which was subsequently discussed by the EU Council and the European Parliament. To strengthen Austria's position through coordinated action in the negotiations on the draft directive, a Basel II secretariat was established and staffed with experts of the Austrian Federal Ministry of Finance, the FMA and the OeNB.

During the Basel II negotiations at EU level, some of the OeNB's major concerns were a comprehensive preferential treatment of loans to small and medium-sized enterprises (SMEs), the easing of data and calculation requirements for banks and the extension of the so-called partial use option, which permits the use of simpler calculation methods for certain types of claims on nonbanks. In many respects, Austria succeeded in incorporating its proposals in the draft. In December 2004, the Austrian Federal Economic Chamber and the OeNB organized a workshop for the Austrian members

OeNB supports small enterprises and banks in the Basel II negotiations

⁴ Basel Committee on Banking Supervision. 2004. *International Convergence of Capital Measurement and Capital Standards: a Revised Framework. Basel.*

⁵ See http://europa.eu.int/comm/internal_market/regcapital/index_en.htm#capitalrequire.

of the European Parliament to inform them especially on SME-relevant aspects of Basel II. The EU's goal is that the European Parliament gives its consent to the new directive in its plenary sessions of May or September 2005. At the current state of negotiations, the EU Member States will be able to implement both the standardized approach and the foundation internal ratings-based (IRB) approach by 2007. However, banks may postpone shifting to the Basel II regime until 2008, at which point it will become mandatory (the advanced IRB approach will also be available from then on).

Preparations to transpose the EU directive into Austrian law started in 2005, and the OeNB will play an active role in the process. At the same time, the OeNB will also continue to exchange information with the Members of the European Parliament and those of the Austrian Nationalrat. A study commissioned by the OeNB in 2004 and conducted by the Austrian Institute for Empirical Social Research (IFES) underscores the importance of an intensified information campaign on Basel II, reporting that Austrian enterprises in almost all economic sectors require more information on Basel II: Seven out of ten SMEs have heard of Basel II, but merely 16% of SMEs have started taking action to meet this challenge. This is why the OeNB decided to launch an information campaign on Basel II (see "The OeNB's Information Policy: Conveying Stability and Security" for further details).

The OeNB Organizes a Wide Range of Activities to Promote Financial Stability

Numerous OeNB activities were targeted at promoting the stability of

the Austrian financial market: The *Financial Stability Report*, a semi-annual OeNB publication which is presented to the public at special press conferences, helps monitor the development of potential risk factors in the financial markets on a regular basis. Moreover, a comprehensive series of lectures on stability-related topics addressed, inter alia, the issue of foreign currency loans. Since the OeNB plays an active role in the evaluation of financial market legislation, it ensures that financial stability considerations are taken into account in the design of new financial market legislation.



Given Austria's high banking density, on-site examinations of a single bank cannot be conducted frequently. This is why off-site analyses play an important role in supervisory procedures in Austria. The OeNB, the FMA and the University of Vienna therefore launched a project to expand the existing analysis procedures by new risk-based off-site analysis models. In the course of this project, two statistical and one structural model were developed after a review of numerous modeling approaches.

A full report presenting the model results for all Austrian banks in a well-structured manner and establishing three risk categories ("problem banks," "institutions re-

OeNB introduces state-of-the-art procedures of risk-based banking analysis

Payment systems
oversight supports
stable infrastructure

Major Loans Register
enhances financial
sector stability

Integration of MLR
data in current risk
monitoring systems

quiring supervisory attention” and “institutions with no material supervisory concerns”) will help integrate the new models in the existing analysis environment. For further details, see the publications *New quantitative models of banking supervision* and *Die Analyse-landschaft der österreichischen Bankenaufsicht*.⁶

The Major Loans Register (MLR), which is maintained by the OeNB pursuant to Article 75 of the Austrian Banking Act and in which monthly data about loans above the reporting threshold of EUR 350,000 are registered, further enhanced its role in banking sector stability. The number of exposure inquiries submitted by reporting institutions, guarantee facilities and bank auditors increased significantly in 2004, which clearly shows that the OeNB’s MLR not only provides valuable information to these institutions prior to making a lending commitment, but that the overwhelming majority of reporting institutions continued to use MLR data during the whole life of the respective loans.

MLR data are also used in several early-warning models in the field of banking supervision.

In particular, the availability of data on the creditworthiness of borrowers from January 2003 onward has made off-site analyses more cost efficient. An extended version of the MLR, which will be worked out in close cooperation with banks, will also take account of Basel II reporting requirements. As cooperation between European credit registers is increasing, it will become possible to

harmonize and extend the coverage and analysis of credit risk data.

Pursuant to Article 44a of the Federal Act on the Oesterreichische Nationalbank, the OeNB is entrusted with payment systems oversight. In accordance with this mandate, the OeNB monitors the systemic safety of multilateral payment systems operating in Austria as well as Austrian banks’ secure participation in international payment systems. The OeNB performs the related inspections according to specific guidelines.⁷ Inspections focus on the measures payment system providers take to ensure the legal, financial, organizational and technical safety of payment systems.

The Secure Information Technology Center – Austria (A-SIT) regularly supports the OeNB in its inspection activities by providing assistance on oversight issues in connection with organizational and technical system stability. In its notification of January 6, 2005, the Austrian Federal Ministry of Economics and Labour recognized A-SIT retroactively as of October 25, 2004, as a supervisory body under the Austrian Accreditation Act (Akkreditierungsgesetz).⁸

Accredited payment system operators benefit from this recognition, since the inspection reports provided by A-SIT are now recognized as official certificates of systemic safety and as such can be used to communicate compliance with systemic safety provisions to the public.

Payment systems statistics were implemented as another important instrument of payment systems over-

⁶ See www.oenb.at or www.fma.gv.at. An English version of the second text is forthcoming.

⁷ See www.oenb.at. Some documents are currently available in German only.

⁸ The accreditation unit of the Austrian Federal Ministry of Economics and Labour is a member of the European Co-operation for Accreditation (EA). It concluded an agreement on the mutual recognition of accreditations by the other members (i.e. the national accreditation units of the EU and EFTA Member States).

sight at the beginning of 2004. These statistics help monitor the development and sound functioning of payment systems on a regular basis. They provide the OeNB with quarterly (or monthly, as with systemically important systems) data on payment system infrastructure (including availability) and sales.

Other key factors for the effective functioning of financial markets are safe and efficient securities settlement systems. A joint working group of the ESCB and the Committee of European Securities Regulators (CESR) was set up in October 2001 to support the establishment of such systems at the EU level. The working group, in which the OeNB and the FMA participate, defined 19 standards aimed at improving systemic safety and efficiency. After extensive consultations with market participants, the group presented its final report entitled *Standards for Securities Clearing and Settlement in the EU* in September 2004. The Governing Council of the ECB and the CESR chairpersons approved the report in October 2004 and agreed to define the measures necessary for implementing the standards in the course of 2005, and to start assessing the various systems in 2006.

Close Cooperation between OeNB and FMA

In the course of the past two and a half years, the cooperation of the OeNB and the FMA, which was established in April 2002, has been intensified and strengthened. In addition to daily “routine” meetings (which result from the OeNB’s significant statutory role in prudential supervision, e.g. in off-site monitoring or in conducting on-site examinations), the managers and heads of divisions of the two institutions hold

meetings on a regular basis to exchange information and discuss both general and specific topics. Joint working groups are established whenever necessary to deal with specific supervision issues, thus pooling the know-how of both institutions and coordinating concerted action at an early stage. The OeNB maintains close contacts with the Austrian Federal Ministry of Finance via the Financial Market Committee, which was established under Article 13 of the Financial Market Authority Act; the Financial Market Committee is a platform for the cooperation and dialogue between the three institutions (Ministry of Finance, OeNB and FMA) which are jointly responsible for financial stability in Austria.

Supervisory cooperation was promoted and institutionalized at an international level as well. On January 1, 2004, the Committee of European Banking Supervisors (CEBS) was set up with representatives of the national central banks and the banking supervisory authorities of the EU Member States and the other European Economic Area (EEA) countries (the latter are granted observer status). CEBS functions as a level 3 committee within the Lamfalussy framework. It performs the following tasks:

- advising the European Commission, in particular in the preparation of drafts of new implementation measures;
- contributing to the consistent implementation of EU directives and sustaining converging supervisory practices in the EU Member States; and
- promoting supervisory cooperation and information exchange.

CEBS carried out no less than three public consultations on various issues in the first year of its existence. In

this period, CEBS focused mainly on Basel II issues (e.g. elaborating proposals for a reduction of national discretion options as proposed in the European Commission's draft directive on Basel II and publishing a consultation paper on Pillar 2). Furthermore, CEBS conducted numerous projects in other fields such as accounting, financial reporting or outsourcing. In addition to being a CEBS member, the OeNB is also represented in the so-called CEBS Bureau, which advises and assists the CEBS chair and monitors the budget.



The Banking Supervision Committee (BSC) of the ESCB continues to serve as a consultative forum for the representatives of central banks and banking supervisory authorities on macroprudential and financial stability issues. The OeNB has a proactive role in this committee's work, for instance by chairing the Working Group on Developments in Banking.

The OeNB considers the new institutional framework for banking supervision in the EU very well suited – at least in the short or medium term – to ensuring a level play-

ing field for banks and to solving the challenges arising from the diversity of banks, the current status of financial market integration and the new regulatory framework (Basel II). However, supervisory authority cooperation and convergence via CEBS will need to be further intensified.

Guidelines for the Austrian Banking Industry

In 2004, the OeNB and the FMA published a series of guidelines on credit risk management in view of the forthcoming changes in the supervisory framework. Guidelines on the regulatory framework of market risk management and a handbook for the valuation of structured products had been published earlier (Guidelines on Market Risk, Structured Product Handbook). These guidelines give an overview of the regulatory environment and outline the technical fundamentals of effective risk management for banks, thus contributing to the effective cooperation of banks and supervisory authorities.

The know-how provided in the series makes supervisors competent partners for banks in the implementation of Basel II. The information is presented to banks and other interested parties in a concise and structured manner with the aim of promoting a constructive dialogue between the banking industry and the supervisory authorities. The series consists of ten publications that deal with issues related to the implementation of Basel II as well as with general key topics of credit risk management.⁹

⁹ A German version of the guidelines can be downloaded from www.oenb.at (PDF) or ordered from the OeNB. English versions of some of these guidelines are also available; others are forthcoming.

The guidelines on *Rating Models and Validation* and on techniques of credit risk management¹⁰ support banks in the process of obtaining authorization to use the more risk-sensitive advanced approaches to regulatory capital requirements under Basel II. The guidelines *Best Practices in Risk Management of Securitized Products* and *Credit Approval Process and Risk Management* describe cur-

rent problems in the field and outline possible solutions. These guidelines pool ideas for the future design of credit risk management. Given the proportions of Austrian enterprises' and banks' activities in the CEECs, six additional guidelines focus on the legal framework of the banking sector in Croatia, the Czech Republic, Hungary, Poland, Slovakia and Slovenia.



¹⁰ The guideline on techniques of credit risk management is currently available in German only.

Integration of Payment Services in Europe and Consolidation of Cash Distribution Structures in Austria

New European Structures for Cashless Payment Services

The OeNB's main objectives in the field of payment services are (1) cost-efficient provision of effective services for processing both large-value and retail payments, (2) active cooperation in the establishment and implementation of harmonized standards for Austrian and European payment systems, (3) facilitation and collaboration in national and international payment systems fora as well as (4) participation in payment systems-relevant organizations with a view to guaranteeing high security standards and efficient infrastructures.

New Legal Framework for Payments in the EU to Be Introduced in 2005

To pave the way for a single payment area, it is necessary to implement self-regulatory measures for the banking community, establish a harmonized infrastructure as well as lay down a coherent legal framework. Acknowledging this need, the European Commission has started to devise such a new legal framework for (retail) payments in Europe. The stated objectives are:

- to establish an internal market for cashless payments;
 - to promote efficient and safe payment means and systems;
 - to improve consumer protection and further strengthen public confidence in cashless payment means; and
 - to guarantee a level playing field.
- Reviewing and consolidating the existing legal provisions thus advances the efforts of the European banking industry to create an integrated market for payments.

The European Commission's initiative resulted in the release of the consultative document *A New Legal Framework for Payments in the Internal Market* in December 2003. Submitting its fifth revision of this draft directive, the Commission launched a final public consultation among the stakeholders in November 2004. The directive is scheduled to be finalized by the European Commission in mid-2005.

Consumers and businesses in the EU are set to benefit from a single payment area offering less costly and more efficient payment services. The OeNB welcomes this initiative and is committed to supporting the modernization and integration of Austria's payment systems infrastructure.

OeNB experts closely cooperate with the competent EU bodies and contribute to the relevant working groups at the European level.

Judging from the current and presumably final draft, the new legal framework will not pose a challenge to the OeNB's payment systems strategy. On the contrary, the efforts to increase competitiveness and transparency in cashless payment services, in particular of card-based transactions, tie in well with the OeNB's policy. The same holds true for the intention to open up the market to new payment services providers seeking authorization as "payment institutions."

Initiative for a Single Euro Payments Area (SEPA)

The Single Euro Payments Area will enable European citizens to make cashless payments throughout the euro area from a single current account, using a single set of payment instruments, as easily and safely as they do in the national context today.

Competition and transparency in cashless payment services to be stepped up

Harmonization of national legal provisions on payment systems under way in EU Member States

ESCB promotes implementation of SEPA

The country or bank where customers hold accounts should make no difference for payments. The Eurosystem's vision for the SEPA, hence, is that all payments effected in the euro area should be treated like domestic payments.

One first milestone in approximating national, i.e. intra-Member State, and domestic, i.e. inter-Member State, payments was the implementation of Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro, which stipulated that as of July 1, 2002, customer charges on cross-border payments¹ in the euro area must no longer exceed those on national transactions. Furthermore, 42 European banks as well as the European credit sector associations demonstrated their support of implementing a SEPA by 2010, issuing a White Paper in May 2002 and establishing the European Payments Council (EPC)² in June 2002. The Eurosystem recommends that relevant instruments be made available as an option – in addition to the existing structures in the Member States – for national payments to individuals and enterprises as early as 2008. A full migration for banks and their customers to pan-European solutions is targeted to be achieved by end-2010.

The OeNB welcomes the ECB's initiative in implementing a SEPA and supports the Austrian banking in-

dustry in taking the necessary preparatory measures. The OeNB was able to provide Austrian banks with a neutral gateway to the EBA³-operated STEP2 system at the earliest possible date. EBA's pan-European automated clearing house (PEACH), as yet the only clearing house to offer EU-wide services, processes euro payments covered by Regulation (EC) No 2560/2001. By providing a STEP2 access point, the OeNB underlines its operational commitment to guaranteeing safe payment processing and increasing market efficiency.



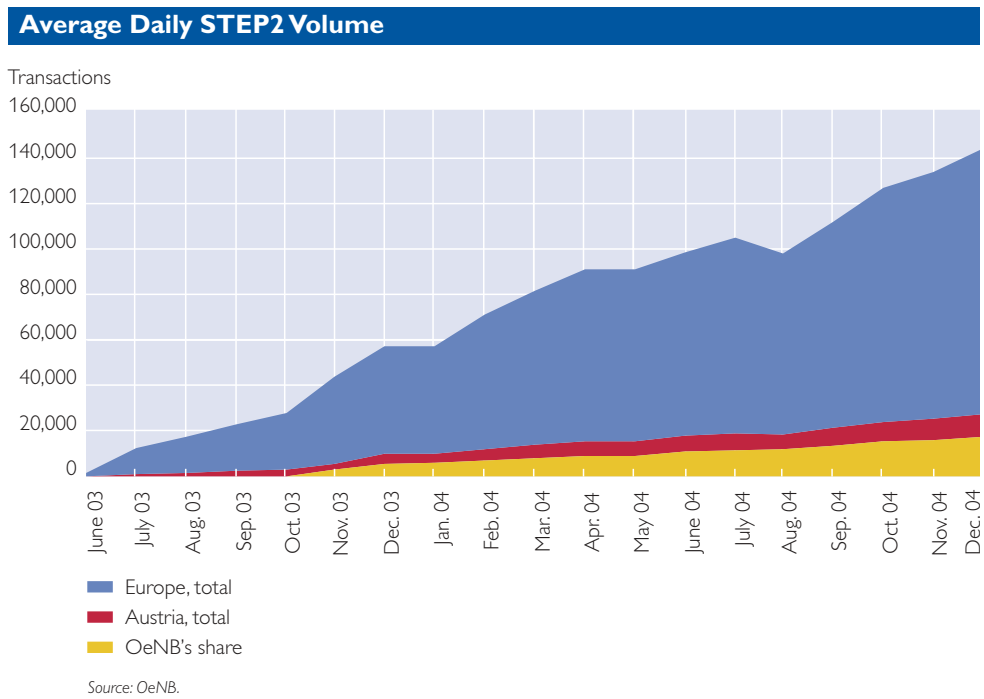
The OeNB strives to continually improve the legal framework as well as the standardization and automation of its range of payment services with a view to optimizing market structures. This way, the OeNB contributes to positioning Austria as a competitive financial marketplace and backs Austrian banks in bringing about a SEPA.

OeNB welcomes ECB initiative for SEPA implementation and supports banks' preparatory work

¹ Up to EUR 12,500 provided the BIC and the IBAN are indicated.

² Body formed in June 2002 by European banks and banking associations to provide strategic orientation and guidance in implementing a Single Euro Payments Area.

³ EBA: Euro Banking Association. In 1985, 18 commercial banks and the European Investment Bank, with the support of the European Commission, founded EBA, which is based in Paris and, as at end-2004, comprised some 200 institutional members. In end-1998, EBA Clearing was set up to operate the large-value payment system EURO1, which went live at the beginning of 1999. Apart from EURO1, EBA developed two payment solutions for low- and medium-value payments, STEP1 and STEP2, under the S.T.E.P.S. (Straight Through Euro Payment System) program.



STEP2 – Pan-European Clearing of Retail Payments

As a direct EBA STEP2 participant, the OeNB has been offering a neutral access point open to all market participants since November 3, 2003. This allows banks to effect cross-border credit transfers up to EUR 12,500 in line with Regulation (EC) No 2560/2001 in a cost-efficient manner. At present, more than 80 European banks are direct and some 1,400 banks indirect participants of STEP2. Accounting for over 12% of the total European STEP2 transaction volume,⁴ the OeNB ranks among the most active STEP2 participants.

Customers benefit not only from lower fees, but also from a shorter transfer execution time. According to a survey carried out by the Austrian Society for Payment System Re-

search and Cooperation (STUZZA)⁵ in 2004, executing a cross-border transfer in the EU now takes 2.2 days on average, which is quite an improvement compared with the average execution time documented in studies for 1999 (3.4 days) and 2001 (3.3 days).

For customers to benefit from the lower transaction charges, the credit transfer must be in euro and must not exceed EUR 12,500. This cap is scheduled to be raised to EUR 50,000 in early 2006. The receiving account designated in the payment order must be held in an EU Member State. The scope of the regulation was broadened in early 2005 to include Norway and Iceland, and Liechtenstein is due to follow in July 2005. Both the Bank Identifier Code (BIC) and the

⁴ Based on the average of the fourth quarter of 2004.

⁵ A cooperation platform of the OeNB and the largest Austrian credit institutions founded in 1991. STUZZA plays a pivotal role in the pursuit of cost cutting and service enhancements in the field of payment processing via standardization and the use of innovative methods.

International Bank Account Number (IBAN) must be indicated in the payment order. The automatic processing of the payment order up to the crediting of the beneficiary's account is only possible if these two codes are (correctly) indicated. Customers may ask their banks to provide their BIC and IBAN.

Thanks to the OeNB's centralized STEP2 service, which the overwhelming majority of Austrian banks uses, it was possible to harness synergies and prevent the development of

parallel structures. The realized economies of scale and a price structure based on the principle of cost recovery rather than a for-profit approach afford all participants attractive transaction fees.

Given Austrian banks' strong foothold in the new Member States and the interest of banks based outside of Austria in gaining access to STEP2, the OeNB started to service credit institutions in other EU countries in May 2004. At the end of last year, banks from the Czech Republic, Ger-

OeNB plays an active role in Central and Eastern Europe

**Indirect STEP2 Participants Connected via the OeNB's Access Point
and Total STEP2 Participants**



- 85% of all Austrian banks
- Countries where the OeNB services participants
- Other countries with STEP2 connectivity

Source: OeNB.

ARTIS payments
in 2004

Central government
sends payment orders
to OeNB via SWIFT

OeNB takes anti-
money laundering
action

Smooth Transition to
SWIFTNet FIN

many, Hungary, Malta, Poland, Slovakia and Slovenia were using the OeNB's STEP2 access point. In addition, Slovakia's Národná banka Slovenska became the first central bank with the status of an indirect STEP2 participant. The OeNB's average daily STEP2 transaction volume more than tripled over the course of 2004.

With its STEP2 access, the OeNB – in cooperation with the banking industry – has succeeded in providing a solution that secures Austrian banks' competitiveness also in the field of cashless payments, having earlier enhanced cash logistics with the establishment of the cash services company GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H.

ARTIS/TARGET⁶ – New Developments in Large-Value Payment Systems

Acting as a role model for the Austrian financial market, the OeNB decided to support Austrian banks in combating money laundering and terrorist financing by implementing a transaction monitoring system designed to ensure compliance with embargo guidelines. The legal basis in this respect was laid down by the Austrian government and the European Parliament. While not obliged to meet the provisions on money laundering and terrorist financing owing to its special status under the Austrian Banking Act, the OeNB nevertheless resolved to introduce precautionary measures to this end.

All relevant data on payment orders received by the OeNB are automatically checked prior to processing. This measure represents another major step toward preventing misuse of the payment systems infrastructure made available by the OeNB.

In 1999, when the Austrian real-time gross settlement (RTGS) system ARTIS was launched, an average of 3,339 transactions with an average total value of EUR 8 billion were processed on a daily basis. In 2004, the daily volume increased to 6,019 transactions worth EUR 10.3 billion, which corresponds to an increase by 80.3% in volume and by 28.8% in value. Year on year, the transaction volume augmented by close to 10% in 2004, while the value remained more or less unchanged.

As from September 8, 2003, the Austrian Federal Financing Agency, a SWIFT⁷ participant under the Member Administered Closed User Group (MA-CUG),⁸ has been sending more than 3,000 messages a month to the OeNB. The use of the SWIFT network and membership in the MA-CUG provide for an efficient and secure electronic message transfer between the central government and the OeNB. Straight-through processing is possible for 97% of payment orders owing to the use of standardized message formats.

From 2003 to 2004, SWIFT migrated all 75 Austrian and some 7,000 banks worldwide from the X.25 (dedicated line) technology to the advanced Internet Protocol (IP)-based SWIFTNet technology. The

⁶ ARTIS: Austrian Real Time Interbank Settlement;
TARGET: Trans-European Automated Real-time Gross settlement Express Transfer.

⁷ SWIFT: Society for Worldwide Interbank Financial Telecommunication. In more than 200 countries, the company, which is owned by the financial industry, provides safe and standardized messaging services and interfacing software for some 7,650 financial institutions.

⁸ A service called for by banks and provided by SWIFT which facilitates the exclusive information exchange among all the SWIFT participants registered in the Closed User Group.

use of SWIFTNet Single Window⁹ now also facilitates liquidity management in real time and the secure transmission of data files on top of financial transaction messaging.

After the Electronic Banking Communication system EBK¹⁰ had been replaced by SWIFTNet FIN in November 2003, the number of messages processed by the OeNB more than quadrupled. In 2004, Austria's transaction growth rate of 32.4% was the highest worldwide. In terms of total messaging volume, Austria is ranked 18th in an international comparison.

TARGET2 – Austria in Favor of Standardization of Large-Value Payments

In 2002, the Governing Council of the ECB laid the foundation for today's integration via an interlinking system of the RTGS systems operated by national central banks in the EU. Compared with the existing TARGET system, the next generation, TARGET2, will offer an extended core service that has been harmonized across Europe as well as a single price structure for national and cross-border payments effected in the entire Eurosystem. Connecting the most important European ancillary systems to TARGET2 via two real-time and four batch-processing models is another milestone in the harmonization and integration of payments in the euro area.

In December 2004, the Governing Council of the ECB approved the establishment of a Single Shared Platform (SSP) for TARGET2 on



the basis of the joint offer made by the Deutsche Bundesbank, the Banca d'Italia and the Banque de France. The OeNB expressed its interest in participating to the ECB as early as August 2003 and notified the ECB in January 2005 of its intent to use the core service of the SSP. The OeNB anticipates that TARGET2 will process large-value euro payments in real time more efficiently compared with today's (decentralized) TARGET system.

In 2004, the TARGET2 project team focused on the identification of the system's functionality in cooperation with the European financial sector as well as on the technical development of the SSP. The Governing Council adopted the General Functional Specifications (GFS) for TARGET2 in July 2004. The User Detailed Functional Specifications (UDFS) are likely to be finalized in April 2005.

TARGET2 will offer comprehensive liquidity management functions that allow banks operating in several European countries to better control

Single Shared
Platform for
TARGET2

Functional TARGET2
specifications

⁹ Unlike in the past, when differing data formats, interfaces, security models and telecommunication networks were used to communicate between different counterparties and market infrastructures, financial market participants today may exchange information via a standardized (uniform) network using a single communication window.

¹⁰ Proprietary Austrian system for the transfer of payment orders.

TARGET2 pricing model

their euro liquidity. The new intraday liquidity pooling feature will enable banks based in the euro area to monitor their accounts held with Eurosystem central banks from a single master account. Euro area banks will be able to group individual accounts and pool the available intraday liquidity for the benefit of all members of the group of accounts. This could reduce banks' need to have recourse to intraday credit.

In addition to the higher level of service, TARGET2 will be based on a state-of-the-art business continuity concept ensuring that in the event of wide-scale regional disruption transactions will be processed via another country.

OeNB sets up national TARGET2 migration team in cooperation with the banking industry

With a view to the transition to TARGET2, the OeNB formed a national migration team (NMT) in May 2004. In close cooperation with Austrian banks, the NMT evaluated TARGET2 functionality and efficient ways of connecting the Austrian financial marketplace to the SSP.

TARGET2 road map

Starting from January 2, 2007, TARGET users are scheduled to migrate to TARGET2 in waves at several predefined dates. Each "migration window" will consist of a group of national banking communities, includ-

ing the central bank and commercial banks. The current RTGS systems and the SSP will coexist during the migration phase. The individual EU countries will be grouped for migration in a way which minimizes project risk.

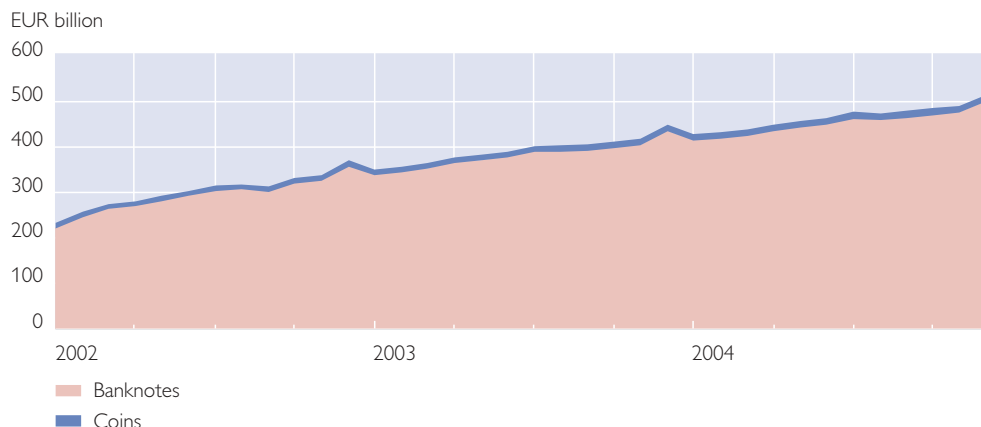
Two pricing models are likely to apply to TARGET2. Participants will be able to choose between transaction fees only and lower transaction fees plus a periodic fee.

The dual pricing scheme should permit recovery of a very large part of the total TARGET2 costs. The fee per transaction will range from EUR 0.25 to EUR 0.80; separate fees will be charged on optional TARGET2 functions, such as the liquidity pooling feature.

The OeNB's Regional Network Ensures Smooth Cash Supply and Cash Handling

At year-end 2004, a total of 9.7 billion euro banknotes (equivalent to EUR 501.3 billion in value terms) and 56.2 billion euro coins (EUR 15.4 billion) were in circulation. This compares with 9 billion euro banknotes (EUR 436.1 billion) and 49 billion euro coins (EUR 14.1 billion) at

Total Value of Euro Banknotes and Coins in Circulation



Source: ECB.

end-2003. In the year under review, the overall value of euro banknotes and coins in circulation thus increased by 15% and 9%, respectively.

Currency in circulation in Austria followed the trend of recent years in 2004 and into 2005: The net balance of euro banknotes issued by and returned to the OeNB continued to decrease steadily, given the free flow of euro cash across borders and the higher number of banknotes returned. In fact, at year-end, the number of banknotes issued less the number of notes returned to the OeNB equaled –43 million; in other words, more banknotes were deposited than withdrawn during the year under review. By contrast, more coins were issued than returned, with the balance equaling 2.3 billion. Following the first drop in the net balance of euro coins issued and returned in Austria so far, namely in November 2004 in the wake of World Thrift Day, the number of coins in circulation increased again to reach a historical high at the end of 2004. Based on transaction data, the OeNB estimates that at the end of 2004, some 300 million euro banknotes were in circulation in Austria. Coin circulation in Austria broadly corresponded to the volume of coin withdrawals minus deposits recorded by the OeNB.

The sustained demand for euro cash can be explained with two factors. On the one hand, cash continues to be the payment instrument of choice in the euro area; in Austria more than 70% of all transactions are still settled in cash despite the growing use of electronic payment means. On the other hand, acceptance of euro payments has increased in non-euro area countries. Surveys conducted in Croatia, the Czech Republic, Hungary, Slovakia and Slovenia show that both the number and

the volume of euro deposits have increased. It is worth noting that in addition to euro payments accepted from tourists, a phenomenon observed for some time now, an increasing percentage of transactions has been settled in euro without in fact involving foreign counterparties. In Croatia and in Slovenia, for instance, more than 7% of the population settled some transactions in euro in 2004.

In parallel with the demand for euro banknotes, the number of counterfeits withdrawn from circulation rose as well. All in all, 594,000 forged euro banknotes were recovered across Europe in 2004 (+9.5%), with the number of counterfeits recorded in Austria totaling 13,386. The number of counterfeits recovered on average in Europe dropped in the second half of the year. In Austria, a downward trend was observed, for the first time, in the final quarter of 2004, even though banknote circulation peaked in the Christmas shopping season in line with historical patterns.

All links in the cash cycle security chain – the central bank, credit institutions, law enforcers and retailers – have vital tasks in effectively protecting the population against counter-

Currency
in circulation
in Austria

Protecting the public
against counterfeits



Verifying security
features without
special equipment

feits. In this respect, the OeNB (and its subsidiaries) focus on

- producing high-quality banknotes and coins (Oesterreichische Banknoten- und Sicherheitsdruck GmbH – OeBS; Münze Österreich Aktiengesellschaft);
- continually checking the authenticity of the banknotes and coins in circulation (GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H. – GSA); and
- educating professional cash handlers (cashiers at banks and retailers; the police) and the general public about the euro.

The OeBS prints the share of euro banknotes allocated to the OeNB in close coordination with the ECB and the printing works of the other euro area countries. A top priority in producing euro banknotes has been the integration of security features anyone can check without special equipment. People run a lower risk of accepting counterfeit banknotes when they know what the genuine banknotes look like and when they take the time to verify a few security features. It pays to tilt the euro banknotes to check for moving images and color-shifting ink features, and to watch out for the unique feel of bank-

Box 5

How to Check the Validity of Euro Banknotes

Feel

Run your finger over the front of the banknote and you will feel the print to be raised in some parts. As a result of intaglio printing methods, the initials of the European Central Bank, the value numerals and the motifs of windows and gateways will feel rough to the touch.



Look

Look at the banknote and hold it up to the light: the watermark, the security thread and the see-through register will then be visible. All three features can be seen from the front and the reverse side of genuine banknotes.



Tilt

Tilt EUR 5, EUR 10 and EUR 20 banknotes to see the moving image on the hologram stripe applied to the front of the banknote: the hologram image will change between the value and the € symbol. On the reverse side, if you tilt the banknote, you can see a glossy gold-colored stripe. Tilt EUR 50, EUR 100, EUR 200 and EUR 500 banknotes to see the moving image on the hologram patch applied to the front of the banknote: the hologram image will change between the value and a window or doorway. On the reverse side, if you tilt the banknote, you can see a color-shifting ink feature, i.e. the value numeral in the right-hand corner shifting color from purple to olive green or brown.



note paper and the distinctive “raised” feel produced by intaglio printing. In all known counterfeit categories, forgers have so far failed to successfully reproduce these features. While the quality of the counterfeits recovered has increased, the FEEL – LOOK – TILT test (see box 5) remains sufficient to detect euro counterfeits.

To remain at the cutting edge of technical progress and innovation, banknote series are replaced at regular intervals. A key aspect in designing the new series of euro banknotes is the Eurosystem’s objective to provide state-of-the-art security features. Since banknotes are highly sophisticated products that need to be produced in large quantities, preparatory work on the next banknote series already started in 2004. The first banknotes of the new series are expected to be issued toward the end of this decade.

When it comes to establishing the authenticity of banknotes, their quality (“fitness”) is a key factor. The better the quality is, the easier it is to check the security features, especially the property of the paper and the raised ink features. In order to guarantee the fitness of the euro banknotes circulating in Austria, the OeNB and GSA processed approximately 960 million banknotes in 2004. In other words, every banknote circulating in Austria was checked three to four times on average by OeNB or GSA experts and removed from circulation when found unfit.

At the same time, more and more banks and retailers with a high cash turnover use special equipment on site to check banknotes for authenticity and, to some extent, for quality. To be able to offer guidance to users and producers of such equipment, a Test Center was installed in the

OeNB’s Cashier Division in 2004, where banknote and coin handling machines can be checked for their usefulness and effectiveness. Furthermore, work is under way to establish a structured procedure for making the test results available to a closed user group (via the dedicated website for professional cash handlers, <https://bargeld.oenb.at>). At the same time, the OeNB thus meets ECB requirements for cash recycling machines.

Yet the efforts to produce state-of-the-art banknotes and ensure the fitness of circulating banknotes alone are not enough; cash users must also be familiar with the security features of banknotes. This is why educating the general public, but above all professional cash handlers about the distinctive features of euro banknotes is of utmost priority. After all, cashiers at banks and retailers and the police are at the forefront of protecting the public at large against counterfeits. In this respect, the OeNB again considerably stepped up its information activities in 2004. All in all, the OeNB hosted 495 workshops to provide in-depth information to more than 10,000 cash-handling experts. Furthermore, the OeNB reached out to approximately 68,000 people via its mobile branch office, the euro bus touring Austria, as well as at trade fairs.

The OeNB uses its regional network of cash service providers as a channel for disseminating information and hosting training sessions on banknotes. The OeNB’s branch network offering cash services throughout Austria was reorganized in 2004 following the changeover to the euro. The establishment of four regional hubs ensures that the OeNB’s range of services continues to be accessible throughout Austria. The decision to

Continuous
monitoring of
banknote quality

OeNB’s regional
network of cash
service providers

Called-in Banknotes and Dates at which Exchange Periods End	
<p>ATS 1,000, 3rd motif (Bertha v. Suttner) August 30, 2005</p>	
<p>ATS 100, 5th motif (Angelika Kaufmann) November 28, 2006</p>	
<p>ATS 500, 2nd motif (Josef Ressel) August 31, 2007</p>	
<p>ATS 50, 3rd motif (Ferdinand Raimund) August 31, 2008</p>	
<p>ATS 20, 4th motif (Carl Ritter v. Ghega) September 30, 2009</p>	
<p>ATS 500, 3rd motif (Otto Wagner) April 20, 2018</p>	
<p>ATS 1,000, 4th motif (Erwin Schrödinger) April 20, 2018</p>	

turn the euro bus into a permanent mobile branch office underlines the OeNB's commitment to enhance customer orientation.

The euro bus is literally a vehicle for spreading information but also continues to provide welcome opportunities for converting old schilling

holdings locally into euro free of charge. Approximately 10% of all schilling holdings converted in 2004 were returned to the OeNB via the euro bus. On balance, the volume of outstanding schilling banknotes and coins shrank from ATS 12 billion to ATS 11.5 billion.

The schilling coins and banknotes of the last series may be converted into euro indefinitely at the OeNB free of charge. In contrast, the exchange deadlines for banknotes of earlier series, all called in by the time the euro was launched, continue to apply (see box 6). Thus, conversion of the ATS 1,000 banknote featuring Bertha von Suttner will only be possible until the end of August 2005. To date, some 464,000 called-in banknotes of this motif have not yet been returned to the OeNB.



Cash Services and Cashless Payment Solutions Provided by the OeNB through Its Associated Companies

Over the past two decades the OeNB has developed a portfolio of subsidiaries and associated companies that support the central bank in providing *cash services* and *cashless payment solutions*. These associates are a key pillar of the overall framework put in place to ensure that Austria will be adequately supplied with cash and that payment systems work smoothly. Through its associated companies, the OeNB can pursue its security aims and take confidence-building measures at the operational level in the field of cash services and payment solutions. The network of associates supports the OeNB in meeting its responsibility to help maintain the stability of the financial system, creating a positive business and investment climate in Austria. Through the provision of effective and efficient services that ensure a smooth implementation of operations, the associated companies substantially support the OeNB in fulfilling its tasks.

The core business of Münze Österreich Aktiengesellschaft and of Oesterreichische Banknoten- und Sicherheitsdruck GmbH is to produce coins and banknotes. In addition, a cash services company – GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H. – provides cash processing and cash logistics services for both banknotes and coins. The pooling of these services has made it possible to keep cash handling costs to a minimum.

AUSTRIA CARD – Plastikkarten und Ausweissysteme Gesellschaft m.b.H. is a producer of highly secure chip cards. In the field of *cashless payment solutions*, the OeNB moreover holds minority interests in Austrian Payment Systems Services (APSS) GmbH, in the certification services provider A-Trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH, and in Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr (STUZZA) G.m.b.H. The strategic objective of these undertakings is to provide a secure payment systems infrastructure and ensure the provision of reliable financial services.

The Payment
Instruments Cluster

The role of the
OeNB's associated
companies

The OeNB's Payment Instruments Cluster

Cash services

Cash production

Münze Österreich Aktiengesellschaft (100%)

- minting, distribution and withdrawal of divisional and negotiable coins
- production and sale of items made of noble and other metals
- engineering and consulting services

Oesterreichische Banknoten- und Sicherheitsdruck GmbH (100%)

- banknote and security printing
- print product business
- research and development services



Cash processing

GELDSERVICE AUSTRIA

Logistik für Wertgestionierung und Transportkoordination G.m.b.H. (91.4%)

- cash processing
- supply of banknotes and coins
- logistics

Cashless payments solutions

Production of payment instruments

AUSTRIA CARD- Plastikkarten und Ausweissysteme Gesellschaft m. b. H. (100%)

- production and sale of credit cards, card systems and related forms as well as of equipment for the production and use of card systems
- production and sale of ID systems



Provision of infrastructure and ensuring the provision of reliable financial services

Austrian Payment Systems Services (APSS) GmbH (38%)

- establishment and development of ATM and POS terminal services
- IT services

A-Trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH (9.1%)

- certification services in the area of electronic signatures

Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr G.m.b.H. (STUZZA) (25%)

- research association for the development of concepts and measures to reduce credit institutions' payment transaction costs

The percentage in parentheses indicate the shares that the OeNB holds in the individual companies.

OeNB subsidiaries
provide efficient
services and ensure
market proximity

The OeNB's associates are separately managed companies that put a key emphasis on efficient performance and the use of best practices in business management.

As these companies need to assert themselves in the national and international markets, they are constantly seeking to minimize costs and are dedicated to the principles of innova-

tion, flexibility and customer orientation. The associated companies use their know-how and resources to offer also products and services that go beyond the central banking business or related activities. By boosting the financial results, these additional activities help secure the company's future and thus the provision of the central bank-related activities.

Synergy effects contribute to maximizing the benefits provided by the OeNB and its associates. This is why special emphasis is put on exploiting both horizontal and vertical synergies by building alliances with firms in the same industry as well as upstream or downstream partners in the value chain.

At the strategic level, the OeNB and its associates strive to create synergies by optimizing the business portfolio and by bundling procedures.

Last, but not least, increased cost-efficiency is ensured by the joint use of human and capital resources.

Exploiting the
potential for synergy



The OeNB's Information Policy – Conveying Stability and Security

Communicating Monetary Policy Objectives – A Prerequisite for Credibility and Trust

“Stability and
Security” – the
OeNB's information
campaign

Communication is an important value-adding factor. As such, it can be planned, controlled and measured, promoting understanding, trust and transparency. The OeNB has embraced this principle jointly with the other euro area NCBs and the ECB; it is enshrined in the joint Eurosystem Mission Statement.



Trust has always been a sensitive key value for central banks, and public confidence in the OeNB has traditionally stood at high levels, as was recently confirmed by an IFES (Institute for Empirical Social Research) survey. According to IFES, 78% of Austrians continued to have high confidence in the OeNB in the fourth quarter of 2004. The OeNB has built up this trust over decades by pursuing credible and stability-oriented monetary policy objectives and by displaying exceptional know-how in key central banking areas. High public confidence forms the basis for communicating the current monetary policy strategy, which in turn reinforces trust in the OeNB. In communicating the single monetary policy the OeNB makes use of all media our informa-

tion society has to offer. As economics is frequently about complex processes, it is a challenge for public relations experts to convey these processes to the general public in a clear, understandable manner.

To improve the general understanding of basic macroeconomic processes and to strengthen confidence in the euro, in 2004, the OeNB launched an information campaign revolving around the key values “Stability and Security” The objective of this campaign has been to inform the public about the euro (price stability, security features), the single monetary policy and the OeNB's tasks. Based on the overarching principles of stability and security, the campaign has been designed to familiarize the public with the OeNB's main task, i.e. the maintenance of price stability.

The OeNB has been placing advertisements and has been broadcasting TV commercials conveying a message along the lines of “I work hard for my money. *Good that each euro is worth it.*” and has been using media cooperation and advertorials to address not only the general public, but also the people it has not been able to reach so far. To prepare and fine-tune the campaign to the needs of the latter target group, the OeNB conducted both quantitative and qualitative surveys with polling institutes. As a result, the campaign was designed to channel the patriotism of this target group into the euro as a European value.

The print media campaign focused on the following topics:

- The euro on a path of stability
- The euro's stability as a guarantee of our purchasing power
- First-rate security features
- Understanding price developments

- Handling euro banknotes and coins

Furthermore, the OeNB addressed a broad range of TV viewers of all age groups. The topics covered were:

- The basket of goods and services and its calculation
- The euro as a secure currency
- Purchasing power and prices
- Handling euro banknotes and coins
- Cents' worth
- The euro abroad

To provide the youngest TV viewers with information about the euro and to help them learn about money matters through play, the OeNB launched a contest in the children's program "Confetti TiVi" where children aged 8 to 12 designed their own euro banknote. In January 2005, three winners were drawn from the best entries and rewarded with attractive prizes.

The OeNB plans to continue these public relations activities throughout 2005, building on the 2004 information campaign.

In addition to the measures outlined above, the OeNB organized a comprehensive series of seminars for financial and business journalists in the reporting year, which culminated in a visit to the ECB when the Governing Council held a monetary policy meeting. These seminars provided a forum for discussing all aspects of central banking, with a particular focus on the Eurosystem's single monetary policy.

29 press conferences and press talks as well as 170 press releases made 2004 a very active year for the OeNB.



The OeNB's website (www.oenb.at) was relaunched to consolidate and optimize the OeNB's information on the Internet. During the relaunch, various e-services and the website contents, which had been provided since 1995 and had been constantly expanding ever since, were modernized and (re)integrated into a state-of-the-art website. The new website sports well-structured navigation for content from all of the OeNB's business areas as well as full-text search options. A powerful search engine allows users to search all website contents and PDF files for key words. The website's consistent design was created in accordance with the guidelines drawn up by the Web Accessibility Initiative, an initiative promoting accessible web design.

The new OeNB
website

Moreover, the range of information and data the OeNB provides has been expanded, restructured, and complemented by user-friendly query options. In addition, a number of macroeconomic and statistical products have been redesigned to better meet customer demand (see box 7).

Redesign of the OeNB's Macroeconomic and Statistical Products

In recent years, the OeNB has redesigned a number of its print publications and has developed several new information products to improve customer orientation. In the course of this process, the OeNB revised its Annual Report several years ago and published the first issue of its Financial Stability Report in 2001. The reporting year, however, saw the greatest number of changes, all of which were preceded by well-targeted customer surveys.

- In May 2004 the OeNB published its first issue of *Monetary Policy & the Economy* (German version: *Geldpolitik & Wirtschaft*), a quarterly review of economic policy which replaced *Focus on Austria* (German version: *Berichte und Studien*). The individual studies published in *Monetary Policy & the Economy* are refereed by external experts and released by an editorial board. The Q2/05 issue, which is scheduled for late June 2005, will have a special focus: 10 years of Austrian EU membership. This special topic will be dealt with from various economic perspectives.
- In mid-2004 the new series *Workshops – Proceedings of OeNB Workshops* replaced the special focus issues of *Focus on Austria*. The new series is published exclusively in English. To date, four issues have been published on monetary and economic policy topics.
- In October 2004, the first issue of *Focus on European Economic Integration* was published. This new publication replaces *Focus on Transition*, which had up to then provided analyses of Central and Eastern European countries (CEECs). *Focus on European Economic Integration* is published twice a year and is available exclusively in English.
- In September 2004 the quarterly statistical publication *Statistiken – Daten & Analysen* (available exclusively in German with executive summaries in English) replaced the former monthly *Statistisches Monatsheft*. Unlike its predecessor, the new statistical series also provides short reports and analyses, which focus on Austrian financial institutions, financial flows and external sector developments. Daily updates of the statistical series' tables (available in German and English) can be viewed on the OeNB's website under the heading "Statistics and Reporting." Special issues on specific statistical topics complement the information provided in the statistical series. A survey conducted in early 2005 showed that users are very satisfied with the new design of the OeNB's statistical series, which has been in place since September 2004.
- The OeNB's website (www.oenb.at) offers user-friendly access to all publications listed above. Under the "Media and Publications" heading, PDF files containing entire publications or individual contributions are available free of charge.

Basel II information campaign

An IFES survey on the information level of SMEs, which was conducted in October 2004, revealed that a mere 16% of SMEs have made preparations for the New Basel Capital Accord (Basel II) so far. For this reason, the OeNB decided to organize a Basel II information campaign. A five-step immediate action plan has already been launched: In early December 2004, the OeNB thoroughly briefed the Austrian Members of the European Parliament on Basel II. In cooperation with the Austrian Federal Economic Chamber, the OeNB also organized a nationwide road show focusing on Basel II-re-

lated issues. During the entire road show, OeNB experts offered their expertise to interested SMEs. Thus, Austrian SMEs had the possibility to thoroughly familiarize themselves with Basel II in a personal setting. As an additional measure, the OeNB and the Financial Market Authority (FMA) have published best practice guidelines to inform Austrian banks about credit risk-minimizing techniques. Furthermore, OeNB experts have compiled a Basel II information folder, which is mainly distributed via commercial bank counters. An electronic newsletter, which continually provides news on Basel II, com-

pletes the OeNB's information kit on Basel II.

Because of the high number of counterfeit euro banknotes, the OeNB and the Austrian Broadcasting Corporation's radio station Ö3 decided to revive their joint public relations campaign "MEHRscheinchen." At the heart of this campaign was a competition based on the serial numbers and security features of banknotes; winners were awarded money prizes. This initiative reached 84% of Ö3 listeners and familiarized them with the security features of the euro banknotes. All in all, 800,000 people participated in the "MEHRscheinchen" contest, which involved checking euro notes for the winning serial number and examining their security features.

The Eurotour bus first toured Austria in 2002 and 2003, providing Austrians all across the country with the opportunity to exchange their schillings for euro and to obtain information about money matters. As this service was very well received (90,000 persons visited the Eurotour bus) and as Austrian citizens' need for information is increasing steadily, the OeNB decided to turn the Eurotour bus into a permanent mobile branch office. To this end, a new bus was furnished with state-of-the-art equipment. With 97 stops all over Austria, 2004 has been the most successful year for the Eurotour so far. 113,000 Austrians visited the Eurotour bus, receiving information about the euro and exchanging around ATS 63 million for euro.

In 2004 the number of questions addressed to the OeNB's information services (hotline and electronic query) went up by 15% to 31,400. This marked increase is largely attributable to the considerable rise in e-mail queries, whose number grew

by 2,000 to 6,800 year on year in 2004. The number of electronic queries was driven up primarily by questions about monetary policy and central banking issues raised by university and Fachhochschule staff and students as well as business people, which are also responsible for the rising complexity and increasingly demanding nature of these inquiries. As a consequence, more time and effort has gone into providing answers to hotline inquiries.

Cooperation with Ö3,
Eurotour bus



The Statistics Hotline offers competent advice and information on the OeNB's financial statistics to the Austrian public. Like the general information hotline, the Statistics Hotline was in high demand in 2004; the number of requests grew by 17% year on year, reaching 1,800. 90% of all inquiries were answered within 24 hours. The clients of the Statistics Hotline not only include experts from commercial banks, law firms as well as consulting companies and financial analysts, but also a growing number of journalists.

Humming hotlines

In September 2004 the professional management of the OeNB's Money Museum was rewarded with the Austrian quality seal for museums – a memorable highlight for the museum's staff.

The OeNB's Money
Museum



In 2004 the Money Museum recorded around 10,500 visitors, 29% of whom were not with a group. 58% participated in one of the 237 guided group tours offered by Money Museum employees.

Important additions to the Money Museum in 2004 included the “Sammlung Leypold,” a remarkable collection of coins currently on view at the Kunsthistorisches Museum in Vienna, and a Vienna Philharmonic gold bullion coin with a face value of EUR 100,000 acquired by the OeNB with the consent of the General Council. With its weight of 31 kg and a diameter of 37 cm, the EUR 100,000 Vienna Philharmonic is the world’s largest gold coin. There are only 15 EUR 100,000 Vienna Philharmonic gold coins altogether, and the OeNB’s Money Museum owns the only one in Austria.

The OeNB as a National and International Forum for Dialogue

Over the years, the OeNB has developed into a nationally and internationally recognized platform for dia-

logue. The varied events the OeNB organizes provide economic policy-makers with a forum for the exchange of ideas and foster economic discourse in general. In 2004, the OeNB hosted events on a total of 288 days, welcoming around 12,000 participants. The OeNB’s major conferences, the *Economics Conference* and the *Conference on European Economic Integration*, figure most prominently.

The OeNB’s 32nd *Economics Conference*, which took place in Vienna on May 27 and 28, 2004, again dealt with a highly topical issue: “Growth and Stability in the EU: Perspectives from the Lisbon Agenda.” All conference participants agreed that to reach the goals set forth in the Lisbon agenda, further structural reform and investment were crucial, in particular in areas such as innovation and education.

The *Conference on European Economic Integration* (CEEI, the successor to the OeNB’s *East West Conference*) took place on November 29 and 30, 2004. As indicated in the title, “South Eastern EUROPEAN Challenges and Prospects,” the first CEEI focused especially on this area, thus constituting one of the OeNB’s first concrete contributions to analyzing developments in Southeastern Europe. The conference mainly concentrated on areas of major importance from a central banking perspective: monetary and exchange rate policies as well as the banking sector in Southeastern Europe, a region in which Austrian banks have been particularly active.

Policymakers in particular have always been important dialogue partners for the OeNB. At regular intervals, the OeNB's Governor and Vice Governor report to parliament, specifically the finance committee of

the Austrian Nationalrat, on the current overall economic situation, on monetary policy in the euro area and on important financial market developments.



The OeNB – An Innovative, Dynamic and Cost-Efficient Enterprise

In 2004 the OeNB again performed a wide and complex range of functions. These functions are, on the one hand, defined by the OeNB's responsibilities within the ESCB/Eurosystem and, on the other hand, by domestic business areas. In fulfilling its tasks, the OeNB is guided by its mission statement and strategic orientation as well as by the Eurosystem Mission Statement, which was published in 2004.

All OeNB activities are informed by considerable cost consciousness. This chapter gives a detailed account of the measures which allowed the OeNB to continuously perform its

functions efficiently and effectively and which strengthened its position as a flexible, innovative and dynamic enterprise.

As the OeNB's control and management system is based on decentralized responsibilities in many areas, transparency is particularly important for performance. In this context, measuring performance by means of specific indicators was a pivotal activity in 2004. The above-mentioned factors, along with many others, have helped the OeNB earn high esteem as a competent partner within the Eurosystem and on the Austrian financial market.

Box 8

The OeNB's Customer-Oriented Range of Services

The OeNB performs its functions within the framework of a uniform structure for the Eurosystem:

- *Monetary policy decisions*
 - *Economic analysis and research*
 - *Participation of the OeNB's governor in the Governing Council and in the General Council of the ECB*
- *Implementation of monetary policy decisions*
 - *Conduct of monetary policy operations with Austrian banks*
 - *Participation in Eurosystem foreign exchange interventions*
 - *Management of the OeNB's own reserve assets and of the reserves transferred to the ECB*
 - *Conduct of minimum reserve operations and monitoring of minimum reserve holdings of Austrian banks*
 - *Interfacing between the Eurosystem, Austrian economic agents, policymakers and the general public*
- *Supervisory functions and financial stability*
 - *Participation in the prudential supervision of Austrian banks and payment systems oversight to secure financial stability*
 - *Risk analysis of financial markets and banks*
- *Statistics*
 - *Provision of conclusive, high-quality statistics, above all monetary, interest rate and prudential statistics as well as external trade statistics (e.g. balance of payments and financial accounts)*
- *Cash supply*
 - *Provision of banknotes and coins to Austrian businesses and consumers and ensuring smooth cash circulation*
- *Payment services*
 - *Provision and promotion of reliable domestic and cross-border payment systems (ARTIS, TARGET)*
- *International cooperation*
 - *Cooperation within a wide range of Eurosystem, ESCB and EU bodies*
 - *International monetary policy cooperation and participation in international financial institutions*
- *Provision of advice to the Austrian authorities*

Structures Aligned to the OeNB's Strategy

In line with its strategy, the OeNB's activities continue to cover the entire range of central banking core areas, complemented by selected fields of activity. The previous chapters of this annual report have described the OeNB's tasks in detail. This chapter will now provide some examples of the OeNB's relational and structural capital and explain a number of organizational changes.

In the reporting year, members of the OeNB's management and staff represented the OeNB's interests in 198 international bodies, in particular those of the ESCB/Eurosystem, the European Union (EU), the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD). Moreover, OeNB staff participated in 95 national panels focusing on financial and economic policy.

To provide guidance in view of the increasingly complex interconnections between participating central banks, the Eurosystem adopted a joint Mission Statement¹ in 2004. In essence, this Mission Statement clarifies the Eurosystem's objectives, values and principles and lays down the basic parameters for smooth and efficient cooperation. With the aim of strengthening the basis for a common identity, the Mission Statement describes the roles and responsibilities of all Eurosystem members.

Relying on its longstanding experience, the OeNB has been able to provide valuable input to the development of a Eurosystem-wide cost accounting system. In this area, in particular, factors like comparability

and transparency play a key role. These vital elements have provided a basis for building a harmonized and efficient network across the Eurosystem.

With a view to strengthening cooperation, in 2004 the OeNB again participated in the *Central Bank Governance Network* coordinated by the BIS. This cooperative venture, which previously had been limited to answering inquiries in writing, also included specialist working meetings in 2004. This formalized face-to-face exchange of experience is intended to promote general workflow optimization (by defining examples of best practice) and working solutions.

Since the beginning of the 1990s the OeNB has evolved into a competence center for the analysis of economic developments in the Central and Eastern European countries. In 2004, the OeNB expanded the focus of its expertise to the countries of Southeastern Europe. This new strategic orientation is appropriate to accommodate the ongoing European integration and reflects the importance this neighboring economic area has for Austria.

Another example of intensified cooperation and networking is the

Cooperation and
networks



¹ See www.oenb.at or www.ecb.int.

Efficient procurement
structures

Joint Vienna Institute (JVI), which was established in Vienna in 1994. It is a multilateral training center that supports transition countries, in particular in Central and Eastern Europe and the former Soviet Union, on their way to becoming market-oriented economies. The IMF, the Austrian Federal Ministry of Finance and the OeNB share the cost of the regular training courses offered at the JVI. In 2004, the OeNB organized a number of seminars which covered topics like Economic and Monetary Union, payment means and payment systems, and central bank management.

Organizational
changes

In November 2004, the OeNB successfully completed the reorganization of its branch offices. In the course of this reorganization, the original framework of eight branches was restructured according to market-related regional aspects. Aside from the OeNB's head office in Vienna, which covers Eastern Austria, there are now three regional branch offices:

- Northern Austria branch office, located in Linz, with a representative office in Salzburg;
- Southern Austria branch office, located in Graz, with a representative office in Klagenfurt; and
- Western Austria branch office, located in Innsbruck.

The regional model supports the OeNB's decentralized approach to fulfilling its tasks. The tasks of the OeNB's branch offices range from public relations and communications activities to holding cash reserves, providing information on payment instruments, handling cash, observing the local economy, supporting the supervision of financial markets and carrying out payment transactions.

Following the introduction of a new front office system in 2003 and

in view of the changing framework conditions, organizational and workflow structures in the treasury domain were optimized to ensure that the OeNB's *Treasury Section* operates in an economical and sustainable manner.

As a public sector contractor, the OeNB is subject to the Federal Procurement Act, which prescribes a call for tenders for procurements exceeding a certain threshold. In 2004, a total of 26 calls for tender were carried out, guaranteeing efficient, free and fair competition in the procurement process. The OeNB succeeded in reducing costs massively in 2004 by continuously optimizing efficiency. All corporate expenditure-related activity follows economic and ecological principles.

To ensure process efficiency, an e-procurement system is used to handle all orders with IT support. A procurement platform open to all OeNB subsidiaries has been established to achieve synergy effects in procurement across the OeNB group.

By introducing an integrated environmental management system for all its offices across Austria, the OeNB has further strengthened its leading position in environmental protection among European central banks. With this step, the OeNB has signaled its willingness to go far beyond the ecological requirements businesses have to meet by law.

Environmental efforts are measured on the basis of ecological indicators for businesses, which rely on input-output data. These indicators make it possible to regularly assess the improvement of environmental efforts, facilitate comparisons with other companies in the industry and thus help identify potential for long-term improvement. The following table gives a brief overview of the

Overview of the OeNB's Ecological Indicator Values

Energy	Location	2004	2003	2002	2001	Unit ¹	Benchmark ²		
							+	~	-
Electricity consumption	Vienna	8.37	8.4	8.7	9.2	MWh/emp	<4.5	6	>8
Heat consumption	Vienna	73	80	135	119	kWh/m ²	<110	130	>150
Water									
Water consumption	Vienna	121	114	128	131	l/emp/day	<60	100	>120
Consumption of materials and products									
Total paper consumption	All sites	212	186	254	467	kg/emp	<100	200	>500
Consumption of writing/photocopying paper	All sites	12,330	20,958	25,377	27,797	pieces/emp	<8,000	10,000	>12,000
Share of recycled paper	All sites	90	65	34	34	%	>30	20	<10
Consumption of cleaning products	Vienna	31	105	105	105	g/m ²	not available		
CO₂ emissions (total)									
CO ₂ emissions ³	All sites	3.0	4.1	4.3	4.9	t/emp	<2.8	4	>4.5

¹ emp = employee.

² Source: Association for Environmental Management in Banks, Savings Banks, and Insurance Companies; Austrian Society for Environment and Technology guideline.

³ Operation and business trips.

Source: OeNB.

OeNB's ecological indicator values and provides a comparison with other financial services providers.

In 2004, the OeNB's IT quality management system (QMS) was re-certified to the ISO 9001:2000 standard. The main objective of the QMS, which was introduced in 2001, is to implement and continuously optimize standardized IT processes that cater to user needs – an approach that guarantees the provision of state-of-the-art services to the OeNB's IT customers. The long-term benefits of the QMS include not only high-quality reproducible services but also a secure and stable infrastructure for the IT products the OeNB provides. Thus, the IT Section contributes substantially to the high productivity of the OeNB group's business processes.

Innovative Projects Pave the Way for Future-Oriented Management and Top Performance

2004 saw the large-scale evaluation and documentation of OeNB processes and products designed to ensure the sustainable development of the strongly customer-oriented product

portfolio as well as the efficient allocation of resources. All of the OeNB's products were evaluated and examined for optimization potential. On the basis of these assessments, detailed process analyses were carried out.

In 2004, the OeNB devoted around 11% of its staff resources to projects which are intended to bring about sustainable long-term changes in the OeNB's internal structures and thus to optimize customer orientation. Some of the most important related projects are described below.

To further optimize cost, an internal cost allocation project identified those internal support services for which precise internal cost allocation is economically feasible.

In line with an agreement with the ECB, the OeNB has taken responsibility for the IT maintenance and further development of the Counterfeit Monitoring System, a restricted-access ESCB-wide database providing information on counterfeit euro banknotes and coins. This agreement, under which the OeNB is remunerated for its services, is a pilot project within the ESCB which may serve as a

The OeNB's IT quality management system recertifies to ISO 9001 standard

Internal cost allocation

OeNB responsible for the IT maintenance and further development of the Counterfeit Monitoring System within the ESCB

Balance of
payments – the new
reporting system for
Austria's external
trade statistics

Operational
risk management at
the OeNB

2003 Intellectual
Capital Report – the
prototype for a new
annual publication

Progress with
IT-related prepara-
tions for Basel II

model for future cooperation and the division of responsibilities in IT-related matters.

In 2004 the OeNB's IT-related activities centered around the implementation of the new reporting system for the balance of payments statistics. By the end of the reporting year, the system's key components had been completed and tested. Another central activity was the organization of an information campaign targeted at reporting agents in the financial sector. The campaign comprised a road show, which toured all of Austria's provinces, and several special lectures organized together with various interest groups. In December 2004 the Balance-of-Payments Reporting Regulation ZABIL 1/2004 of the Oesterreichische Nationalbank² was published. It provides a detailed description of reporting requirements in the financial sector.

The *TOPAS/TOPIT* project, designed to transform the OeNB into a partner for risk analysis and the supervision of financial stability, was successfully completed on schedule in late 2004. In the course of this project, which had been launched in January 2002, the OeNB's analyses of the banking sector and of individual banks were generally overhauled; moreover, the applied methods and technical aspects were updated. As an important step, primary data management was reformed to incorporate state-of-the-art features. Measured against other central banks' and supervisory authorities' results, the OeNB's new models of banking analysis have proved very successful by international standards. The IT-related preparations for the New Basel

Capital Accord (Basel II) consisted of the expansion of the processing systems for banking statistics, the Major Loans Register and the existing banking analysis tools.

The introduction of operational risk management at the OeNB (ORION) and the ensuing close cooperation between the responsible OeNB divisions reduced potential risks by improving contingency management at the interfaces between the various divisions. Furthermore, the OeNB for the first time conducted a LAN failure test under live conditions in 2004. The annual business continuity test, which ensures that the infrastructure needed to conduct business is available, was also completed successfully.

By publishing the prototype of what is to become an annual Intellectual Capital Report, the OeNB has once more reaffirmed its leading position in the field of transparent corporate governance. The report is ideally suited to communicating information on the OeNB's intellectual capital and thus promotes the OeNB's policy of actively providing comprehensive facts to the general public.

In line with the OeNB's mission statement and strategic orientation, the first Intellectual Capital Report defined knowledge goals with respect to human, structural, relational and innovation capital. The report outlined the underlying Intellectual Capital Report model, the OeNB's knowledge goals and ways of measuring their attainment by defining suitable indicators. The Intellectual Capital Report is an innovative product which will serve as a controlling tool in the future.

² See www.oenb.at under the "Statistics and Reporting" heading.

Sound Expert Knowledge – A Major Success Factor

The OeNB's staff members make a decisive contribution to fulfilling Austria's demanding tasks within the ESCB/Eurosystem and to coping with a business environment that is changing at an ever greater pace. Adjusted for employees on secondment or leave (such as maternity and parental leave), the average number of staff working in the OeNB's core business areas (expressed in full-time equivalents) came to 957.3 in 2004. 37.3% of OeNB staff held university degrees, which represented a year-on-year rise by five percentage points.

As an enterprise that strongly relies on the expertise of its employees, the OeNB places particular emphasis on the training and education of its staff. In training its new staff members, the OeNB increasingly resorted to e-learning methods in 2004. E-learning allows new employees to familiarize themselves with the OeNB's and ESCB's main tasks on an individual, unscheduled basis. In 2004 more than 65% of OeNB staff members participated in at least one educational activity. Knowledge exchange within the OeNB as well as between the OeNB and the ECB or other NCBs is additionally promoted through job rotation programs. In the reporting year, 46 staff members took advantage of job rotations to learn more about other functions and institutions. The number of job rotations thus went up by 31% year on year.

Through its participation in the *Steering Committee* for training activities in the ESCB/Eurosystem, the OeNB's Personnel Division is actively involved in preparing projects for joint human resources development measures. Within the ESCB/Eurosys-



tem training activities in specific fields are, for example, being harmonized: International seminars for new staff members and managers as well as for language training were organized under this heading in 2004. The OeNB is involved in both the planning and implementation of these educational measures. In addition to the training opportunities outlined above, the OeNB and the Deutsche Bundesbank organized specialist seminars on Basel II-related topics in Vienna, which were open to all 25 NCBs within the ESCB.

The exchange of know-how among the individual NCBs is of crucial importance within the ESCB. Thus, in 2004, the OeNB's Personnel Division pioneered a meeting with central bank representatives from Austria's neighbors (the Czech Republic, Hungary, Slovakia and Slovenia) to intensify relations in the field of human resources management.

The OeNB is an equal opportunity employer and lays great store by a healthy work-life balance. In the reporting year the percentage of women in total headcount was 40%. Among the many measures taken to improve the compatibility of work and family, the various part-time schemes (50% to 80%) the OeNB offers stand out in particular. Moreover,



OeNB employees on parental leave have the possibility to opt for a 20% or 30% part-time solution. The considerable share of part-time employees in total headcount (7.5%) demonstrates that this measure meets with a high degree of approval among staff.

OeNB Shows Commitment to Research, Science and Culture

As the OeNB takes a strong interest in securing the future of Austrian science and research, it has provided Austrian researchers with considerable funds for almost 40 years. In 1966, the OeNB set up the Anniversary Fund for the Promotion of Scientific Research and Teaching (Anniversary Fund) to mark the 150th anniversary of its establishment. Since then, the Anniversary Fund has provided approximately EUR 653 million of financial support for close to 8,300 projects of basic and applied research, making it an indispensable pillar of Austrian research promotion. Therefore, the Anniversary Fund will continue to provide direct support for Austrian researchers in addition to the recently established National Foundation for Research, Technology and Development (National Foundation). Research promotion is part of

our social responsibility – a responsibility which becomes more important the more Austrian universities have to prove their international competitiveness.

The National Foundation guarantees the sustainable, strategic long-term financing of Austrian research initiatives independently of government budgets. Its efforts are particularly targeted at financing interdisciplinary research projects which are likely to generate long-term benefits. The provision of sustainable funding for such initiatives is to help visibly position Austrian excellence in research in the international arena. In the reporting year, the OeNB provided a total of EUR 75 million of support to the National Foundation.

In 2004, the OeNB made direct grants to the tune of some EUR 11.6 million for 207 research projects in economics, medicine (clinical research), social sciences and the humanities, with an emphasis on reinforcing the promotion of economic science projects. The OeNB Anniversary Fund provides a forum in which cutting-edge economics and human medicine project results are frequently presented to an expert audience. In addition to the initiatives outlined above, the OeNB provided considerable basic funding to three economic research institutes – the Institute for Advanced Studies (IHS), the Austrian Institute of Economic Research (WIFO) and The Vienna Institute for International Economic Studies (WIIW) – and supported the third research year of the Austrian Academy of Sciences' Institute of Molecular Biotechnology (IMBA).

Like many other Austrian businesses, the OeNB puts a particular emphasis on promoting cultural activities. Its collection of valuable old string instruments currently com-

Almost 40 years of
research promotion

Special cultural
promotion and art
collections

prises 34 instruments, which are on loan to rising Austrian violin stars and Austrian chamber music ensembles and orchestras. The OeNB sees it as its duty to make the collection, which ranks among Europe's finest, accessible to the general public. To this end, the OeNB once again organized a "Stradivari & Co" event at the RadioKulturhaus in cooperation with the Austrian Broadcasting Corporation (ORF).

In the late 1980s the OeNB, which has always shown a strong commitment to the arts, started to build a collection of Austrian paintings stemming from the period between World War I and World War II. This period was chosen deliberately, as its art

could hardly gain a foothold in museums and among its contemporaries in the face of the overpowering popularity of Viennese Art Nouveau. In the past 20 years the OeNB has bought more than 70 museum-quality paintings by 44 Austrian artists from this period, uniting them in an extensive collection which provides a representative cross-section of Austrian art between 1918 and 1938. Moreover, the OeNB maintains a collection of Austrian figurative sculptures and paintings stemming from the second half of the 20th century.

Through its cultural activities, the OeNB helps keep Austrian art in the country to preserve this heritage for Austria and for future generations.





Financial Statements
of the Oesterreichische Nationalbank
for the Year 2004

Balance Sheet

as at December 31, 2004

Assets

	December 31, 2004	December 31, 2003
	EUR	EUR
1 Gold and gold receivables	3,179,012,958.74	3,372,242,953.48
2 Claims on non-euro area residents denominated in foreign currency	5,589,745,328.36	6,535,718,790.90
2.1 Receivables from the IMF	722,997,433.49	1,003,176,673.28
2.2 Balances with banks and security investments, external loans and other external assets	4,866,747,894.87	5,532,542,117.62
3 Claims on euro area residents denominated in foreign currency	746,608,748.13	876,766,003.17
4 Claims on non-euro area residents denominated in euro	617,603,102.40	827,413,460.35
4.1 Balances with banks, security investments and loans	617,603,102.40	827,413,460.35
4.2 Claims arising from the credit facility under ERM II	—	—
5 Lending to euro area credit institutions related to monetary policy operations denominated in euro	8,853,559,167.—	2,896,906,773.—
5.1 Main refinancing operations	8,029,000,000.—	2,414,278,263.—
5.2 Longer-term refinancing operations	824,559,167.—	482,628,510.—
5.3 Fine-tuning reverse operations	—	—
5.4 Structural reverse operations	—	—
5.5 Marginal lending facility	—	—
5.6 Credits related to margin calls	—	—
6 Other claims on euro area credit institutions denominated in euro	136,214.40	108,785.47
7 Securities of euro area residents denominated in euro	3,085,653,396.16	1,862,961,571.09
8 General government debt denominated in euro	362,922,577.16	368,843,680.31
9 Intra-Eurosystem claims	4,148,728,298.24	2,829,032,357.67
9.1 Participating interest in the ECB	116,475,959.82	117,970,000.—
9.2 Claims equivalent to the transfer of foreign reserves	1,157,451,203.42	1,179,700,000.—
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates ¹	×	×
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	2,874,801,135.—	—
9.5 Other claims within the Eurosystem (net)	—	1,531,362,357.67
10 Items in course of settlement	90,938,617.90	88,458,230.92
11 Other assets	8,908,155,713.87	9,614,454,782.05
11.1 Coins of euro area	210,722,512.58	265,217,658.85
11.2 Tangible and intangible fixed assets	163,644,100.60	158,410,572.90
11.3 Other financial assets	7,176,598,738.76	7,843,816,244.29
11.4 Off-balance-sheet instruments' revaluation differences	6,792,217.76	9,282,874.57
11.5 Accruals and prepaid expenditure	294,596,508.26	300,090,443.66
11.6 Sundry	1,055,801,635.91	1,037,636,987.78
	<u>35,583,064,122.36</u>	<u>29,272,907,388.41</u>

¹ Only an ECB balance sheet item.

Liabilities

	December 31, 2004 EUR	December 31, 2003 EUR
1 Banknotes in circulation	13,416,143,605.—	11,691,232,000.—
2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4,000,043,265.50	4,255,393,088.81
2.1 Current accounts (covering the minimum reserve system)	3,993,473,265.50	4,254,943,088.81
2.2 Deposit facility	6,570,000.—	450,000.—
2.3 Fixed-term deposits	—	—
2.4 Fine-tuning reverse operations	—	—
2.5 Deposits related to margin calls	—	—
3 Other liabilities to euro area credit institutions denominated in euro	—	—
4 Debt certificates issued¹	x	x
5 Liabilities to other euro area residents denominated in euro	7,626,156.01	18,485,317.36
5.1 General government	6,903,198.34	16,669,332.60
5.2 Other liabilities	722,957.67	1,815,984.76
6 Liabilities to non-euro area residents denominated in euro	6,292,924.74	2,377,747.85
7 Liabilities to euro area residents denominated in foreign currency	47,360.94	76,491,601.88
8 Liabilities to non-euro area residents denominated in foreign currency	156,255.63	372,099,005.07
8.1 Deposits, balances and other liabilities	156,255.63	372,099,005.07
8.2 Liabilities arising from the credit facility under ERM II	—	—
9 Counterpart of Special Drawing Rights allocated by the IMF	204,039,682.—	210,915,010.—
10 Intra-Eurosystem liabilities	9,000,500,379.24	3,063,716,155.—
10.1 Liabilities equivalent to the transfer of foreign reserves ¹	x	x
10.2 Liabilities related to promissory notes backing the issuance of ECB debt certificates	—	—
10.3 Net liabilities related to allocation of euro banknotes within the Eurosystem	—	3,063,716,155.—
10.4 Other liabilities within the Eurosystem (net)	9,000,500,379.24	—
11 Items in course of settlement	—	7,326,392.62
12 Other liabilities	597,408,380.49	785,886,706.52
12.1 Off-balance sheet instruments' revaluation differences	907,327.70	4,108,930.56
12.2 Accruals and income collected in advance	20,271,797.34	33,281,888.71
12.3 Sundry	576,229,255.45	748,495,887.25
13 Provisions	2,280,637,317.78	2,159,747,078.41
14 Revaluation accounts	1,935,987,262.97	2,369,447,875.54
15 Capital and reserves	4,104,427,565.58	4,212,581,524.28
15.1 Capital	12,000,000.—	12,000,000.—
15.2 Reserves	4,092,427,565.58	4,200,581,524.28
16 Profit for the year (of which profit brought forward in 2003: EUR 177,761.25)	29,753,966.48	47,207,885.07
	<u>35,583,064,122.36</u>	<u>29,272,907,388.41</u>

¹ Only an ECB balance sheet item.

Profit and Loss Account for the Year 2004

	Financial year 2004 EUR	Financial year 2003 EUR
1.1 Interest income	691,121,580.37	737,663,078.36
1.2 Interest expense	-242,510,370.53	-270,576,156.83
1 Net interest income	448,611,209.84	467,086,921.53
2.1 Realized gains/losses arising from financial operations	264,521,726.71	317,282,184.04
2.2 Writedowns on financial assets and positions	-263,543,394.87	-698,963,294.91
2.3 Transfer to/from provisions for foreign exchange and price risks	214,178,897.52	726,445,196.43
2 Net result of financial operations, writedowns and risk provisions	215,157,229.36	344,764,085.56
3.1 Fees and commissions income	3,304,450.43	2,398,562.96
3.2 Fees and commissions expense	-2,316,197.10	-2,148,589.65
3 Net income from fees and commissions	988,253.33	249,973.31
4 Income from equity shares and participating interests	21,096,009.05	100,663,842.13
5 Net result of pooling of monetary income	-30,871,847.36	11,119,729.18
6.1 Income from the release of reserves		
General reserve fund	—	955,000,000.—
Freely disposable reserve fund	—	545,000,000.—
		<u>1,500,000,000.—</u>
Expense in connection with the appropriation to the OeNB Anniversary Fund for the endowment of the National Foundation for Research, Technology and Development	—	<u>-1,500,000,000.—</u>
6.2 Other income – other	7,506,145.76	8,120,102.87
6 Other income	7,506,145.76	8,120,102.87
Total net income	662,486,999.98	932,004,654.58
7 Staff cost	-98,034,796.58	-98,084,228.08
8 Administrative expenses	-89,901,715.55	-94,048,735.46
9 Depreciation of tangible and intangible fixed assets	-16,181,905.35	-13,902,434.67
10 Banknote production services	-7,157,705.06	-11,314,432.50
11 Other expenses	-393,203.54	-2,077,190.19
Total expenses	-211,669,326.08	-219,427,020.90
	450,817,673.90	712,577,633.68
12 Corporate income tax	-153,278,009.13	-242,276,395.45
	297,539,664.77	470,301,238.23
13 Central government's share of profit	-267,785,698.29	-423,271,114.41
14.1 Net income	29,753,966.48	47,030,123.82
14.2 Profit brought forward	—	177,761.25
14 Profit for the year	29,753,966.48	47,207,885.07

Notes to the Financial Statements 2004

General Notes to the Financial Statements

Accounting Fundamentals and Legal Framework

The Oesterreichische Nationalbank (OeNB) is committed (pursuant to Article 67 paragraph 2 of the Federal Act on the Oesterreichische Nationalbank 1984 as amended and as promulgated in Federal Law Gazette I No. 55/2002 – Nationalbank Act) to prepare its balance sheet and its profit and loss account in conformity with the policies established by the Governing Council of the European Central Bank (ECB) under Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB). These policies are laid down in an accounting guideline that the Governing Council adopted on 5 December 2002.¹ The OeNB's financial statements for the year 2004 were prepared fully in line with the provisions set forth in the accounting guideline. In cases not covered by this guideline, the generally accepted accounting principles referred to in Article 67 paragraph 2 second sentence of the Nationalbank Act were applied. The other Nationalbank Act provisions that govern the OeNB's financial statements (Articles 67 through 69 and Article 72 paragraph 1 of the Nationalbank Act) remained unchanged from the previous year.

When the Austrian Fair Value Act² went into force on January 1, 2004, the Commercial Code was amended to include Article 237a, which contains instructions on the disclosure of fair value information about financial assets, i.e. on the recognition and meas-

urement of financial assets and liabilities in financial statements. The instructions were taken into account in the compilation of these financial statements.

In accordance with Article 67 paragraph 3 of the Nationalbank Act, the OeNB continued to be exempt in 2004 from preparing consolidated financial statements as required under Article 244 et seq. of the Commercial Code.

The financial statements for the year 2004 were prepared in the format laid down by the Governing Council of the ECB.

Accounting Policies

The financial statements of the OeNB are prepared in conformity with the policies governing the accounting and reporting operations of the Eurosystem, which follow accounting principles harmonized by Community law and generally accepted international standards. The key policy provisions are summarized below:

- economic reality and transparency
- prudence
- recognition of post-balance sheet events
- materiality
- going-concern basis
- accruals principle
- consistency and comparability

Transactions in financial assets and liabilities are reflected in the accounts on the basis of the date on which they were settled.

Foreign currency transactions whose exchange rate is not fixed against the accounting currency were recorded at the euro exchange rate prevailing on the day of the transaction.

¹ Guideline of the European Central Bank of 5 December 2002 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2002/10).

² (Fair Value-Bewertungsgesetz), Federal Law Gazette I No. 118/2003.

At year-end, both financial assets and liabilities were revalued at current market prices/rates. This applies equally to on-balance sheet and off-balance sheet transactions. The revaluation of forward rate agreements took place on the basis of the London Interbank Offered Rate (LIBOR) curve of the respective currency. The arbitrage pricing principle is used to value gold interest rate swaps and gold forward interest rate swaps. To this end, the products are split into the components (the LIBOR curve, gold swap rates and gold forward rates) that are traded on international exchanges.

The revaluation took place on a currency-by-currency basis for foreign exchange positions and on a code-by-code basis for securities. Securities held as permanent investment (financial fixed assets) which are shown under *other financial assets* were valued at cost.

Gains and losses realized in the course of transactions were taken to the profit and loss account. For gold, foreign currency instruments and securities, the average cost method was used in accordance with the daily netting procedure for purchases and sales. As a rule, the realized gain or loss was calculated by juxtaposing the sales price of each transaction with the average acquisition cost of all purchases made during the day.

In the case of net sales, the calculation of the realized gain or loss was based on the average cost of the respective holding for the preceding day.

Unrealized revaluation gains were not taken to the profit and loss account, but transferred to a revaluation account on the liabilities side of the balance sheet. Unrealized losses were recognized in the profit and loss account when they exceeded

previous revaluation gains registered in the corresponding revaluation account; they may not be reversed against new unrealized gains in subsequent years. Furthermore, the OeNB's management determined that unrealized foreign currency losses that must be expensed were to be covered by the release of an off-setting amount from the *reserve fund for exchange risks* accumulated in the run-up to 1999. Unrealized losses in any one security, currency or in gold holdings were not netted with unrealized gains in other securities, currencies or gold, since netting is prohibited under the ECB's accounting guideline.

The average acquisition cost and the value of each currency position were calculated on the basis of the sum total of the holdings in any one currency or gold, including both asset and liability positions and both on-balance sheet and off-balance sheet positions. Own funds invested in foreign exchange assets are recorded in a separate currency position.

In compliance with Article 69 paragraph 4 of the Nationalbank Act, which stipulates that a reserve fund for exchange risks be set up or released on the basis of the risk assessment of the nondomestic assets, the value-at-risk (VaR) method was used to calculate the currency risk. VaR is defined as the maximum loss of a gold or foreign currency portfolio with a given currency diversification at a certain level of confidence (97.5%) and for a given holding period (one year). The potential loss calculated under this approach is to be offset against the *reserve fund for exchange risks*, the *revaluation accounts*, the *reserve for nondomestic and price risks* and the *provision for exchange rate risks*.

Future market developments, especially interest and exchange rate movements, may entail considerable fluctuations of the income accruing to the OeNB, the other Eurosystem NCBs and the ECB as a result of the harmonized accounting rules with which they have had to comply since January 1, 1999.

Premiums or discounts arising on securities issued or purchased were calculated and presented as part of interest income and amortized over the remaining life of the securities.

Participating interests were valued on the basis of the net asset value of the respective company (equity method).

Tangible and intangible fixed assets were valued at cost less depreciation. Depreciation was calculated on a straight-line basis, from the quarter after acquisition throughout the expected economic lifetime of the assets according to the following formula:

- computers, related hardware and software, and motor vehicles: 4 years
- equipment, furniture and plant in building: 10 years
- buildings: 25 years

Fixed assets costing less than EUR 10,000 were written off in the year of purchase.

Realized Gains and Losses and Revaluation Differences and Their Treatment in the Financial Statements of December 31, 2004

	Realized gains (posted to the profit and loss account) EUR million	Realized losses EUR million	Unrealized losses EUR million	Change in revaluation accounts EUR million
Gold	84.551	–	–	–114.023
Foreign currency holdings for own account	59.842	6.535	254.179 ¹	–3.129
own funds	0.521	0.034	–	+1.028
Securities holdings for own account	116.037	29.743	7.579	–42.642
own funds	8.933	0.008	0.582	–7.410
IMF euro holdings	29.859	–	–	–
Participating interests	–	–	0.992	–4.790
Off-balance sheet instruments	8.651	7.552	0.211	–2.490
Total	308.394	43.872	263.543	–173.456

¹ This amount did not have an impact on profit because the loss was offset against the reserve for nondomestic and price risks.

Risk Management

Financial and operational risk incurred in connection with central banking activities have a crucial impact on the financial result of an entity and on its ability to continue as a going concern. The OeNB's risk management is based on binding rules, risks are determined by means of recognized procedures, and risk control is guaranteed through continuous monitoring. Moreover, there are regular reporting procedures.

Financial Risks

Financial risk covers a range of collateral-related risks, basically market, credit and liquidity risk. Reserve asset and risk management principles are laid down in a rule book adopted by the OeNB's Governing Board. The investment of reserve assets is governed by a benchmarking system and subject to defined limits and

durations. Moreover, the OeNB holds separately managed investment portfolios for different asset types and currencies. Regular reports are made to an investment committee and to the Governing Board of the OeNB. The Governing Board must authorize diversification options to include new types of investment.

Market Risk

Market risk is the risk of exposure arising from movements in markets, in particular exchange rate and interest rate changes, as determined by generally recognized value-at-risk (VaR) calculation models. Exchange rate risk is controlled through a dual benchmarking system, namely strategic and tactical benchmarks. The strategic benchmarks, which are adopted by the Governing Board of the OeNB, as a rule for one-year periods, also define the upper exposure limits.

The strategic measures are complemented by tactical benchmarks, which are defined at the regular meetings of the responsible investment committee for shorter periods to reflect short-term market developments and the like. Interest rate risk is managed on the basis of duration targets or limits.

Credit Risk

Credit risk is the risk of incurring a loss due to the failure of a counterparty. Here, risk management relies on a credit risk limit system which documents current credit risk limits and actual exposure. Credit risk reports reflecting this information as well as information derived from monitoring developments in financial markets are discussed thoroughly at regular investment committee meetings and are reviewed at annual intervals by the Governing Board.

Liquidity Risk

Liquidity risk is the risk arising from a counterparty's inability to meet its financial obligations in time or in full or the risk that the OeNB may not

dispose of sufficient funds to meet its obligations. To avoid this risk, the OeNB selects counterparties with a high credit standing and strictly applies the established limits, with a particular emphasis on security and liquidity. These principles take precedence over profitability considerations.

Operational risk

Operational risk is the risk of incurring losses due to defects, inadequate procedures or systems, human error or unforeseen events affecting operations. The OeNB has set up adequate risk controls, as laid down in its risk management handbook *ORION – Handbuch Risiko- und Krisenmanagement* (ORION stands for Operationales Risikomanagement in der Oesterreichischen Nationalbank – operational risk management at the Oesterreichische Nationalbank). Valuation takes into account the impact of various risk scenarios on the OeNB's reputation, costs and any losses. Risk valuation is an ongoing process, and reports are submitted to management every half year.

Financial risk and financial provisions comprised the following items on December 31, 2004:

Risk	Risk assessment		Financial provisions	
		EUR million	EUR million	
Gold risk	VaR	509	509 ¹	revaluation account
Exchange rate risk	VaR	1,548	537	reserve fund for exchange risks
			40	revaluation accounts
			931	reserve for nondomestic and price risks
			40	provisions for foreign exchange risks
		1,548	1,548	
Risk of interest rate change and pro rata Eurosystem risk	VaR	1,042	1,042	reserve for nondomestic and price risks
Total		3,099	3,099	

¹ Holdings on the revaluation accounts come to EUR 743 million.

Capital movements

Movements in Capital Accounts in 2004

	Dec. 31, 2003	Increase	Decrease	Dec. 31, 2004
	EUR million	EUR million	EUR million	EUR million
Capital	12.000	–	–	12.000
Reserves				
General reserve fund	477.683	–	477.683	–
Reserve for nondomestic and price risks	1,622.000	351.263	–	1,973.263
Reserve for retained earnings	–	2.226	–	2.226
Earmarked capital funded with net interest income from ERP loans	569.399	16.040	–	585.439
OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching				
Initial OeNB Anniversary Fund	31.500	–	–	31.500
OeNB Anniversary Fund National Foundation endowment	1,500.000	–	–	1,500.000
	4,200.582	369.529	477.683	4,092.428
Profit for the year	47.208	–	17.454	29.754
Total	4,259.790	369.529	495.137	4,134.182
Revaluation accounts				
Reserve fund for exchange risks	851.190	–	313.841	537.349
Initial valuation reserve	281.441	–	0.290	281.151
Eurosystem revaluation accounts	1,236.817	55.165	174.495	1,117.487
Total	2,369.448	55.165	488.626	1,935.987

For details of the various changes, please refer to the notes to the respective balance sheet items.

Development of the OeNB's Currency Positions in the Financial Year 2004

Net Currency Position (including gold)

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Gold and gold receivables	3,372.243	3,179.013	-193.230	-5.7
Claims on non-euro area residents denominated in foreign currency ¹	7,905.320	7,129.312	-776.008	-9.8
Claims on euro area residents denominated in foreign currency	876.766	746.609	-130.157	-14.8
Other assets	20.309	22.932	+2.623	+12.9
less:				
Liabilities to euro area residents denominated in foreign currency	76.492	0.047	-76.445	-99.9
Liabilities to non-euro area residents denominated in foreign currency	372.099	0.156	-371.943	-99.9
Counterpart of Special Drawing Rights allocated by the IMF	210.915	204.040	-6.875	-3.3
Off-balance sheet instruments' revaluation differences	4.109	0.712	-3.397	-82.7
Other liabilities	0.063	-	-0.063	-100.0
Revaluation accounts ²	74.912	59.326	-15.586	-20.8
Total	11,436.048	10,813.585	-622.463	-5.4

¹ Excluding the share of the IMF quota which was not drawn, expressed in euro.

² Resulting from the change in net unrealized exchange rate gains on foreign currency-denominated securities on December 31, 2003, and December 31, 2004.

Notes to the Balance Sheet

Assets

1 Gold and gold receivables

Closing balance Dec. 31, 2004	EUR 3,179.013 million
Closing balance Dec. 31, 2003	EUR 3,372.243 million
Change	-EUR 193.230 million -5.7%

This item comprises the OeNB's holdings of physical and nonphysical gold, which amounted to 307 tons on December 31, 2004. At a market value of EUR 321.562 per fine ounce (i.e. EUR 10,338.46 per kg of fine gold), the OeNB's gold holdings were worth EUR 3,179.013 million at the balance sheet date.

The valuation on December 31, 2004, resulted in unrealized valuation losses of EUR 114.023 million.

In 2004, 10 tons of gold were sold to the Bank for International Settlements (BIS) at EUR 107.454 million. The sales were effected within the framework of the Joint Statement on Gold concluded by 14 central banks (including the OeNB) and the ECB in March 2004. The price gains of EUR 84.551 million realized on the sales were disclosed under item 2.1 *Realized gains/losses arising from financial operations* of the profit and loss account.

The Joint Statement on Gold provides for annual sales over a period of five years under a concerted program; annual sales are not to exceed 500 tons and total sales over the five-year period are limited to 2,500 tons. Moreover, gold leaseings and the use of gold futures and options will not be increased over the period.

2 Claims on non-euro area residents denominated in foreign currency

Closing balance Dec. 31, 2004	EUR million	5,589.745
Closing balance Dec. 31, 2003	EUR million	6,535.718
Change	-EUR million	945.973
		-14.5%

These claims consist of receivables from the International Monetary Fund (IMF) and claims denominated in foreign currency against non-euro area countries, i.e. counterparties resident outside the euro area.

Subitem 2.1 *Receivables from the IMF* comprises the following accounts:

	Dec. 31, 2003	Dec. 31, 2004	Change	%
	EUR million	EUR million	EUR million	
Total claims (Austrian quota) equivalent to SDR 1,872.3 million ¹	2,205.568	2,133.673	-71.895	-3.3
less:				
Balances at the disposal of the IMF	1,369.601	1,539.566	+169.965	+12.4
Receivables from the IMF	835.967	594.107	-241.860	-28.9
Holdings of SDRs	143.649	117.494	-26.155	-18.2
Other claims against the IMF	23.560	11.396	-12.164	-51.6
Total	1,003.176	722.997	-280.179	-27.9

¹ Pursuant to federal law as promulgated in Federal Law Gazette No. 309/1971, the OeNB assumed the entire Austrian quota at the IMF on its own account on behalf of the Republic of Austria.

Drawings of Special Drawing Rights (SDRs) on behalf of IMF members and the revaluation of euro holdings by the IMF as well as transfers by the IMF boosted *receivables from the IMF* by a total of EUR 85.604 million. Conversely, repayments by members reduced the receivables from the IMF by a total of EUR 255.569 million. Revaluation losses (-EUR 72.748 million) reduced these claims, whereas realized exchange rate gains and book value reconciliation (+EUR 0.852 million) enlarged them.

The IMF remunerates participations in the IMF at a rate of remuneration that is updated weekly. In 2004, this rate hovered between 1.57% and 2.24% per annum, mirroring the prevailing SDR rate.

The holdings of *Special Drawing Rights*³ were recognized in the balance sheet at EUR 117.494 million on December 31, 2004, which is equivalent to SDR 103 million. The net reduction in 2004 of holdings by EUR 26.155 million resulted from the sale of SDRs equivalent to EUR 72.478 million and the purchase of

³ Pursuant to federal law as promulgated in Federal Law Gazette No. 440/1969, the OeNB is entitled to participate in the SDR system on its own account on behalf of the Republic of Austria and to enter the SDRs purchased or allocated gratuitously on the asset side of the balance sheet as cover for the total circulation.

SDRs equivalent to EUR 38.831 million. Interest credited, above all remunerations of the participation in the IMF, boosted holdings by EUR 11.368 million.

No purchases arising from designations by the IMF were effected in 2004. Principally, the OeNB continues to be obliged under the IMF's statutes to provide currency on demand in exchange for SDRs. Members designated by the IMF may use SDRs up to the point at which the OeNB's holdings of SDRs are three times as high as its net cumulative allocation. The OeNB's net cumulative allocation amounted to SDR 179.045 million on December 31, 2004.

Other claims against the IMF comprise the OeNB's other contributions to loans under special borrowing arrangements. In the financial statements for 2004, this item relates exclusively to claims arising from contributions (SDR 10 million) to the Poverty Reduction and Growth Facility (PRGF). The PRGF is a special initiative designed to support the IMF's objectives by granting the poorest countries credits at highly concessional terms in order to finance economic programs targeted at fostering economic growth and ensuring a strong, sustainable recovery of the balance of payments.

Subitem 2.2 *Balances with banks and security investments, external loans and other external assets* covers the following accounts:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Balances with banks	1,212.263	861.379	-350.884	-28.9
Securities	4,315.000	4,000.386	-314.614	-7.3
Other external assets	5.279	4.983	-0.296	-5.6
Total	5,532.542	4,866.748	-665.794	-12.0

Balances with banks outside the euro area include foreign currency deposits on correspondent accounts, deposits with agreed maturity and overnight funds. Securities relate to instruments issued by non-euro area residents. As a rule, operations are carried out only with financially sound counterparties.

3 Claims on euro area residents denominated in foreign currency

Claims on euro area residents denominated in foreign currency are as follows:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Balances with banks	365.854	286.195	-79.659	-21.8
Securities	510.912	460.414	-50.498	-9.9
Total	876.766	746.609	-130.157	-14.8

4 Claims on non-euro area residents denominated in euro

This item includes all euro-denominated investments and accounts with counterparties which are not euro area residents.

On December 31, 2003, and December 31, 2004, the subitems of this balance sheet item closed as follows:

	Dec. 31, 2003 EUR million	Dec. 31, 2004 EUR million	Change EUR million	%
Securities	764.209	373.613	-390.596	-51.1
Other investments	63.204	243.990	+180.786	+286.0
Total	827.413	617.603	-209.810	-25.4

5 Lending to euro area credit institutions related to monetary policy operations denominated in euro

This balance sheet item represents the liquidity-providing transactions executed by the OeNB.

The principal components of this item are:

	Dec. 31, 2003 EUR million	Dec. 31, 2004 EUR million	Change EUR million	%
5.1 Main refinancing operations	2,414.278	8,029.000	+5,614.722	+232.6
5.2 Longer-term refinancing operations	482.628	824.559	+341.931	+70.8
5.3 Fine-tuning reverse operations	-	-	-	-
5.4 Structural reverse operations	-	-	-	-
5.5 Marginal lending facility	-	-	-	-
5.6 Credits related to margin calls	-	-	-	-
Total	2,896.906	8,853.559	+5,956.653	+205.6

5.1 Main refinancing operations

Main refinancing operations are regular liquidity-providing reverse transactions that were executed by the NCBs with a weekly frequency and a maturity of two weeks in the form of standard (variable rate) tender operations. The ECB Governing Council's decision of December 1, 2003,⁴ resulted in a reduction of the maturity of the main refinancing operation from two weeks to one week from March 8, 2004. All counterparties which fulfill the general eligibility criteria may submit bids within a timeframe of 24 hours from the tender announcement.

The *main refinancing operations* are the most important open market operations conducted by the Eurosystem, playing a pivotal role in signaling the stance of monetary policy. They provide the bulk of liquidity to the financial sector.

5.2 Longer-term refinancing operations

Longer-term refinancing operations are regular liquidity-providing reverse transactions with a monthly frequency and a maturity of three months. They are aimed at providing counterparties with additional longer-term refinancing and are executed through standard tenders by the NCBs. All *longer-term refinancing operations* conducted in 2004 were carried out in the form of variable rate tenders.

5.3 Fine-tuning reverse operations

Fine-tuning reverse operations are executed on an ad hoc basis with a view to managing the liquidity situation in the market and steering interest rates, in particular to smooth the effects on interest rates caused by un-

expected liquidity fluctuations in the market. The choice of instruments and procedures depends on the type of transaction and the underlying motives. Fine-tuning operations are normally executed by the NCBs through quick tenders or through bilateral procedures. It is up to the Governing Council of the ECB to empower the ECB to conduct fine-tuning operations itself under exceptional circumstances.

In 2004, no such operations were conducted.

5.4 Structural reverse operations

The ECB may use *structural reverse operations* to adjust the structural position of the Eurosystem vis-à-vis the financial sector.

In 2004, no such operations were carried out.

5.5 Marginal lending facility

Counterparties may use the *marginal lending facility* to obtain overnight liquidity from NCBs at a prespecified interest rate against eligible assets. The facility is intended to satisfy counterparties' temporary liquidity needs. Under normal circumstances, the interest rate on the facility provides a ceiling for the overnight interest rate.

The *marginal lending facility* was accessed repeatedly in 2004.

5.6 Credits related to margin calls

Credits related to margin calls arise when the value of underlying assets regarding credit extended to credit institutions increases beyond collateral requirements, obligating the central bank to provide counterparties with additional credit to offset the value in excess of requirements. If

⁴ Guideline of the European Central Bank of 1 December 2003 amending Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem (ECB/2003/16).

such credit is provided not by the return of securities but rather by an entry on an account, a claim on the counterparty is recorded in this sub-item.

No claims were recorded under this item in 2004.

6 Other claims on euro area credit institutions denominated in euro

Closing balance Dec. 31, 2004	EUR 0.136 million
Closing balance Dec. 31, 2003	EUR 0.109 million
Change	+EUR 0.027 million +25.2%

This item comprises claims on euro area credit institutions not related to monetary policy operations.

7 Securities of euro area residents denominated in euro

Closing balance Dec. 31, 2004	EUR 3,085.653 million
Closing balance Dec. 31, 2003	EUR 1,862.961 million
Change	+EUR 1,222.692 million +65.6%

This item covers all marketable securities (including securities stemming from before EMU) denominated in constituent currencies of the euro that are not used in monetary policy operations and that are not part of investment portfolios earmarked for specific purposes.

The annual change is mainly due to additions resulting from net sales.

8 General government debt denominated in euro

Closing balance Dec. 31, 2004	EUR 362.923 million
Closing balance Dec. 31, 2003	EUR 368.844 million
Change	-EUR 5.921 million -1.6%

This balance sheet item subsumes the claim on the Austrian Federal Treasury from silver commemorative coins issued before 1989, based on the 1988 Coinage Act as promulgated

in Federal Law Gazette No. 425/1996.

In theory, the maximum federal liability is the sum total of all silver commemorative coins issued before 1989, minus any coins returned to and paid for by the central government, minus any coins directly withdrawn by Münze Österreich Aktiengesellschaft. Repayment of the maximum federal liability of EUR 1,229.573 million is effected by annual installments of EUR 5.814 million out of the central government's share of the OeNB's profit. The proceeds from metal recovery, including the interest on the investment of these proceeds by Münze Österreich Aktiengesellschaft, are designated for repayment by the contractual deadline (every year on December 15). Any amount outstanding on December 31, 2040, will have to be repaid in the five following years (2041 to 2045) in five equal installments.

The net increase in this claim resulted from returns of silver commemorative coins to the central government in the course of 2004 with a total face value of EUR 12.725 million less redemptions made out of the central government's share in the OeNB's profit for the year 2003 plus the proceeds from metal recovery, which together totaled EUR 18.646 million.

9 Intra-Eurosystem claims

Closing balance Dec. 31, 2004	EUR 4,148.728 million
Closing balance Dec. 31, 2003	EUR 2,829.032 million
Change	+EUR 1,319.696 million +46.6%

This balance sheet item consists of the claims arising from the OeNB's share of the ECB's capital and the claims equivalent to the transfer of foreign reserves to the ECB. Further-

more, this item shows TARGET balances and other (net) claims within the Eurosystem.

Subitem 9.3 *Claims related to promissory notes backing the issuance of ECB debt certificates* in this accounting scheme does not apply to the OeNB; it is exclusively an ECB balance sheet item.

Intra-Eurosystem claims consisted of the following subitems on December 31, 2003, and December 31, 2004:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
9.1 Participating interest in the ECB	117.970	116.476	-1.494	-1.3
9.2 Claims equivalent to the transfer of foreign reserves	1,179.700	1,157.451	-22.249	-1.9
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates	x	x	x	x
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	-	2,874.801	+2,874.801	-
9.5 Other claims within the Eurosystem (net)	1,531.362	-	-1,531.362	-100.0
Total	2,829.032	4,148.728	+1,319.696	+46.6

9.1 Participating interest in the ECB

This subitem shows the share that the OeNB holds in the capital of the ECB. Pursuant to Article 28 of the ESCB Statute, the ESCB national central banks are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the ESCB Statute and which must be adjusted every five years. The first such adjustment following the establishment of the ECB took effect on

January 1, 2004. On May 1, 2004, a second change of the ECB's capital key followed as a result of the accession of ten Member States. Based on the Council Decision of 15 July 2003 on the statistical data to be used for the determination of the key for subscription of the capital of the European Central Bank (2003/517/EC), the capital keys of the NCBs were adjusted as follows on January 1, 2004, and May 1, 2004, by means of transfers among the NCBs:

Percentage Shares of the Capital of the ECB

	January 1, 1999 to December 31, 2003 %	January 1, 2004 to April 30, 2004 %	since May 1, 2004 %
Nationale Bank van België/Banque Nationale de Belgique	2.8658	2.8297	2.5502
Deutsche Bundesbank	24.4935	23.4040	21.1364
Bank of Greece	2.0564	2.1614	1.8974
Banco de España	8.8935	8.7801	7.7758
Banque de France	16.8337	16.5175	14.8712
Central Bank and Financial Services Authority of Ireland	0.8496	1.0254	0.9219
Banca d'Italia	14.8950	14.5726	13.0516
Banque centrale du Luxembourg	0.1492	0.1708	0.1568
De Nederlandsche Bank	4.2780	4.4323	3.9955
Oesterreichische Nationalbank	2.3594	2.3019	2.0800
Banco de Portugal	1.9232	2.0129	1.7653
Suomen Pankki – Finlands Bank	1.3970	1.4298	1.2887
Share of the Eurosystem central banks	80.9943	79.6384	71.4908
Česká národní banka	0.0000	0.0000	1.4584
Danmarks Nationalbank	1.6709	1.7216	1.5663
Eesti Pank	0.0000	0.0000	0.1784
Central Bank of Cyprus	0.0000	0.0000	0.1300
Latvijas Banka	0.0000	0.0000	0.2978
Lietuvos bankas	0.0000	0.0000	0.4425
Magyar Nemzeti Bank	0.0000	0.0000	1.3884
Central Bank of Malta/Bank Ċentrali ta' Malta	0.0000	0.0000	0.0647
Narodowy Bank Polski	0.0000	0.0000	5.1380
Banka Slovenije	0.0000	0.0000	0.3345
Národná banka Slovenska	0.0000	0.0000	0.7147
Sveriges Riksbank	2.6537	2.6636	2.4133
Bank of England	14.6811	15.9764	14.3822
Share of the remaining ESCB central banks	19.0057	20.3616	28.5092
Total	100.0000	100.0000	100.0000

Consequently, on January 1, 2004, the share that the OeNB held in the subscribed capital of the ECB – EUR 5 billion in total – decreased from 2.3594% to 2.3019% and asset subitem 9.1 *Participating interest in the ECB* decreased by EUR 2.875 million to EUR 115.095 million.

In accordance with Article 49.3 of the Statute of the ESCB, which was added to the Statute by the Treaty of Accession, the ECB's subscribed capital is automatically increased when a new member joins the EU and its NCB joins the ESCB. The increase is determined by multiplying the prevailing amount of the subscribed capital (i.e. EUR 5 billion) by the ratio, within the expanded capital key, between the weighting of the entering NCB(s) and the weighting of those NCBs that

are already members of the ESCB. Therefore, on May 1, 2004, the subscribed capital of the ECB was increased to EUR 5.565 billion. Consequently, on May 1, 2004, the share that the OeNB held in the increased subscribed capital of the ECB – EUR 5.565 billion in total – decreased from 2.3019% to 2.0800% and asset subitem 9.1 *Participating interest in the ECB* increased by EUR 0.650 million to EUR 115.745 million.

As a result of the aforementioned capital key changes, the relative shares of NCBs in the accumulated net profits of the ECB (also referred to as net equity) as at December 31, 2003, and April 31, 2004, changed. Subitem 9.1 *Participating interest in the ECB* also reflects the net increase of the OeNB's share in this respect.

9.2 Claims equivalent to the transfer of foreign reserves

These represent the OeNB's claims arising from the transfer of foreign reserve assets to the ECB. The claims are denominated in euro at a value fixed at the time of their transfer. They are remunerated at the latest available marginal rate for the Euro-system's main refinancing operations, adjusted to reflect a zero return on the gold component.

The adjustments to the capital key weightings of the ECB on January 1, 2004, and May 1, 2004, also resulted in the adjustment of the claim of the OeNB with respect to the foreign reserve assets transferred to the ECB. Reflecting its reduced capital key share, the OeNB's euro-denominated claim decreased by EUR 28.750 million to EUR 1,150.950 million on January 1, 2004, and increased by EUR 6.501 million to EUR 1,157.451 million on May 1, 2004.

	January 1, 1999 to December 31, 2003 EUR	January 1, 2004 to April 30, 2004 EUR	since May 1, 2004 EUR
Nationale Bank van België/Banque Nationale de Belgique	1,432,900,000	1,414,850,000	1,419,101,951
Deutsche Bundesbank	12,246,750,000	11,702,000,000	11,761,707,508
Bank of Greece	1,028,200,000	1,080,700,000	1,055,840,343
Banco de España	4,446,750,000	4,390,050,000	4,326,975,513
Banque de France	8,416,850,000	8,258,750,000	8,275,330,931
Central Bank and Financial Services Authority of Ireland	424,800,000	512,700,000	513,006,858
Banca d'Italia	7,447,500,000	7,286,300,000	7,262,783,715
Banque centrale du Luxembourg	74,600,000	85,400,000	87,254,014
De Nederlandsche Bank	2,139,000,000	2,216,150,000	2,223,363,598
Oesterreichische Nationalbank	1,179,700,000	1,150,950,000	1,157,451,203
Banco de Portugal	961,600,000	1,006,450,000	982,331,062
Suomen Pankki – Finlands Bank	698,500,000	714,900,000	717,118,926
Total	40,497,150,000	39,819,200,000	39,782,265,622

9.4 Net claims related to the allocation of euro banknotes within the Eurosystem

Intra-Eurosystem balances on euro banknotes in circulation net the OeNB's liabilities resulting from the share of the total value of euro banknotes put into circulation allocated to the balance sheet of the ECB with its claim resulting from the allocation of euro banknotes in circulation within the Eurosystem (this allocation procedure is referred to as the Capital Share Mechanism – CSM). On December 31, 2004, these balances resulted in a net claim of EUR 2,874.801 million stemming from the adjustments of euro banknotes

in circulation. In the previous year, this item had been recognized as a net liability under subitem 10.3 *Net liabilities related to the allocation of euro banknotes within the Eurosystem*.

9.5 Other claims within the Eurosystem (net)

This item shows net claims arising from balances of TARGET accounts and other (net) claims within the Eurosystem, provided that these items closed the reporting year with net claims. As the balance recorded on December 31, 2004, was a net liability, it is represented under liability item 10.4 *Other liabilities within the Eurosystem (net)*.

10 Items in course of settlement

This claim results from 2004 net float items settled at the beginning of January 2005.

11 Other assets

Other assets comprise the following subitems:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
11.1 Coins of euro area	265.218	210.723	-54.495	-20.5
11.2 Tangible and intangible fixed assets	158.411	163.644	+5.233	+3.3
11.3 Other financial assets	7,843.816	7,176.599	-667.217	-8.5
11.4 Off-balance sheet instruments' revaluation differences	9.283	6.792	-2.491	-26.8
11.5 Accruals and prepaid expenditure	300.090	294.596	-5.494	-1.8
11.6 Sundry	1,037.637	1,055.802	+18.165	+1.8
Total	9,614.455	8,908.156	-706.299	-7.3

11.1 Coins of euro area

This item represents the OeNB's stock of fit coins issued by euro area countries.

11.2 Tangible and intangible fixed assets

Tangible and intangible fixed assets comprise OeNB *premises* and *equipment* (including machinery, computer hardware and motor vehicles) *tangible real assets* and *intangible fixed assets*.

Premises developed as follows:

	EUR million
Cost incurred until Dec. 31, 2003	116.561 ¹
Purchases in 2004	8.205
Sales in 2004	-
Accumulated depreciation	24.066
Book value on Dec. 31, 2004	100.700
Book value on Dec. 31, 2003	96.752
Annual depreciation in 2004	4.257

¹ Premises acquired prior to December 31, 1956, were booked at the cost recorded in the schilling opening balance sheet (Federal Law Gazette No 190/1954).

Purchases in 2004 mainly relate to capitalized costs of work in the main building and the OeNB's northern office building.

Equipment developed as follows:

	<i>EUR million</i>
Cost incurred until Dec. 31, 2003	96.596
Purchases in 2004	10.112
Sales in 2004 (at cost)	23.072 ¹
Accumulated depreciation	57.431
Book value on Dec. 31, 2004	26.205
Book value on Dec. 31, 2003	28.081
Annual depreciation in 2004	11.910

¹ The balance between the book value of the sales and the underlying historical costs is EUR 0.078 million.

Tangible real assets worth EUR 36.096 million represent the OeNB's collection of antique string instruments, which it started to acquire in 1989, and coins purchased for the Money Museum's Coin Collection (EUR 0.481 million). The coin purchases include a 1,000 fine ounce gold bullion Vienna Philharmonic coin acquired from Münze Öster-

reich Aktiengesellschaft. Münze Österreich Aktiengesellschaft minted 15 of these coins to commemorate the 15th anniversary of the first issue of the Vienna Philharmonic gold bullion coin.

On December 31, 2004, the OeNB's collection of valuable instruments encompassed 26 violins, 5 violoncellos and 3 violas. These instruments are on loan to musicians deemed worthy of special support.

Intangible fixed assets (residence rights) developed as follows:

	<i>EUR million</i>
Cost incurred until Dec. 31, 2003	0.720
Purchases in 2004	–
Sales in 2004	–
Accumulated depreciation	0.077
Book value on Dec. 31, 2004	0.643
Book value on Dec. 31, 2003	0.658
Annual depreciation in 2004	0.015

11.3 Other financial assets

Other financial assets comprise the following accounts:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Securities	6,555.781	6,020.453	-535.328	-8.2
Participating interests	818.481	814.355	-4.126	-0.5
Other investments	469.554	341.791	-127.763	-27.2
Total	7,843.816	7,176.599	-667.217	-8.5

Of the OeNB's securities portfolio, EUR 1,592.591 million represented investments of the pension reserve, another EUR 1,342.658 million reflect investments of the OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching (of which EUR 1,295.761 million were earmarked as an endowment for the National Foundation for Research, Technology and Development, also referred to in brief as the National Foundation). Moreover, the securities portfolio related to capital and reserves, i.e. the OeNB's own funds management, came to EUR 3,085.203 million.⁵ Revaluations of the portfolios resulted in unrealized valuation gains of EUR 92.196 million and unrealized price losses of EUR 0.596 million as well as unrealized foreign currency gains of EUR 1.836 million.

Of the *participating interests*, EUR 511.750 million formed part of the own funds portfolio and EUR

302.605 million formed part of the investment portfolio relating to investments of the pension reserve.

Other investments include investments of the pension reserve (EUR 73.297 million), investments to promote the National Foundation (EUR 222.902 million), investments of the initial OeNB Anniversary Fund (i.e. excluding the National Foundation; EUR 8.262 million) and the own funds portfolio (EUR 37.331 million) and consisted mainly of overnight funds.

Participating interests developed as follows:

	EUR million
Net asset value on Dec. 31, 2003	818.481
Purchases in 2004	0.419
Sales in 2004 (at book value)	0 ¹
Annual depreciation in 2004	0.992
Revaluation in 2004	-3.553
Net asset value on Dec. 31, 2004	814.355

¹ The balance between the book value of the sales and the underlying historical costs is EUR 0.008 million.

⁵ The own funds of the OeNB shown under liabilities include its capital, the general reserve fund, the freely disposable reserve fund, the reserve for nondomestic and price risks, earmarked ERP capital funded with net interest income from loans, the reserve fund for exchange risks and general provisions, above all provisions for exchange rate risks and provisions for general banking risks.

11.6 Sundry

Sundry assets comprise the following accounts:

	Dec. 31, 2003	Dec. 31, 2004	Change
	EUR million	EUR million	EUR million
Claims arising from ERP loans to companies	645.023	649.991	+4.968
OeKB overnight account for ERP lending	266.068	277.216	+11.148
ERP loan portfolio managed by the OeNB	911.091	927.207	+16.116
Schilling coins	86.805	88.566	+1.761
Shareholder loans	7.616	6.720	-0.896
Advances on salaries	6.459	6.734	+0.275
Other claims	25.666	26.575	+0.909
Total	1,037.637	1,055.802	+18.165

According to Article 3.2 of the ERP Fund Act, the ceiling of the OeNB's financing commitment corresponds to the sum by which the federal debt was written down initially (EUR 341.955 million) plus interest accrued (EUR 585.439 million on December 31, 2004). The ERP loan portfolio managed by the OeNB thus totaled EUR 927.394 million on December 31, 2004. The provisions governing the extension of loans

from this portfolio are laid down in Article 83 of the Nationalbank Act.

The residual terms of advances on salaries generally exceed one year. All advance payments are secured by life insurance plans.

Other claims came to EUR 26.575 million at December 31, 2004, and mainly comprised advances, accounts receivable and claims arising from day-to-day business.

Liabilities

1 Banknotes in circulation

Closing balance Dec. 31, 2004	EUR million	13,416.143
Closing balance Dec. 31, 2003	EUR million	11,691.232
Change	+EUR million	1,724.911
		+14.8%

This item consists of the OeNB's share of the euro banknotes in circulation in the entire Eurosystem calculated by applying the banknote allocation key⁶; it developed as follows:

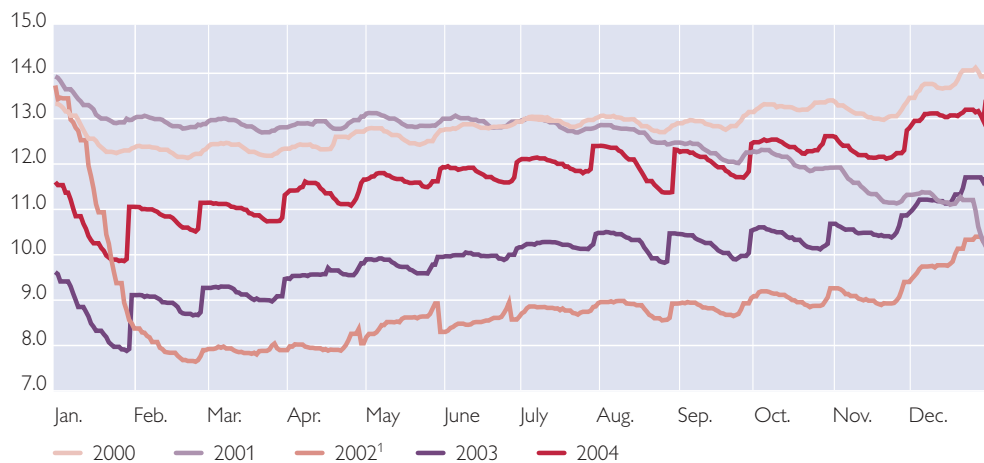
	Dec. 31, 2003	Dec. 31, 2004	Change
	EUR million	EUR million	EUR million
Total value of euro banknotes in circulation	14,754.948	10,541.342	-4,213.606
less:			
Liability resulting from the share allocated to the balance sheet of the ECB (8%)	-1,016.629 ¹	-1,166.712 ²	-150.083
Liability or claim resulting from allocation of euro banknotes within the Eurosystem (CSM)	-2,047.087 ¹	4,041.513 ²	+6,088.600
Value of euro banknotes actually put into circulation	11,691.232	13,416.143	+1,724.911

¹ In 2003 this amount was shown under Intra-Eurosystem liabilities item 10.3.

² In 2004 this amount was shown under Intra-Eurosystem claims item 9.4.

OeNB's Banknotes in Circulation over the Past Five Years

Calendar-day volumes, EUR billion



Source: OeNB.

¹ In the financial year 2002 OeNB's banknotes in circulation included two components:

1. euro banknote liabilities (the 2.68% share of total banknotes in circulation allocated to the OeNB as at January 1, 2002, and subsequently as at the end of the month plus cumulative transactions made by the OeNB between cutoff dates);
2. schilling banknotes in circulation (only until December 31, 2002).

⁶ This key has come to 2.6765% for the OeNB since May 1, 2004. It is calculated on the basis of the OeNB's share of the paid-up capital of the ECB, of which 92% are used as a calculation basis.

The table below shows the annual average figures of banknotes in circulation during the past five years:

	Banknotes in circulation, annual average ¹	Change	
	EUR million	EUR million	%
2000	12,851	+756	+6.3
2001	12,519	-332	-2.6
2002	8,887	-3,632	-29.0
2003	9,913	+1,026	+11.5
2004	11,751	+1,838	+18.5

¹ The values for 2000 and 2001 represent schilling banknotes in circulation. In 2002 the figures cover both euro banknote circulation liabilities and schilling banknotes in circulation. From 2003, the figures refer exclusively to euro banknote circulation liabilities.

2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

This item consists of the following accounts:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
2.1 Current accounts (covering the minimum reserve system)	4,254.943	3,993.473	-261.470	-6.1
2.2 Deposit facility	0.450	6.570	+6.120	-
2.3 Fixed-term deposits	-	-	-	-
2.4 Fine-tuning reverse operations	-	-	-	-
2.5 Deposits related to margin calls	-	-	-	-
Total	4,255.393	4,000.043	-255.350	-6.0

2.1 Current accounts (covering the minimum reserve system)

This subitem contains primarily credit institutions' accounts that are used to hold minimum reserves.

Banks' minimum reserve balances have been remunerated on a daily basis since January 1, 1999, at the prevailing interest rate for the Euro-system's main refinancing operations.

Following a consultation of euro area credit institutions, the Governing Council of the ECB⁷ decided to

change the reserve maintenance period in 2004. Accordingly, the maintenance period now starts on the settlement day of the main refinancing operation following the meeting of the Governing Council at which the monthly assessment of the monetary stance is prescheduled. To facilitate the transition to the new system, the first transition reserve maintenance period lasted until March 9, 2004.

⁷ Regulation (EC) No 1745/2003 of the European Central Bank of 12 September 2003 on the application of minimum reserves (ECB/2003/9).

2.2 Deposit facility

The *deposit facility* refers to overnight deposits placed with the OeNB by Austrian banks that access the Eurosystem's liquidity-absorbing standing facility at the prespecified rate. In 2004, the volume of such transactions averaged EUR 18.319 million.

5 Liabilities to other euro area residents denominated in euro

Closing balance Dec. 31, 2004	EUR 7.626 million
Closing balance Dec. 31, 2003	EUR 18.485 million
Change	-EUR 10.859 million -58.7%

This item comprises general government deposits of EUR 6.903 million and current account deposits of credit institutions that are not subject to minimum reserve requirements and of nonbanks.

6 Liabilities to non-euro area residents denominated in euro

Closing balance Dec. 31, 2004	EUR 6.293 million
Closing balance Dec. 31, 2003	EUR 2.378 million
Change	+EUR 3.915 million +164.7%

This item contains euro-denominated liabilities to non-Eurosystem central banks and monetary institutions.

9 Counterpart of Special Drawing Rights allocated by the IMF

Closing balance Dec. 31, 2004	EUR 204.040 million
Closing balance Dec. 31, 2003	EUR 210.915 million
Change	-EUR 6.875 million -3.3%

This item represents the counterpart in euro of the SDR 179 million allocated gratuitously to the OeNB, measured at current market values

on the balance sheet date. The OeNB was allocated SDRs in six installments from 1970 to 1972 and from 1979 to 1981, always on January 1.

10 Intra-Eurosystem liabilities

Closing balance Dec. 31, 2004	EUR 9,000.500 million
Closing balance Dec. 31, 2003	EUR 3,063.716 million
Change	+EUR 5,936.784 million +193.8%

In the financial statements for 2004, this item shows the net liabilities arising from balances of TARGET accounts with the 11 other Eurosystem central banks as well as the remaining 3 ESCB central banks (the Bank of England, Sveriges Riksbank and Danmarks Nationalbank) on the one hand and with the ECB on the other hand. Moreover, this item covers the net result at year-end of the difference between monetary income to be pooled and distributed, the balances arising from the redistribution of ECB seignorage income as well as the balances arising from the correspondent accounts⁸ of individual NCBs.

The individual bilateral end-of-day balances of the OeNB with the other NCBs are netted by novating them to the ECB.

The ECB remunerates the net balance at the prevailing interest rate for the Eurosystem's main refinancing operations.

On December 31, 2003, this item consisted exclusively of net liabilities related to the allocation of euro banknotes within the Eurosystem.

⁸ The correspondent accounts may be used for a limited number of transactions in case of temporary disruptions of TARGET.

11 Items in course of settlement

Closing balance Dec. 31, 2004	–
Closing balance Dec. 31, 2003	EUR 7.326 million
Change	–EUR 7.326 million –100.0%

This item comprises float amounts pending settlement after the accounts have been closed for the year.

12 Other liabilities

Other liabilities are broken down as follows:

	Dec. 31, 2003 EUR million	Dec. 31, 2004 EUR million	Change EUR million	%
12.1 Off-balance sheet instruments' revaluation differences	4.109	0.907	–3.202	–77.9
12.2 Accruals and income collected in advance	33.282	20.272	–13.010	–39.1
12.3 Sundry	748.496	576.229	–172.267	–23.0
Total	785.887	597.408	–188.479	–24.0

12.1 Off-balance sheet instruments' revaluation differences

The *off-balance sheet instruments' revaluation differences* subsume the revaluation losses arising on off-balance sheet positions, which are posted to the profit and loss account, and book value reconciliation.

12.3 Sundry

This subitem is composed of the following accounts:

	Dec. 31, 2003 EUR million	Dec. 31, 2004 EUR million	Change EUR million	%
Central government's share of profit (without dividends)	423.271	267.786	–155.485	–36.7
Liability from schilling banknotes in circulation with an exchange deadline	239.296	232.028	–7.268	–3.0
Earmarked funds of the OeNB Anniversary Fund				
Initial OeNB Anniversary Fund	23.632	22.915	–0.717	–3.0
OeNB Anniversary Fund National Foundation endowment	48.073	43.614	–4.459	–9.3
Other	14.224	9.886	–4.338	–30.5
Total	748.496	576.229	–172.267	–23.0

Pursuant to Article 69 paragraph 3 of the Nationalbank Act, the *central government's share of profit* corresponds to 90% of the profit for the year after tax.

According to the General Meeting's decision, EUR 12.579 million of the *profit for the year 2003* were apportioned to the OeNB's Anniversary Fund for the Promotion of Scientific Research and Teaching. Adjusted for the return on investment for 2004 and repayments made, the initial funding of the OeNB Anniversary Fund thus came to EUR 39.816 million. Of these funds, EUR 16.901 million were paid out in 2004; EUR 21.364 million of the remaining undisbursed funds of EUR 22.915 million have been pledged.

In 2004, the General Council decided to allocate an additional EUR 12.494 million to fund 208 projects and EUR 3.580 million to fund three institutes. This means that since funds were first pledged as financial assistance in 1966, a total EUR 652.938 million has been paid out.

The EUR 43.614 million the OeNB Anniversary Fund pledged for the National Foundation are pro rata income from earmarked assets for 2004; payment to the National Foundation is made the day after the General Meeting.

13 Provisions

	Dec. 31, 2003	Transfer from	Transfer to	Dec. 31, 2004
	EUR million	EUR million	EUR million	EUR million
Pension reserve	1,828.650	-90.939	+141.289	1,879.000
Personnel provisions				
Severance payments	45,586	-3.408	+1.639	43,817
Anniversary bonuses	10,347	-0.890	+0.593	10,050
Residual leave entitlements	9,430	-0.002	+0.064	9,492
Sabbatical	-	-	+0.038	0,038
Provisions for				
Schilling banknotes without an exchange deadline	259,829	-25,598	-	234,231
Exchange rate risks	-	-	+40,000	40,000
Retained monetary income	-	-	+39,569	39,569
Corporate income tax	-	-	+10,278	10,278
Conclusion of the renovation work on the OeNB's main building and northern office building	-	-	+5,088	5,088
Accounts payable	1,885	-1,832	+1,260	1,313
Premises management	1,461	-0,061	+0,038	1,438
Accounts payable to subsidiaries	1,330	-1,330	+5,195	5,195
Other	1,229	-1,059	+0,958	1,128
Total	2,159,747	-125,119	+246,009	2,280,637

Under the OeNB's initial retirement plan, the OeNB assumes full liability to provide retirement benefits to the employees with contracts concluded up to April 30, 1998. To cover this liability, the OeNB is obligated by law to establish a pension reserve corresponding to the actuarial present value of its pension liabilities.

Following a change in the retirement plan, staff recruited after May 1, 1998, stands to receive a state pension supplemented by an occupational pension from an externally managed pension fund. For this supplementary pension, the OeNB took out a contract effective May 1, 1999, which also applies retroactively to employees taken on in the 12 months from May 1, 1998. With the OeNB's direct liability to pay retirement benefits now limited to staff recruited before May 1, 1998, the pension reserve set up to secure this liability has become a closed system. The OeNB taps this pension reserve to pay out retirement benefits.

Pension benefits as covered by the pension reserve augmented by EUR 2.481 million or 2.8% to EUR 90.939 million in 2004. This includes the remuneration of 15 retired board members or their dependents (totaling EUR 4.043 million; 2003: EUR 3.966 million).

The income on investment relating to the pension reserve was transferred to the pension reserve when the financial statements for 2004 were prepared. The pension reserve is shown at its actuarial present value. The pension reserve on December 31, 2004, was calculated according to actuarial principles; the discount rate of 3.50% per annum is the same as that applied in 2003.

Provisions for severance payments and anniversary bonuses are calculated according to actuarial principles; again, the discount rate of 3.50% per annum is the same as that applied in 2003.

No provisions for pending lawsuits were made, as none are expected to have a material impact.

14 Revaluation accounts

This item consists of the following accounts:

	Dec. 31, 2003 EUR million	Dec. 31, 2004 EUR million	Change EUR million
Eurosystem revaluation accounts			
Gold	857.402	743.380	-114.022
Foreign currency	41.690	39.588	-2.102
Securities	149.090	151.928	+2.838
Participating interests	179.352	175.799	-3.553
Off-balance sheet instruments	9.283	6.792	-2.491
Subtotal	1,236.817	1,117.487	-119.330
Unrealized valuation gains from January 1, 1999 (initial valuation)			
Securities	1.713	1.423	-0.290
Participating interests	279.728	279.728	-
Subtotal	281.441	281.151	-0.290
Reserve fund for exchange risks (funded up to the end of 1998)			
	851.190	537.349	-313.841
Total	2,369.448	1,935.987	-433.461

Revaluation on the *revaluation accounts* is effected on a currency-by-currency and code-by-code basis. The above amounts reflect the valuation gains established in the valuation of assets as at December 31, 2004. Those gains are realizable only in the context of future transactions in the respective category or can be used only to reverse revaluation losses that may arise in future years. The revaluation gains in each currency cover the risks associated with nondomestic assets (as established with the VaR method).

In line with requirements, the initial valuation gains recorded in the opening balance sheet of January 1, 1999, were partly realized during 2004 in the course of sales of underlying assets.

Article 69 paragraph 1 of the Nationalbank Act obliges the OeNB to maintain a reserve fund covering exchange risks which may arise on nondomestic assets. The *reserve fund for exchange risks* posted in the financial statements for 2004 contains exchange gains accrued in the run-up to 1999 totaling EUR 537.349 million. On the one hand, the annual change reflects the realization of exchange rate gains resulting from the sale of underlying assets. On the other hand, the fund is used to cover unrealized exchange losses that must be expensed, as well as any exchange risks (as calculated with the VaR approach) that are not offset by the balances on the revaluation accounts. As from January 1, 1999, no further allocations to this fund have been permitted.

15 Capital and reserves

A summary of the OeNB's reserves shows the following developments:

	Dec. 31, 2003	Dec. 31, 2004	Change	
	EUR million	EUR million	EUR million	%
General reserve fund	477.683	–	–477.683	–100.0
Reserve for nondomestic and price risks	1,622.000	1,973.263	+351.263	+21.7
Reserve for retained earnings	–	2.226	+2.226	–
Earmarked capital funded with net interest income from ERP loans	569.399	585.439	+16.040	+2.8
OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching	1,531.500	1,531.500	–	–
Total	4,200.582	4,092.428	–108.154	–2.6

EUR 477.683 million were reappropriated from the *general reserve fund* to the *reserve for nondomestic and price risks* in recognition of the risen risk ascertained by means of risk assessment procedures on December 31, 2004. The section Risk Management above contains more information on the OeNB's risk management principles.

Since 2003, the capital of the OeNB's Anniversary Fund for the Promotion of Scientific Research and Teaching (EUR 1,531.500 million) has consisted of its initial funding (EUR 31.500 million) and of an endowment created in 2003 to support innovation (EUR 1,500.000 million earmarked for the National Foundation).

The initial funding of EUR 31.500 million consists of EUR 7.267 million apportioned from the net income for the year 1965 in April 1966 and EUR 24.233 million allocated from the profit for the year 2002 in May 2003.

The endowment of EUR 1,500.000 million for the National Foundation was established in 2003 by earmarking funds reappropriated from the *freely disposable reserve fund* (EUR 545.000 million) and from the *general reserve fund* (EUR 955.000 million).

Earmarked ERP capital funded with net interest income from loans serves to cover losses on the ERP loan portfolio managed by the OeNB.

Other financial liabilities (off-balance sheet positions)

Apart from the items recognized in the balance sheet, the following financial liabilities and financial derivatives were stated off the balance sheet on December 31, 2004:

- contingent liabilities to the IMF under the New Arrangements to Borrow totaling EUR 464.957 million;
- obligation under the IMF's statutes to provide currency on demand to participants using SDRs up to the point at which the OeNB's holdings of SDRs are three times as high as its net cumulative allocation of EUR 494.624 million;
- obligation to make a supplementary contribution of EUR 34.188 million (equivalent to SDR 30 million) to the OeNB's stake in the capital of the Bank for International Settlements (BIS) in Basel consisting of 8,000 shares of SDR 5,000 each;
- liabilities of EUR 18.773 million from foreign currency investments effected in the OeNB's name for third account;

- repayment obligations to the amount of EUR 15.188 million arising from pension contributions paid by OeNB staff members payable on termination of employment contracts;
- contingent liability equivalent to the OeNB's share of EUR 1,040.000 million of the maximum of EUR 50 billion of additional foreign reserve assets of the euro area NCBs on which the ECB is entitled to call; and
- contingent liability equivalent to the OeNB's share of EUR 104.000 million of the EUR 5 billion by which the ECB may increase its paid-up capital.

Holdings of derivatives were as follows on December 31, 2004:

	Underlying value EUR million	Market value gains EUR million	Market value losses EUR million
Forward rate agreements			
Purchases	14.683	0.005	0
Sales	22.025	0.002	0.017
Bond futures			
Sales	65.000	–	0.194
Interest rate swaps			
Sales	174.930	6.089	–

The market values represent the valuation of December 31, 2004, with gains entered in the *revaluation accounts* (liability item 14) and losses entered in the profit and loss account as *writedowns on financial assets and positions* (item 2.2).

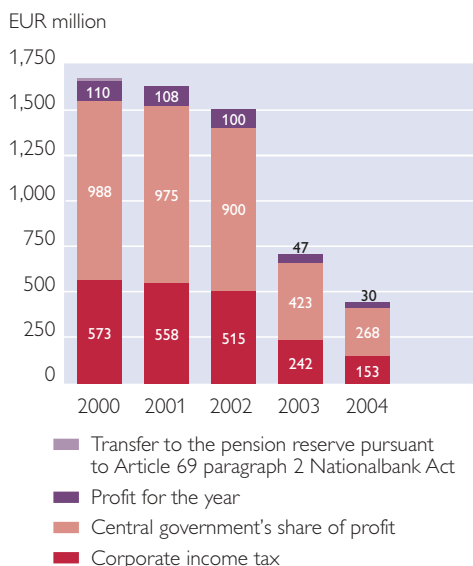
Moreover, foreign currency and security options were traded in 2004, all of which matured prior to December 31, 2004. The result of these transactions was taken to item 1 *Net interest income* of the profit and loss account.

Notes to the Profit and Loss Account

	2003	2004	Change ¹	
	EUR million	EUR million	EUR million	%
1 Net interest income	467.087	448.611	-18.476	-4.0
2 Net result of financial operations, writedowns and risk provisions	344.764	215.157	-129.607	-37.6
3 Net expense/income from fees and commissions	0.250	0.988	+0.738	+295.3
4 Income from equity shares and participating interests	100.664	21.096	-79.568	-79.0
5 Net result of pooling of monetary income	11.120	-30.872	-41.992	-377.6
6 Other income	8.120	7.507	-0.613	-7.6
Total net income	932.005	662.487	-269.518	-28.9
7 Staff costs	-98.084	-98.035	-0.049	-0.1
8 Administration expenses	-94.049	-89.902	-4.147	-4.4
9 Depreciation of tangible and intangible fixed assets	-13.903	-16.182	+2.279	+16.4
10 Banknote production services	-11.314	-7.157	-4.157	-36.7
11 Other expenses	-2.077	-0.393	-1.684	-81.1
Total expenses	-219.427	-211.669	-7.758	-3.5
Operating profit	712.578	450.818	-261.760	-36.7
12 Corporate income tax	-242.276	-153.278	-88.998	-36.7
13 Central government's share of profit	470.302	297.540	-172.762	-36.7
14.1 Net income	-423.271	-267.786	-155.485	-36.7
14.2 Profit brought forward	47.031	29.754	-17.277	-36.7
	0.177	-	-0.177	-100.0
14 Profit for the year	47.208	29.754	-17.454	37.0

¹ Absolute increase (+) or decrease (-) in the respective income or expense item.

Operating Profit over the Past Five Years



Source: OeNB.

1 Net interest income

Net interest income represents the balance of *interest income* and *interest expense*. The reduction in interest income in 2004 resulted partly from a sharp reduction in the own funds portfolio following the release of reserves at the end of 2003 and partly to the decline in interest rates from 2003.

Net interest income from assets and liabilities denominated in foreign currency totaled EUR 256.658 million (–EUR 68.052 million), that from euro-denominated assets and liabilities came to EUR 123.176 million (–EUR 18.020 million). Monetary policy refinancing operations yielded EUR 115.473 million (+EUR 21.450 million), and the ECB remunerated the transfer of foreign reserves with EUR 20.121 million (–EUR 3.407 million). Income on intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem came to EUR 32.212 million

(+EUR 106.688 million). Conversely, EUR 88.296 million (–EUR 7.947 million) were required to remunerate minimum reserves. Interest expenses of EUR 85.637 million (–EUR 93.947 million) resulted from TARGET liabilities.

2 Net result of financial operations, writedowns and risk provisions

Realized gains or losses from day-to-day financial operations resulted from – receivable or payable – differences between the acquisition cost and the market value of gold, foreign currency, securities or other transactions. Among other things, these gains include price gains from the sale of 10 tons of gold.

Net realized gains contracted by EUR 52.760 million (–16.6%) to EUR 264.522 million. EUR 168.204 million (–EUR 84.068 million) stem from gold and foreign currency operations, EUR 95.219 million (+EUR 28.547 million) from securities transactions.

The *writedowns on financial assets and positions* largely reflect the decline in market prices of balance sheet items as at December 31, 2004, below the average cost of the respective currencies or securities. Foreign currency writedowns came to EUR 254.179 million (–EUR 429.428 million), securities writedowns to EUR 8.161 million (–EUR 5.337 million) and writedowns on derivatives to EUR 0.211 million (–EUR 0.314 million).

The item *transfer to/from provisions for foreign exchange rate and price risks* resulted from transfers from the reserve fund for exchange risks that the OeNB funded up to the end of 1998 with a view to covering unrealized foreign currency losses of EUR 254.179 million. Thus, in compli-

ance with Article 69 paragraph 1 of the Nationalbank Act, these losses did not have an impact on profit. However, in view of the risk assessment of nondomestic assets, a provision for exchange rate risks of EUR 40.000 million was made.

4 Income from equity shares and participating interests

This item records dividend payments of EUR 18.000 million made by Münze Österreich Aktiengesellschaft and of EUR 2.171 million made by the BIS for 2003. The distribution of profit by AUSTRIA CARD-Plastik-karten und Ausweissysteme Gesellschaft m.b.H. resulted in income of EUR 0.366 million. Moreover, this item reflects a repayment of EUR 0.559 million of part of the OeNB's paid-up capital in the ECB's capital on December 31, 2003, resulting from the decrease in the weighting in the ECB capital key on January 1, 2004. Also included under this item is the distribution of the ECB's seigniorage income on its 8% share of euro banknotes in circulation.⁹ In 2004, the ECB's income on euro banknotes in circulation was fully retained by the ECB in accordance with a decision of the Governing Council on December 16, 2004, and in view of the ECB result.

5 Net result of pooling of monetary income

Article 32 of the Statute of the ESCB¹⁰ defines monetary income as the income accruing to the NCBs in the performance of the Eurosystem's monetary policy function. The

amount of each NCB's monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base. Such assets shall be earmarked and the income derived from these assets shall be redistributed among the euro area NCBs in accordance with guidelines to be established by the Governing Council of the ECB (Article 32.2 of the ESCB Statute).

The amount of income the NCBs actually pay into the pool for redistribution is influenced by the costs that they incur in connection with the liquidity-absorbing monetary policy operations and by the remuneration of reserves under the Eurosystem's minimum reserve system, because any interest that the NCBs pay on banks' minimum reserve deposits reduces the amounts they contribute to the pool of monetary income.

The monetary income pooled by the Eurosystem is to be allocated among NCBs in according to the subscribed capital key. The difference between the monetary income pooled by the OeNB amounting to EUR 230.471 million and reallocated to the OeNB amounting to EUR 239.200 million is the net result arising from the calculation of monetary income, EUR 8.729 million. The OeNB's share in monetary income retained to cover the loss incurred by the ECB in 2004 reduced this net result by EUR 39.601 million, so the *net result of pooling of monetary income* represents an expense of EUR 30.872 million.

⁹ Decision of the European Central Bank of 21 November 2002 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the national central banks of the participating Member States (ECB/2002/9).

¹⁰ Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002 (ECB/2001/16).

7 Staff costs

Salaries, severance payments and the employer's social security contributions and other statutory or contractual social charges fall under the heading *staff costs*. These costs were reduced by recoveries of salaries and employees' pension contributions.

As of January 1, 1997, the pension contributions of employees who had joined the OeNB after March 31, 1993, and who qualify for an OeNB pension were raised from 5% of their total basic pay to 10.25% of their basic salaries up to the earnings cap on social security. A rate of 2% applies to income above the earnings cap.

Salaries net of pension contributions collected from staff members grew by EUR 1.002 million or 1.2% to EUR 83.819 million. This increase is attributable primarily to the salary increase negotiated for the banking sector. The OeNB's outlays were reduced by recoveries of salaries totaling EUR 8.675 million for staff members on secondment to subsidiaries and foreign institutions.

Adjusted for employees on secondment or leave such as maternity and parental leave, the average number of staff employed in the OeNB's core business areas (expressed in full-time equivalents, FTEs) came to 957.3 (2003: 952.2). The overall average number of OeNB staff members (in FTEs) declined from 1,179.3 in 2003 to 1,161.8 on average in 2004, a decline by 17.5 FTEs or 1.5%.

The four members of the Governing Board received emoluments¹¹ including remuneration in kind (private use of company cars, subsidies to insurance) totaling EUR 1.030 million

(2003: EUR 0.957 million). The emoluments of Governor Liebscher came to EUR 0.274 million, of Vice Governor Duchatzek to EUR 0.260 million, of Executive Director Zöllner to EUR 0.253 million and of Executive Director Christl to EUR 0.243 million.

The emoluments of President and Vice President amounted to EUR 0.106 million, and EUR 0.035 million represented back pay for 2003 (2003: EUR 0.031 million).

Statutory or contractual social charges totaling EUR 12.778 million (+EUR 0.380 million) contain municipal tax payments of EUR 2.535 million, social security contributions of EUR 6.375 million and contributions of EUR 3.782 million to the Family Burden Equalization Fund.

10 Banknote production services

Expenses for banknote production services resulted from the purchase of euro banknotes from the OeBS.

12 Corporate income tax

A corporate income tax rate of 34% was applied to the taxable income according to Article 72 of the Nationalbank Act and in line with Article 22 paragraph 1 of the Corporate Income Tax Act.

13 Central government's share of profit

Under Article 69 paragraph 3 of the Nationalbank Act, the *central government's share of profit* is 90% of the net income for the year after tax, as in the previous years, and amounts to EUR 267.786 million (2003: EUR 423.271 million).

¹¹ Limits apply under the Federal Constitutional Law Limiting the Emoluments of Public Officials.

Governing Board (Direktorium)

Governor Klaus Liebscher
 Vice Governor Wolfgang Duchatzek
 Executive Director Peter Zöllner
 Executive Director Josef Christl

General Council (Generalrat)

President Herbert Schimetschek
 Vice President Manfred Frey
 August Astl
 Christian Domany (from May 13, 2004)
 Bernhard Felderer
 Lorenz R. Fritz (until August 13, 2004)
 Philip Göth (from August 1, 2004)
 Elisabeth Gürtler-Mauthner (from September 9, 2004)
 Herbert Kofler
 Georg Kovarik (from September 9, 2004)
 Richard Leutner (until July 1, 2004)
 Johann Marihart
 Werner Muhm
 Gerhard Randa
 Walter Rothensteiner
 Karl Werner Rüschi (until July 31, 2004)
 R. Engelbert Wenckheim (until May 13, 2004)
 Johann Zwettler

In accordance with Article 22 paragraph 5 of the Nationalbank Act, the following representatives of the Staff Council participated in discussions on personnel, social and welfare matters: Thomas Reindl and Martina Gerharter.

Vienna, March 30, 2005

Report of the Auditors

We have audited the financial statements of the Oesterreichische Nationalbank for the year ending December 31, 2004, in accordance with generally accepted Austrian auditing standards as recommended by the reports, guidelines and opinions of the Institut Österreichischer Wirtschaftsprüfer.

We have found that the accounting records and the financial statements of the Oesterreichische Nationalbank for the year ending December 31, 2004, are presented in accordance with the provisions of the Federal Act on the Oesterreichische Nationalbank 1984 as amended. The financial statements were prepared in conformity with the accounting policies defined by the Governing Council of the European Central Bank, as set forth in the Guideline of the European Central Bank of 5 December 2002 on the legal framework for accounting and reporting in the European System of Central Banks (ECB/2002/10), in conformity with Article 26.4 of the Protocol on the Statute of the European System of Central Banks and the European Central Bank. In our opinion the accounts provide a true and fair picture of the OeNB's financial position and the results of its operations. The annual report complies with the provisions of Article 68 paragraph 1 and paragraph 3 of the Federal Act on the Oesterreichische Nationalbank 1984 as amended and as promulgated in Federal Law Gazette I No. 55/2002 and corresponds with the financial statements.

Vienna, March 30, 2005

Pipin Henzl
Certified Public Accountant

Peter Wolf
Certified Public Accountant

Profit for the Year and Proposed Profit Appropriation

With the statutory allocation of EUR 267.786 million (2003: EUR 423.271 million) of the OeNB's profit to the central government having been made in conformity with Article 69 paragraph 3 of the Nationalbank Act (item 13 of the profit and loss account), the balance sheet and the profit and loss account show a

Profit for 2004 of		EUR 29,753,966.48.
On March 30, 2005, the Governing Board endorsed the following profit appropriation proposal to the General Council:		
to pay a 10% dividend on the OeNB's capital stock of EUR 12 million		EUR 1,200,000.—
to allocate to the Leopold Museum Private Foundation		EUR 4,391,619.37
to allocate to the OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching:		
funds earmarked for promotion by the OeNB	EUR 12,579,460.15	
funds earmarked for the National Foundation for Research, Technology and Development	EUR 11,582,886.96	EUR 24,162,347.11
		EUR 29,753,966.48



Report of the General Council (Generalrat) on the Annual Report and the Financial Statements for 2004

The General Council (Generalrat) fulfilled the duties incumbent on it pursuant to the Nationalbank Act 1984 by holding its regular meetings, by convening its subcommittees and by obtaining the information required.

The Governing Board (Direktorium) periodically reported to the General Council on the Bank's operations and their current state, on the conditions on the money, capital and foreign exchange markets, on important matters which arose in the course of business, on all developments of importance for an appraisal of the monetary situation, on the arrangements made for supervising the OeNB's financial conduct and on any other significant dispositions and events affecting its operations.

The Financial Statements for the year 2004 were given an unqualified auditors' opinion after examination by the auditors elected by the General Meeting of May 13, 2004,

the certified public accounts Pipin Henzl and Peter Wolf, on the basis of the books and records of the Oesterreichische Nationalbank as well as the information and evidence provided by the Governing Board.

In its meeting of April 14, 2005, the General Council approved the Annual Report of the Governing Board and the Financial Statements for the business year 2004. The General Council submits the Annual Report and moves that the General Meeting approve the Financial Statements of the Oesterreichische Nationalbank for the year 2004 and discharge the General Council and the Governing Board from responsibility for management during the preceding business year. Moreover, the General Council requests that the General Meeting approve the allocation of the profit for the year in accordance with the proposal made in the notes to the Financial Statements 2004 (page 117).





NOTES

Abbreviations

ACH	automated clearing house	IHS	Institut für Höhere Studien und Wissenschaftliche Forschung – Institute for Advanced Studies, Vienna
APSS	Austrian Payment Systems Services (APSS) GmbH	IIF	Institute of International Finance
ARTIS	Austrian Real Time Interbank Settlement (the Austrian RTGS system)	IIP	international investment position
A-SIT	Secure Information Technology Center – Austria	IMF	International Monetary Fund
ASVG	Allgemeines Sozialversicherungsgesetz – General Social Security Act	IRB	internal ratings-based
A-Trust	A-Trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH	ISO	International Organization for Standardization
ATM	automated teller machine	IWI	Industriewissenschaftliches Institut – Austrian Institute for Industrial Research
ATX	Austrian Traded Index	IT	information technology
BCBS	Basel Committee on Banking Supervision (BIS)	JVI	Joint Vienna Institute
BIC	Bank Identifier Code	LIBOR	London Interbank Offered Rate
BIS	Bank for International Settlements	M3	broad monetary aggregate M3
BOP	balance of payments	MLR	Major Loans Register
BSC	Banking Supervision Committee (ESCB)	MFI	monetary financial institution
CACs	collective action clauses	MRO	main refinancing operation
CEBS	Committee of European Banking Supervisors (EU)	MoU	memorandum of understanding
CEE	Central and Eastern Europe	NCB	national central bank
CEECs	Central and Eastern European countries	ÖBB	Österreichische Bundesbahnen – Austrian Federal Railways
CESR	Committee of European Securities Regulators	OeBS	Oesterreichische Banknoten- und Sicherheitsdruck GmbH – Austrian Banknote and Security Printing Works
CIS	Commonwealth of Independent States	OECD	Organisation for Economic Co-operation and Development
CPI	consumer price index	OeKB	Oesterreichische Kontrollbank (Austria's main financial and information service provider for the export industry and the capital market)
EBA	Euro Banking Association	OeNB	Oesterreichische Nationalbank (Austria's central bank)
EBRD	European Bank for Reconstruction and Development	OPEC	Organization of the Petroleum Exporting Countries
EC	European Community	ORF	Österreichischer Rundfunk – Austrian Broadcasting Corporation
ECB	European Central Bank	ÖBFA	Austrian Federal Financing Agency
Ecofin	Council of Economics and Finance Ministers (EU)	ÖNACE	Austrian Statistical Classification of Economic Activities
EDP	excessive deficit procedure (EU)	PEACH	pan-European automated clearing house
EEA	European Economic Area	PISA	Programme for International Student Assessment (OECD)
EFC	Economic and Financial Committee (EU)	POS	point of sale
EFTA	European Free Trade Association	PRGF	Poverty Reduction and Growth Facility (IMF)
EIB	European Investment Bank	R&D	research and development
EMS	European Monetary System	RTGS	Real-Time Gross Settlement
EMU	Economic and Monetary Union	SDR	Special Drawing Right (IMF)
EONIA	Euro OverNight Index Average	SDRM	Sovereign Debt Restructuring Mechanism (IMF)
ERM II	Exchange Rate Mechanism II (EU)	SEPA	Single Euro Payments Area
ERP	European Recovery Program	SPF	Survey of Professional Forecasters
ESA	European System of Accounts	STEP2	Straight-Through Euro Processing system offered by the Euro Banking Association
ESAF	Enhanced Structural Adjustment Facility (IMF)	STP	straight-through processing
ESCB	European System of Central Banks	STUZZA	Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr (STUZZA) G.m.b.H. – Austrian Research Association for Payment Cooperation
ESRI	Economic and Social Research Institute	SWIFT	Society for Worldwide Interbank Financial Telecommunication
EU	European Union	TARGET	Trans-European Automated Real-time Gross settlement Express Transfer
EURIBOR	Euro Interbank Offered Rate	Treaty	refers to the Treaty establishing the European Community
Eurostat	Statistical Office of the European Communities	UNCTAD	United Nations Conference on Trade and Development
FATF	Financial Action Task Force on Money Laundering	UNO	United Nations Organization
Fed	Federal Reserve System	VaR	Value at Risk
FFF	Forschungsförderungsfonds für die Gewerbliche Wirtschaft – Austrian Industrial Research Promotion Fund	WBI	Wiener Börse Index
FMA	Financial Market Authority (for Austria)	WEF	World Economic Forum
FOMC	Federal Open Market Committee (U.S.A.)	WIFO	Österreichisches Institut für Wirtschaftsforschung – Austrian Institute of Economic Research
FSAP	Financial Sector Assessment Program (IMF)	WIIW	Wiener Institut für internationale Wirtschaftsvergleiche – The Vienna Institute for International Economic Studies
FWF	Fonds zur Förderung der wirtschaftlichen Forschung – Austrian Science Fund	WKO	Wirtschaftskammer Österreich – Austrian Federal Economic Chamber
GAB	General Arrangements to Borrow	WTO	World Trade Organization
GATS	General Agreement on Trade in Services		
GDP	gross domestic product		
GNP	gross national product		
GSA	GELDSERVICE AUSTRIA Logistik für Wert- gestionierung und Transportkoordination GmbH (Austrian cash services company)		
HICP	Harmonized Index of Consumer Prices		
IBAN	International Bank Account Number		
IBRD	International Bank for Reconstruction and Development		
IDB	Inter-American Development Bank		
IFES	Institut für empirische Sozialforschung (Institute for Empirical Social Research, Vienna)		
ifo	ifo Institute for Economic Research, Munich		
IGC	Intergovernmental Conference (EU)		

Legend

- × = No data can be indicated technical reasons
- .. = Data not available at the reporting date
- 0 = The numerical value is zero or smaller than half of the unit indicated
- = The numerical value is zero (applicable to the Financial Statements)

Discrepancies may arise from rounding.

Glossary

ARTIS: Austrian Real Time Interbank Settlement. The real-time gross settlement (RTGS) system for euro payments developed and operated by the Oesterreichische Nationalbank (OeNB) that forms the Austrian component of the EU-wide large-value euro payment system **TARGET** run by the European System of Central Banks (ESCB). Since January 4, 1999, ARTIS users have been able to channel intra-EU payments through a single account at the OeNB.

BIC: Bank Identifier Code. Eight-digit code devised by SWIFT, the international messaging system for cross-border payments, that unambiguously identifies participants of payment systems. It is composed of the following three subcodes: (1) the bank code (first 4 digits), (2) the country code (next 2 digits), and (3) the location code (last 2 digits). NABAATWW is, for instance, the BIC of the Oesterreichische Nationalbank.

Budget balance: general government net lending/net borrowing, i.e. the balancing item of the financial account as defined in ESA 1995 (the European System of Accounts), which represents either a financial surplus (net lending) or a financial deficit (net borrowing). Austria's general government sector comprises the central government (including various nonprofit organizations), state government and local government as well as social security funds. The budget balance may be broken down into a cyclical component and a structural, cyclically adjusted component.

Capital adequacy: the minimum amount of own funds that banks must hold relative to their assets to cover their exposure to risk. The capital adequacy framework (Basel I, Basel II) of the Basel Committee on Banking Supervision (BCBS) prescribes a capital ratio of 8%.

Clearing: the process of reconciling and netting payment orders in a net settlement system.

Confidence indicator: also referred to as sentiment indicator. Measure reflecting businesses' or the public's assessment of the economic situation, which serves to e.g. identify cyclical turning points at an early stage.

Convergence criteria: five requirements that are laid down in the Maastricht Treaty and that an EU Member State must fulfill to qualify for participation in Stage Three of Economic and Monetary Union (EMU), i.e. for the introduction of the euro: (1) an inflation rate not more than 1.5 percentage points above that of the three best-performing Member States in terms of price stability, (2) a long-term interest rate not more than 2 percentage points above that of the three best-performing Member States, (3) a government deficit which does not exceed 3% of GDP, (4) a ratio of public debt to GDP which does not exceed 60%, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace, and (5) currency variations within the normal fluctuation margins of the **Exchange Rate Mechanism II** (ERM II) for at least two years and no devaluation against the currency of any other Member State.

Core inflation: inflation measure that excludes changes in selected components from the underlying basket of goods and services. Energy and food are factored out most frequently, given their volatile price development.

Credit risk: the risk of changes in customer creditworthiness affecting a bank's assets.

Excessive deficit procedure: mechanism defined in Article 104 of the Treaty and Protocol No 20 on the excessive deficit procedure that requires EU Member States to maintain budgetary discipline; the **Stability and Growth Pact** substantially extended and accelerated the excessive deficit procedure (EDP). It defines criteria for a budgetary position to be considered as an excessive deficit and sets out the steps to be taken when a Member State has not fulfilled the budget balance or government debt criteria. In line with the conclusions of the European Council of March 22 and 23, 2005, the EDP is scheduled to be amended in the course of 2005.

Exchange Rate Mechanism II (ERM II): exchange rate arrangement that provides the framework for exchange rate policy cooperation between the euro area countries and the EU Member States not participating in Stage Three of Economic and Monetary Union (EMU). It specifies fluctuation bands (up to a maximum of $\pm 15\%$) for the key interest rates of a currency against the euro. Participation in ERM II for at least two years without severe tensions and without a devaluation against the currency of another Member State is one of the criteria a country has to fulfill to qualify for Stage Three of EMU.

IBAN: International Bank Account Number. Internationally agreed standard to identify a customer's account at a financial institution; designed to replace the combination e.g. of an account number and the financial institution's routing/transit code (Bankleitzahl) in Austria. The IBAN was developed by the International Organization for Standardization (ISO) and the European Committee for Banking Standards (ECBS) to assist error-free and smooth processing of cross-border transactions. It is made up of the ISO country code, check digits, a bank code and an account number.

Imported inflation: sustained rise in the general price level attributable exclusively to inflationary pressures abroad.

Institutional analysis: thorough analysis of monetary developments in the euro area based on information derived from many different statistical sources, such as MFI balance sheet statistics, balance of payments data and financial accounts data, which is carried out as part of the second pillar of the monetary policy strategy of the European Central Bank (ECB).

Lamfalussy process: concept developed at the EU level by the Committee of Wise Men, chaired by Baron Alexandre Lamfalussy, on the regulation of European securities markets. In December 2002, the EU Council decided to extend this approach to the entire financial sector. The four-level regulatory approach aims at accelerating the legislative process of the EU, increasing

regulatory cooperation and convergence, and improving implementation and enforcement. Essentially, the approach consists in a subdivision into broad framework principles to be adopted in a codecision procedure by the Council and the European Parliament and technical implementation measures to be issued by the European Commission.

Macroprudential: refers to the thorough analysis at the systemic level of banking and financial stability as well as to supervision at the macro level as opposed to (microprudential) analysis and supervision of individual banks.

Market risk: the risk of financial market fluctuations (e.g. changes in interest rates, stock prices or exchange rates) affecting a bank's assets and liabilities.

Money-holding sector: nonbanks resident in a monetary union as opposed to banks, which are collectively defined as the money-issuing sector. The objective of analyzing the transactions of nonfinancial economic agents is to identify the determinants of money demand (money demand theory).

Off-site analysis: qualitative and quantitative evaluation of the (risk management and balance sheet) data banks report to the Oesterreichische Nationalbank and the Financial Market Authority (FMA) using a set of different methods. The purpose of off-site analysis is to detect problematic developments and initiate countermeasures as early as possible. See also **on-site inspection**.

On-site inspection: thorough examination of individual banks, during which supervisors largely work on the premises of a given bank. Credit institutions are subject to review in particular relevant business areas so that supervisors can add to the data reported by banks firsthand information in as much detail as is required to assess the need for supervisory action. See also **off-site analysis**.

Operational risk: the risk of bank losses resulting from inadequate internal controls (misconduct or human error, breakdown of internal processes or systems) or from external events.

Payment system: any set of payment instruments, banking procedures and interbank transfer systems that ensure the circulation of money.

PEACH: Pan-European Automated Clearing House. Infrastructure for cross-border credit transfers advanced by European banks under the **SEPA** initiative for European retail payment services, which is to be as (cost) efficient as national automated clearing houses (ACHs). Tailored to the requirements of customers of national payment services, a PEACH must offer cost-efficient, effective, swift and secure payment processing, i.e. it should support straight-through processing (STP). **STEP2** is the first and, to date, only PEACH.

Primary balance: government net borrowing or net lending excluding interest payments (as defined by ESA 1995) on consolidated government liabilities.

Rating: assessment of the creditworthiness of an enterprise against standardized qualitative and quantitative criteria. Ratings are used to determine a debtor's probability of default.

Repatriation of capital: return of resident investors' foreign investment capital into the home country, which entails the dissolution of external assets, e.g. through the sale of foreign securities or the withdrawal of cash holdings abroad.

Retail payments: low-value or customer payments as opposed to large-value or interbank payments.

Return on assets: ratio of net profit after taxes to total assets.

Securitization: form of transferring risk from loans or other liabilities by converting them into tradable securities issued by corporations specifically set up to this effect (so-called special purpose entities). Repayment of these securities is contingent on the redemption of the purchased debt instrument (traditional securitization).

SEPA: Single Euro Payments Area. Initiative launched by the European banking industry in spring 2002 to establish standards for payment services in Europe.

Stability and Growth Pact: framework which is based on two EU regulations issued in 1997 and is intended to serve as a means of safeguarding sound government finances in Stage Three of Economic and Monetary Union (EMU) in order to strengthen the conditions for price stability. Over the medium term, the Stability and Growth Pact requires Member States to post a budget close to balance or in surplus.

Stability programs: the euro area countries' annual medium-term government plans and assumptions for the development of key economic and, in particular, budget variables in line with the requirements of the **Stability and Growth Pact**. Countries not participating in the euro area must submit annual convergence programs under the provisions of the Stability and Growth Pact.

STEP2: the first and, to date, only **PEACH** for intra-EU credit transfers, which started operation in April 2003 and had some 90 direct and around 1,350 indirect participants at year-end 2004. With this system, the Euro Banking Association (EBA) offers credit institutions a technical infrastructure for cost-efficient and swift processing of transactions that meet specific requirements. Transactions must, for instance, be in euro, and both the International Bank Account Number (**IBAN**) and Bank Identifier Code (**BIC**) must be correctly indicated on the payment order. The Oesterreichische Nationalbank has been providing access to STEP2 since November 3, 2003.

Stress test: analysis of the impact of drastic, yet plausible stress scenarios in terms of credit and market risk on the adequacy of a bank's capital.

TARGET: Trans-European Automated Real-time Gross settlement Express Transfer. A real-time gross settlement (RTGS) system that processes large-value euro payments in real time, which consists of the 15 national RTGS systems of the EU-15, the ECB payment mechanism (EPM) and the Interlinking system connecting the individual TARGET components. The **ARTIS** system operated by the Oesterreichische Nationalbank is the Austrian RTGS system connected to TARGET.

TARGET2: next generation of the **TARGET** system scheduled to start operation in January 2007. A Single Shared Platform (SSP) to be built by the Deutsche Bundesbank, the Banque de France and the Banca d'Italia will be at the heart of TARGET2, which will offer extended, standardized functionality across Europe at harmonized prices.

Tax-to-GDP ratio: the sum of direct, indirect and capital taxes as well as social security contributions (excluding imputed contributions) as a percentage of GDP at market prices.

Terms of trade: ratio of a country's export prices to import prices in a single currency.

Treaty: refers to the Treaty establishing the European Community and the subsequent amendments. The Treaty was signed in Rome ("Treaty of Rome"), entered into force on January 1, 1958, and created the European Economic Community (EEC). It was amended by the Treaty on European Union ("Maastricht Treaty"), which took effect on November 1, 1993, and established the European Union (EU). The **Stability and Growth Pact** ("Treaty of Amsterdam," May 1, 1999) amended both the Treaty establishing the European Community and the Treaty on European Union; the most recent amendment – the "Treaty of Nice" – entered into force on February 1, 2003.

Twin deficit: a general government deficit coinciding with a current account deficit.

Periodical Publications of the Oesterreichische Nationalbank

For further details on the following publications see www.oenb.at

Statistiken – Daten & Analysen

quarterly

This publication contains reports and analyses focusing on Austrian financial institutions, cross-border transactions and positions as well as financial flows. The contributions are in German, with executive summaries of the analyses in English. The statistical part covers tables and explanatory notes on a wide range of macroeconomic, financial and monetary indicators. The tables including additional information and data are also available on the OeNB's website in both German and English. This series also includes special issues on selected statistics topics that will be published at irregular intervals.

Monetary Policy & the Economy

quarterly

This quarterly publication, issued both in German and English, offers analyses of cyclical developments, medium-term macroeconomic forecasts and studies on central banking and economic policy topics. This publication also summarizes the findings of macroeconomic workshops and conferences organized by the OeNB.

Financial Stability Report

semiannual

The *Financial Stability Report*, issued both in German and English, contains first, a regular analysis of Austrian and international developments with an impact on financial stability and second, studies designed to provide in-depth insights into specific topics related to financial market stability.

Focus on European Economic Integration

seminannual

Focus on European Economic Integration, the successor publication to the *Focus on Transition* (published up to issue 2/2003), contains a wide range of material on Central and Eastern European countries (CEECs), beginning with a topical economic analysis of selected CEECs. The main part of the publication comprises studies, on occasion several studies focusing on a special topic. The final section provides information about the OeNB's CEEC-related activities and conferences as well as a statistical annex.

Annual Report

annual

The *Annual Report* of the OeNB provides a broad review of Austrian monetary policy, economic conditions, new developments on the financial markets in general and the financial market supervision in particular, the changing responsibilities of the OeNB and the role of the OeNB as an international partner in cooperation and dialogue. It also contains the financial statements of the OeNB.

Economics Conference (Conference Proceedings)

annual

The *Economics Conference* hosted by the OeNB represents an important international platform for exchanging views on monetary and economic policy as well as financial market issues. It convenes central bank representatives, economic policy decision makers, financial market players, academics and researchers. The conference proceedings comprise papers of conference participants, most of them in English.

The Austrian Financial Markets

annual

The publication *The Austrian Financial Markets* provides easy access to continuously updated information on the Austrian capital markets to the international investment community. The brochure is jointly edited by the OeNB and the Oesterreichische Kontrollbank AG (OeKB).

Proceedings of OeNB Workshops

recurrent

The proceeding of *OeNB Workshops* were introduced in 2004 and typically comprise papers presented at OeNB workshops at which national and international experts, including economists, researchers, politicians and journalists, discuss monetary and economic policy issues. Workshop proceedings are available in English only.

Working Papers

recurrent

The *Working Paper* series of the OeNB is designed to disseminate and provide a platform for discussing findings of OeNB economists or outside contributors on topics which are of special interest to the OeNB. To ensure the high quality of their content, the contributions are subjected to an international refereeing process. The opinions are strictly those of the authors and in no way commit the OeNB.

Conference on European Economic Integration (Conference Proceedings)

annual

(formerly East-West Conference)

This series, published by a renowned international publishing house, reflects presentations made at the OeNB's annual central banking conference on Central, Eastern and Southeastern European issues and the ongoing EU enlargement process.

For further details see ceec.oenb.at

Newsletter of the Economic Analysis and Research Section

quarterly

The English-language *Newsletter of the Economic Analysis and Research Section* is only published on the Internet and informs an international readership about selected findings, research topics and activities of the Economic Analysis and Research Section of the OeNB. This publication addresses colleagues from other central banks or international institutions, economic policy researchers, decision makers and anyone with an interest in macroeconomics. Furthermore, the *Newsletter* offers information on publications, studies or working papers as well as events (conferences, lectures and workshops).

For further details see hvw-newsletter.oenb.at

Artwork

All artwork featured in this *Annual Report* is reproduced from the OeNB's collection "Austrian paintings of the interwar years."



Lisl Engels
Mödling 1916

"Philodendron und Gummibaum mit Früchten" (1934)
(Philodendron and Rubber Plant with Fruits)
90 x 65 cm, oil on canvas



Oskar Kokoschka
Pöchlarn 1886 – 1980 Montreux

"Zwei Mädchen" (1934)
(Two Young Women)
50,5 x 60,5 cm, oil on canvas
© VBK, Vienna, 2005



Wilhelm Thöny
Graz 1888 – 1949 New York

"Motiv aus Graz"
(Graz motif)
36 x 45 cm, oil on cardboard



Ernst Huber
Vienna 1895 – 1960 Vienna

"Fest im Freien"
(Alfresco Fête)
60,5 x 73,5 cm, oil on canvas



Robin Christian Andersen
Vienna 1890 – 1969 Vienna

"Obststilleben"
(Still Life with Fruits)
50,4 x 66,5 cm, oil on cardboard



Ernst Huber
Vienna 1895 – 1960 Vienna

"Landpartie im Sommer"
(Summer Outing in the Country)
54 x 65 cm, oil on plywood

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