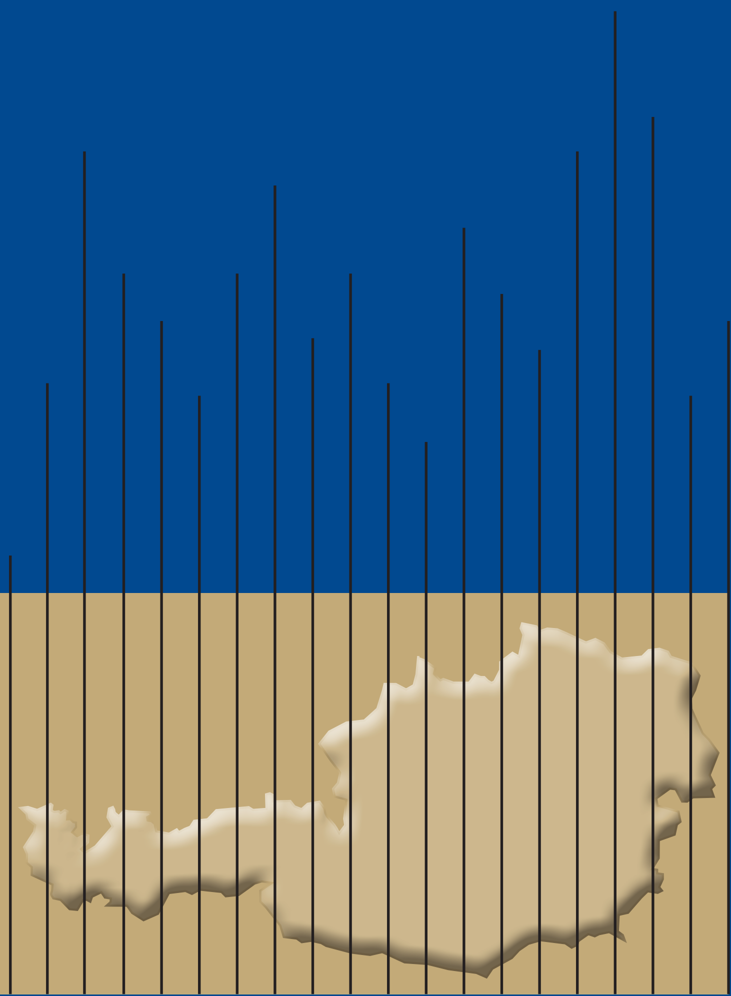
OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

FACTS ON AUSTRIA AND ITS BANKS



Stability and Security.

July 2015

Contents

Cut-off date for data: April 22, 2015.

Key indicators for the Austrian economy

Cut-off date for data: July 15, 2015.

Economic indicators

(OeNB forecast, June 2015)

	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	2014	2015	2016	2017
Economic activity	*EUR billion (four-quarter moving sums)*								
Nominal GDP	324.4	326.3	328.0	329.5	330.7	329.5	336.1	348.7	361.8
	Change on previous period in % (real)								
GDP	0.1	0.1	0.0	0.0	0.1	0.4	0.7	1.9	1.8
Private consumption	0.0	0.0	0.1	0.1	0.1	0.2	0.7	1.8	1.6
Public consumption	0.3	0.2	0.2	0.3	0.3	1.0	0.9	0.9	1.1
Gross fixed capital formation	0.4	–0.1	–1.1	–1.0	–0.4	0.0	–1.9	1.7	2.6
Exports of goods and services	0.9	0.1	0.3	0.6	0.8	1.8	2.8	4.8	4.8
Exports of goods	0.9	–0.1	0.2	0.6	0.7	1.7	2.6	4.7	4.8
Imports of goods and services	0.6	0.2	0.0	0.0	0.9	2.2	2.0	4.7	5.1
Imports of goods	0.5	0.2	–0.1	–0.4	0.8	1.8	1.8	4.8	5.1
	% of nominal GDP								
Current account balance	×	×	×	×	×	0.8	1.3	2.1	2.8
Prices	*Annual change in %*								
HICP inflation	1.5	1.6	1.5	1.3	0.6	1.5	0.9	1.9	2.0
Compensation per employee	1.9	1.9	1.8	1.7	1.3	1.8	1.9	2.0	2.3
Unit labor costs	2.4	2.3	2.2	2.1	1.9	2.2	1.9	1.2	1.5
Productivity	–0.5	–0.4	–0.4	–0.4	–0.6	–0.4	0.0	0.9	0.8
Income and savings	*Annual change in %*								
Real disposable household income	–0.7	–0.3	1.0	1.1	–0.4	0.4	1.8	2.8	1.6
	% of nominal disposable household income								
Saving ratio	×	×	×	×	×	7.5	7.9	8.6	8.6
Labor market	*Change on previous period in %*								
Payroll employment	0.2	0.2	0.1	0.3	0.5	0.8	0.8	1.1	1.0
	% of labor supply								
Unemployment rate (Eurostat)	5.6	5.6	5.6	5.6	5.5	5.6	5.7	5.7	5.5
Public finances	*% of nominal GDP*								
Budget balance	×	×	×	×	×	–2.4	–1.8	–1.8	–1.4
Government debt	×	×	×	×	×	84.5	85.7	83.8	81.6

Source: OeNB, Eurostat, Statistics Austria.

Note: All data for 2015 to 2017 are based on the OeNB's December 2014 forecast. x = data not available.

Financial indicators

	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	2011	2012	2013	2014
Austrian banking system	*Consolidated in EUR billion*								
Total assets	1,074	1,072	1,096	1,079	1,105	1,166	1,164	1,090	1,079
Equity capital[1]	91.2	90.3	88.7	87.8	88.6	88.1	88.2	89.0	87.8
Exposure to CESEE[2]	199.8	197.5	194.0	184.8	189.6	216.1	209.8	201.8	184.8
Structural indicators	*Consolidated in %*								
Total capital adequacy ratio[1]	15.6	15.5	15.5	15.6	15.4	13.6	14.2	15.4	15.6
Tier-1 capital ratio[1]	12.1	11.8	11.9	11.8	11.6	10.3	11.0	11.9	11.8
Leverage[3]	5.2	5.3	5.8	5.7	5.7	5.8	6.1	6.5	5.7
Credit growth and quality (AT)	*EUR billion*								
Flow of loans to nonbanks	–0.2	–0.2	0.5	0.7	0.7	2.3	0.4	–0.4	0.7
	Share of loans to nonbanks in %								
Share of foreign currency loans	12.1	11.8	11.6	11.1	11.7	17.4	14.4	12.3	11.1
Loan loss provision ratio	3.7	3.6	3.6	3.3	3.3	3.2	3.3	3.5	3.3
Nonperforming loan ratio	4.7	4.5	4.4	4.4	4.4	4.5	4.7	4.1	4.4
Profitability	*Consolidated in EUR billion*								
Net result after tax	1.1	–0.6	1.0	1.4	1.2	0.7	3.0	–1.0	1.4
	Consolidated in %								
Return on assets	0.5	–0.04	0.2	0.1	0.5	0.1	0.3	–0.04	0.1
Cost-to-income ratio	63.7	77.7	66.8	67.6	62.6	66.4	61.7	73.0	67.6
Subsidiaries in CESEE[4]	*%*								
Loan-to-deposit ratio	100.3	100.9	100.3	96.7	96.6	105.8	99.4	95.8	96.7
Return on assets	0.9	0.7	0.4	0.3	0.9	0.7	0.8	0.8	0.3
Cost-to-income ratio	54.3	54.9	50.0	52.7	52.2	50.1	52.4	52.7	52.7
Loan loss provision ratio	7.7	7.6	7.6	7.3	7.1	7.3	7.6	8.0	7.3
Households and nonprofit institutions serving households	*EUR billion*								
Financial assets	561.4	566.1	566.3	571.9	584.0	528.0	548.0	557.3	571.9
Financial liabilities (loans)	163.6	164.5	165.8	165.7	169.4	164.4	164.5	164.5	165.7
of which foreign currency loans	*27.8*	*27.3*	*26.7*	*25.4*	*27.5*	*38.7*	*32.9*	*28.4*	*25.4*
of which foreign currency housing loans	*21.0*	*20.7*	*20.3*	*19.5*	*21.4*	*27.7*	*24.3*	*21.5*	*19.5*
Nonfinancial corporations	*EUR billion*								
Financial assets	427.0	432.7	435.5	448.4	462.9	390.6	403.8	427.3	448.4
Financial liabilities	653.0	662.7	663.1	669.0	686.6	606.2	634.1	653.5	669.0
of which loans and securities (other than shares and other equity)	*335.8*	*342.9*	*345.2*	*346.7*	*352.0*	*316.6*	*329.5*	*337.8*	*346.7*
of which shares and other equity	*296.8*	*298.9*	*296.5*	*300.2*	*312.0*	*268.3*	*283.9*	*295.6*	*300.2*
	EUR billion (four-quarter moving sums)								
Gross operating surplus	72.9	72.9	73.3	72.9	72.4	73.9	74.2	72.3	72.9

Source: OeNB, Statistics Austria.

[1] *Capital ratios are based on CRD IV definitions from 2014 onward, which limits the comparability with earlier measures.*
[2] *CESEE exposure of majority Austrian-owned banks (BIS definition).*
[3] *Defined according to Basel III provisions from 2014 onward. Earlier measures correspond to tier-I capital after deductions in % of total assets.*
[4] *From 2014 onward, these figures include the pro-rata share of Yapi ve Kredi Bankasi, a joint venture of UniCredit Bank Austria in Turkey.*

Overview of major economic developments in Austria[1]

The Austrian economy is robust

- *In the last decade, Austria outperformed the euro area in terms of GDP growth and, hence, welfare levels. The growth rates for 2014 and 2015 are lagging behind euro area growth, though.*
- *The Austrian economy is well diversified and its sectoral structure is well balanced.*
- *Given high employment and low unemployment rates as well as a low strike frequency, social stability is high.*
- *Since the launch of the euro in 1999, HICP inflation has averaged 1.9% in the euro area and in Austria, thus being in line with the ECB's price stability target. Yet since September 2012, HICP in Austria has exceeded inflation in the euro area and in individual euro area countries.*
- *Austria has not experienced a real estate bubble and bust in recent years. House prices have markedly risen in some regions and market segments since the onset of the financial crisis, but for the country as a whole they are broadly in line with economic fundamentals.*
- *Austria's saving ratio (2014: 7.6%) is below the euro area average. The large stock of financial assets held by the household sector totaled EUR 572 billion (or 177% of GDP) in 2014, serving as an important refinancing source for other economic sectors.*
- *Austria's household debt ratio (2014 Q4: 88.2% of net income) has decreased significantly in recent years; both this ratio and Austria's corporate debt ratio (2014 Q4: 239.4% of gross operating surplus or 93.4% of GDP) are below the corresponding euro area ratios.*
- *Given high employment growth in a context of moderate output growth, Austria has been losing ground in unit labor costs and productivity per employee vis-à-vis the euro area.*
- *Foreign trade in goods is well diversified both by region and by product type. In 2014, Austria transacted about half of its foreign trade with other euro area countries, i.e. without any exchange rate risk. Almost one-third of goods exports went to Germany.*
- *A steady string of current account surpluses since 2002 (2014: 0.8%) confirms the international competitiveness of the Austrian economy and has enabled Austria to balance its international investment position in 2014 reaching EUR 7.05 billion (2.1% of GDP).*
- *Austria's public debt ratio increased significantly in 2014, to 84.5%. This increase was driven above all by the reorganization of the Hypo Alpe Adria group. The corresponding capital transfers were also the main reason for the increase in the general government budget deficit, which reached –2.4% in 2014. The outlook for 2015 implies a marked improvement of the budgetary position.*
- *Within the European semester for economic policy coordination, the European Commission publishes annual Alert Mechanism Reports. Austria's latest scoreboard, which is a major component of this report, does not show significant imbalances that would require an in-depth analysis by the European Commission.*

[1] *Cut-off date for data: April 22, 2014.*

Significant challenges persist for Austrian banks – harmonized supervisory regime is taking shape

- *The consolidated net result of Austrian banks (including cross-border banking subsidiaries) returned to positive territory in 2014 (EUR 1.4 billion), following a first-time loss in 2013 (–EUR 1.0 billion). The 2014 result does not reflect the losses of Hypo Alpe Adria International, though, which has been put into resolution.*
- *The main risks identified have remained the same: the comparatively weak profitability performance of domestic business, the exposures to Central, Eastern and Southeastern Europe (CESEE) and the heightened concentration of profits in a small number of CESEE countries, the relative size of the Austrian banking system, and capital positions that are below those of peer banks.*
- *Yet the activities of Austrian banks' subsidiaries in CESEE remain an important business area. In recent years, profits were increasingly concentrated in the Czech Republic and Slovakia as well as Russia and Turkey, which are subject to higher volatility.*
- *The net result for 2014 generated by Austrian banks' subsidiaries in CESEE was below the 2013 result, which can be explained above all with the higher need for risk provisions in Romania and measures related to foreign currency lending in Hungary. Furthermore, the lower profits of Austrian banks' subsidiaries in CESEE reflect geopolitical tensions involving Russia and Ukraine.*
- *The capital positions of domestic banks, while having gradually improved since 2008 as a result of both supervisory action and banking sector efforts, continue to be below the average of European peers. In contrast, the leverage ratios of Austrian banks are more favorable than those of their European peers. In view of the phasing in of more stringent capital requirements under Basel III and given the risk exposure of Austrian banks to CESEE and to outstanding foreign currency loans, Austrian banks will need to make further efforts to strengthen their risk resilience.*
- *Macroprudential supervision was given a new institutional framework in Austria in 2014. The mandate of identifying and analyzing risks to the stability of the Austrian financial system in a forward-looking manner was assigned to a new coordinating body, the Financial Market Stability Board. It is currently preparing the introduction of capital buffers as a provision against structural systemic risks.*
- *These buffers will enhance a series of earlier macroprudential measures: The Financial Market Authority (FMA) and the OeNB have been cautioning against the risks arising from foreign currency loans and loans with an accompanying repayment vehicle for more than ten years. Responding to supervisory guidance, banks have been granting fewer new foreign currency loans both in Austria and in CESEE. And outstanding loan stocks, while remaining a source of risk – especially Swiss franc loans following the removal of the floor against the euro – are gradually diminishing.*
- *Another macroprudential measure is the supervisory guidance for large internationally active Austrian banks that the Austrian authorities adopted in March 2012 ("sustainability package"). At the end of the third quarter of 2014, all monitored Austrian banking subsidiaries had a sustainable local funding model (based on year-on-year comparisons).*
- *On November 4, 2014, the ECB started to directly supervise the most significant banks in the euro area (including 8 Austrian banks) within the framework of the Single Supervisory Mechanism (SSM). Alongside the SSM, the Single Resolution Mechanism (SRM) has been largely operational as a second component of the European banking union since January 2015. The SSM, the single rulebook approach to banking supervision, and the SRM are essential pillars of a robust and resilient framework to help prevent future financial crises as well as to ensure effective intervention and, ultimately, the resolution of banks whose business models are no longer sustainable.*

1 The Austrian economy is in a structurally strong position

1.1 Austria is one of the most robust economies in the euro area

Output growth in Austria lags behind euro area growth in 2014 and 2015

While the Austrian economy outperformed the euro area in the period from 2006 to 2013 in terms of GDP growth (with the exception of 2010), domestic growth lagged behind euro area growth in 2014, and will do so also in 2015. The IMF expects this growth gap to close in 2016, projecting 1.6% of GDP growth for both Austria and the euro area.

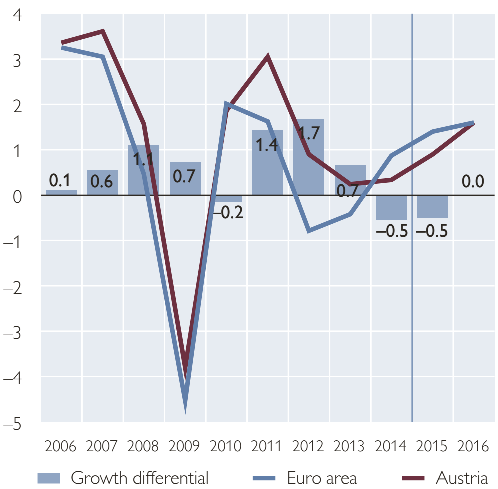
Austria's weaker GDP growth compared with the euro area can be traced to developments in the euro area as well as in the domestic economy. The euro area went through a second recession in 2012 and 2013 (after 2009). Following sweeping structural adjustments, some crisis states (Spain and Ireland) have started to achieve significantly higher growth rates than the euro area, thus raising the euro area average. Austria, meanwhile, has been recording higher inflation rates than the euro area in recent years. High domestic inflation has caused the real disposable income of households to stagnate, which has dampened private consumption in Austria. At the same time, the domestic economy has been losing price competitiveness, which has dented Austria's export performance.

In 2015, the Austrian economy will benefit from a range of positive, growth-supporting effects: the economic recovery in the euro area, strong GDP growth in Germany, the monetary policy measures of the Eurosystem, the substantial decline in energy prices compared to 2014 levels and the depreciation of the euro; and from 2016 onward, the tax reform adopted this March will provide additional scope for private consumption spending. Together, these factors should refuel the Austrian economy and bring it back onto a sustainable growth path.

Chart 1

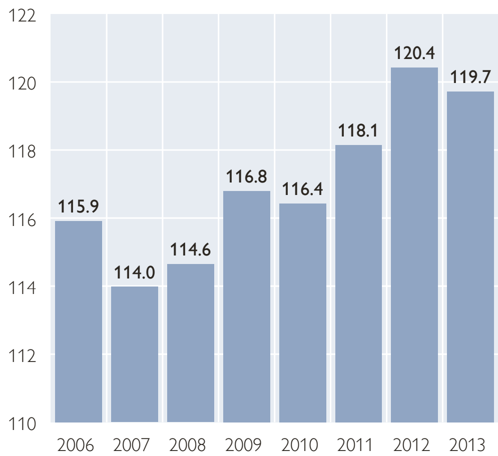
Growth differential between Austria and the euro area

Real GDP: annual change in %; growth differential in percentage points



Welfare differential between Austria and the euro area

Real GDP per capita at purchasing power standards; euro area = 100



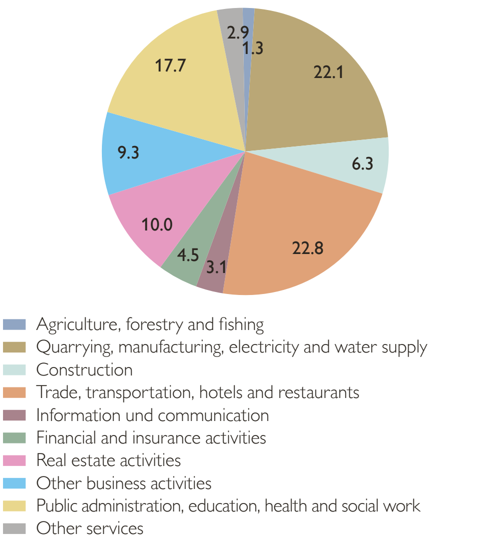
Source: Eurostat, IMF.

Note: Data for 2015 to 2016 as published in the IMF WEO of April 2015.

Chart 2

Gross value added in Austria in 2014

% of total gross value added, at current prices



Source: Statistics Austria.

The sectoral structure of the Austrian economy is well balanced

The Austrian economy is solidly based on a well-balanced sectoral structure. The largest share of gross value added (close to 30%) is generated by the range of private sector services. Activities classified under "quarrying, manufacturing, electricity and water supply" as well as "trade, transportation and hotels and restaurants" account for more than 20% each. Manufacturing in Austria is characterized by a high diversity of industries. The construction sector's contribution to gross value added (some 6.3%) is relatively low by international standards.

Austria records the second-lowest unemployment rate in the EU

The Austrian labor market not only proved resilient to the financial and economic crisis but has also been outperforming international developments in the subsequent economic upswing. While employers cut working hours in the crisis year 2009, the number of employees decreased only marginally and has in fact been growing at an above-average rate since then, even under the adverse economic conditions of 2012–2014. Unemployment figures have been rising since mid-2011, though, to levels that are very high for Austria in a historical context. Yet in an EU-wide comparison, Austria posts the second-lowest unemployment rate, behind Germany. The Austrian labor market continues to benefit from its basic flexibility but in particular also from the balance of interests achieved by the social partners as well as from well-designed social and employment measures (e.g. subsidized short-term working); hence, it is a key pillar of the Austrian economy.

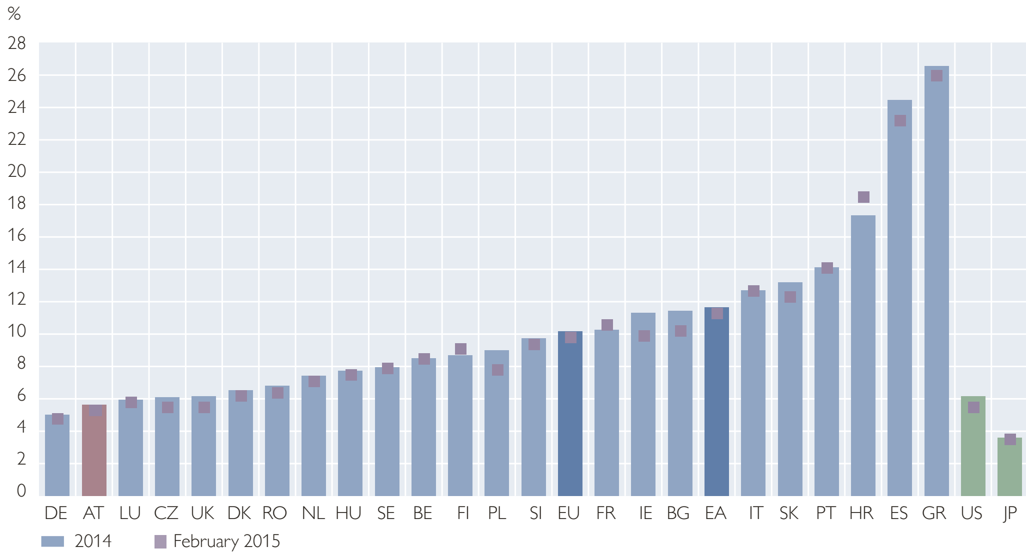
In the same vein, Austria is among the top-ranking countries worldwide as regards social stability (measured, for example, by the frequency of strikes).

Inflation low by historical standards, but high compared with other euro area countries

The ECB has met its price stability goal of keeping inflation close to, but below 2% since the introduction of the euro in January 1999. Notwithstanding the distinct rise in inflation before the onset of the economic crisis in 2008 and during the recovery phase in 2011 and notwithstanding the decline in inflation in mid-2009 and early 2015, HICP inflation has averaged 1.9% in the euro area as well as in Austria since 1999. A comparison of HICP inflation rates for Austria and the euro area shows that domestic inflation was consistently below euro area inflation until 2009. Subsequently, domestic inflation moved in sync with euro area inflation

Chart 3

Unemployment rates

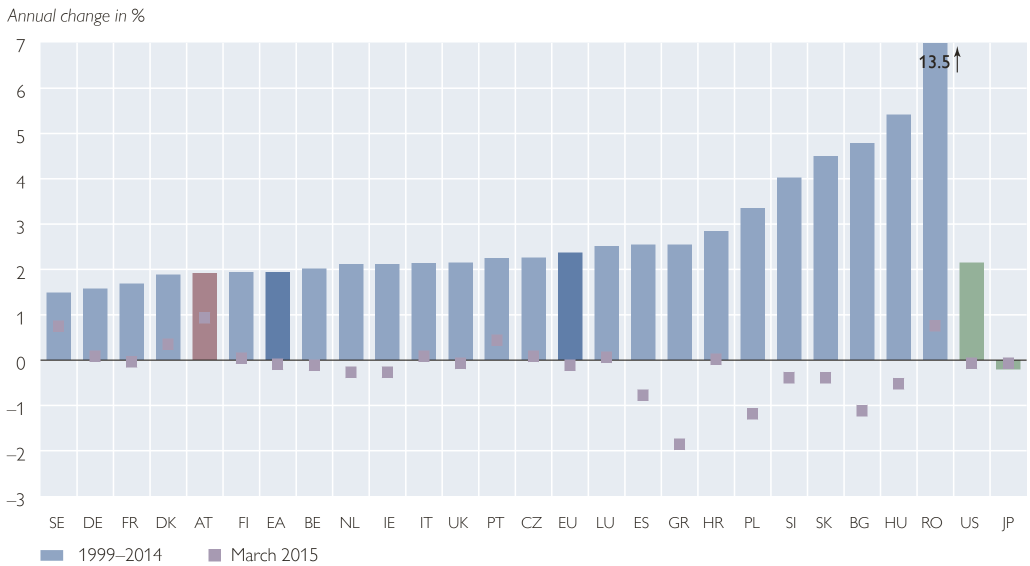


Source: Eurostat.

Note: GR and UK: December 2014; HU and JP: January 2015.

Chart 4

HICP inflation rate



Source: Eurostat, Statistics Bureau of Japan, U.S. Bureau of Labor Statistics.

from 2009 to 2012. Since September 2012, HICP inflation in Austria has exceeded euro area inflation, though.

As with GDP growth, these developments can be explained with inflation developments in some euro area countries which are going through a phase of price and wage cuts or even declining price and wage growth, with a view to improving their competitiveness. Inflation in these countries is suppressing the inflation measure for the euro area as a whole. At the same time, this inflation differential also reflects domestic developments, such as comparatively strong price increases in the service sector (hotels and restaurants) and tax increases. Finally, despite the significant drop in oil prices, there are currently no signs of a prolonged period of deflation in either the euro area or Austria.

Austrian real estate market: price increases but no bubble

In the period from 2004 (when comparable data for EU members became available) to 2014, real estate prices in Austria rose at a clearly stronger pace than prices in the euro area and the EU. However, unlike other EU countries (like Spain, Ireland and Cyprus) Austria did not experience the development and, ultimately, bursting of real estate price bubbles, which are masked by the period aggregates. The OeNB closely monitors price developments on the housing market and launched a fundamentals indicator for residential property prices in January 2014.

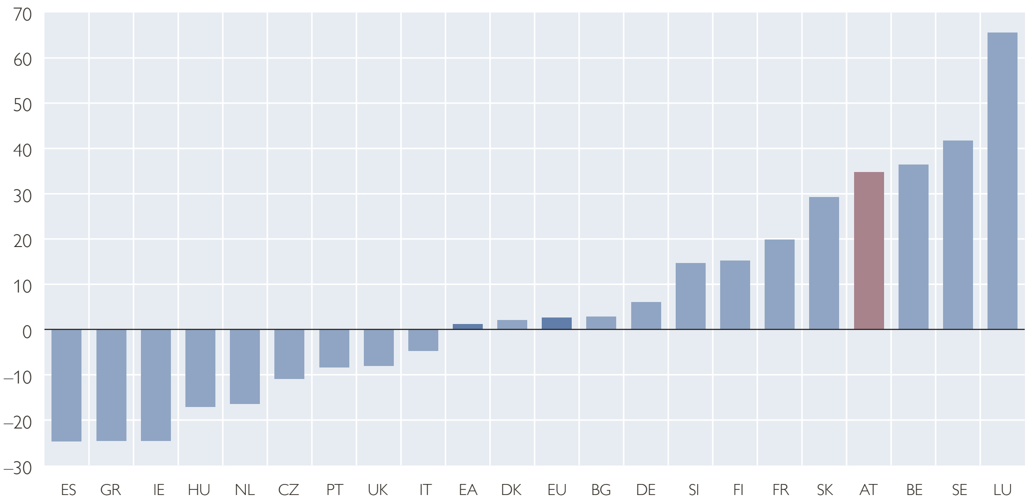
High level of financial assets – stable and moderate levels of household and corporate debt

In 2014, households including nonprofit institutions serving households saved about 7.6% of their net disposable income. With total financial assets coming to some EUR 557.2 billion (173% of GDP) at the end of 2014, the household sector is a key supplier of capital to other sectors in Austria.

Chart 5

Real house prices in EU Member States, 2004–2014

Change against 2004 in %

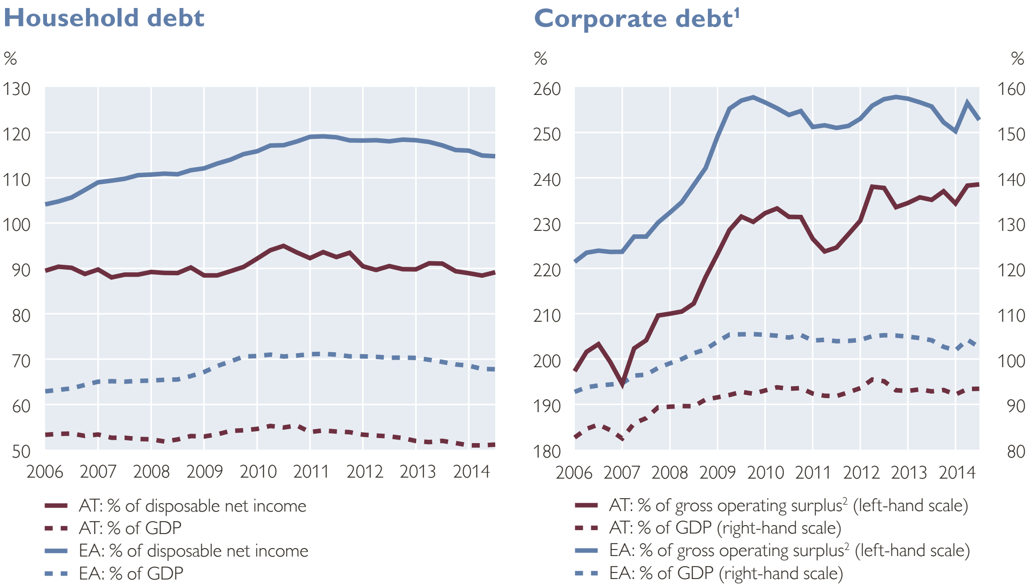


Source: ECB.

Note: HU: 2004–2011; CZ, PT, IT, DK, BE, LU: 2004–2013; no data for RO, PL.

Austrian household debt totaled 50.7% of GDP in the second quarter of 2014, which is significantly below the euro area average of 61.3%. At 229.7% of the gross operating surplus or 89.9% of GDP, corporate debt in Austria in the second quarter of 2014 was also below the euro area average of 248.0% (relative to gross operating surplus) and 100.7% (relative to GDP).

Chart 6



Source: EA data: ECB, Austria data: OeNB.

[1] Short- and long-term loans, money and capital market instruments.
[2] Including mixed income of the self-employed.

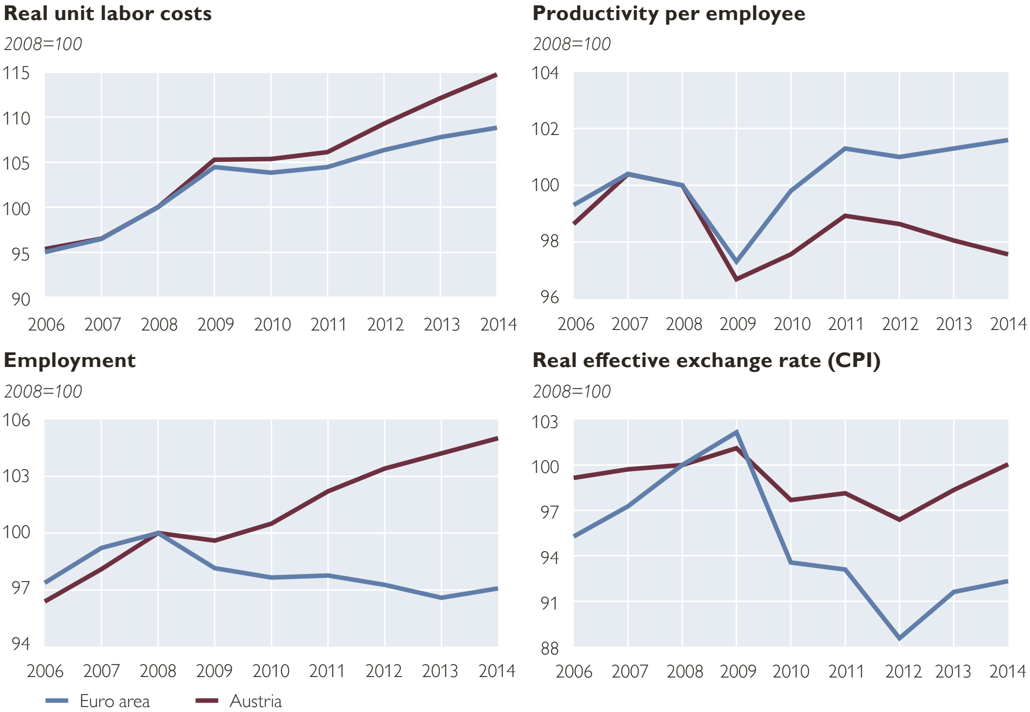
1.2 Competitiveness of the Austrian economy comes under pressure

Favorable employment climate dampened productivity growth

In the aftermath of the crisis, Austria has been losing in price competitiveness on account of comparatively weaker productivity gains. Labor hoarding in the corporate sector during the crisis years, stronger GDP growth in 2010–11 and the later opening of the domestic labor market to EU CESEE nationals, in 2011, caused headcount employment to increase at a visibly stronger pace in Austria than in the euro area. Employment continued to increase in the period from 2012 to 2014 despite the low growth environment. As a consequence, Austria has been losing ground in both unit labor costs and productivity per employee relative to the euro area. Furthermore, the euro area was losing competitiveness before the crisis based on real effective exchange rates (deflated with the CPI), but regaining competitiveness between 2009 and 2012, whereas the real effective exchange rate for Austria has remained broadly stable. This also translates into a loss of competitiveness for Austria vis-à-vis the euro area. 2013 and 2014 saw an appreciation of the real effective exchange rate for both Austria and the euro area, which also translates into a loss of price competitiveness. Moreover, since September 2012, Austria has faced higher inflation rates than the euro area and its main trading partners, Germany and Italy. This inflation gap results in a real appreciation of the real effective exchange rate, which will continue to dampen Austria's competitiveness position in the coming years.

Chart 7

International competitiveness



Source: Eurostat.

Austria's external trade is regionally diversified, exposure to foreign exchange risk is low

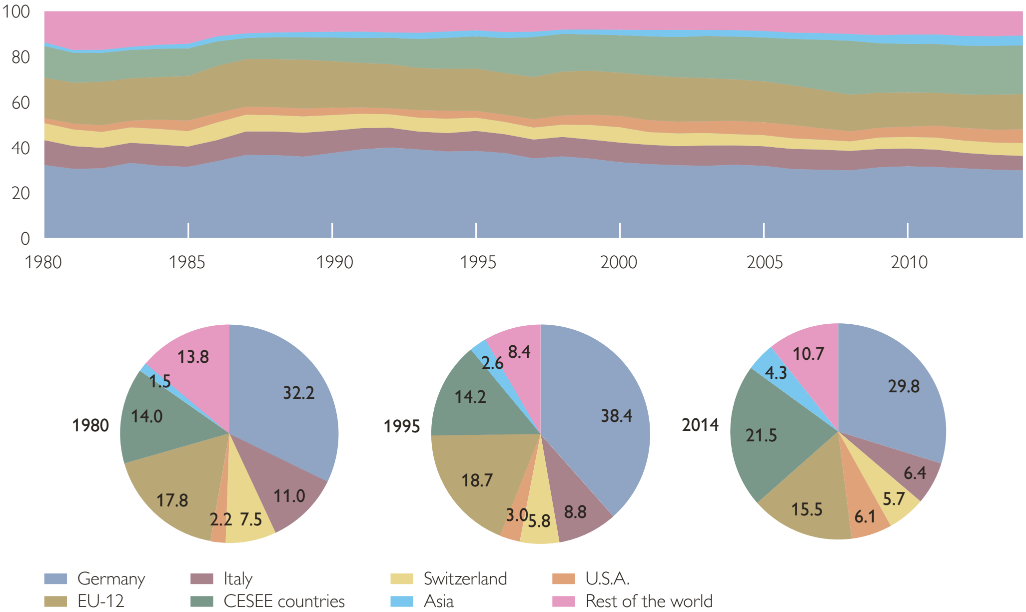
In 2014, about half of Austria's goods exports went to euro area countries, thus remaining unaffected by the euro's exchange rate changes. Unpegging the Swiss franc from the euro did not have substantial trade effects for Austria. Among Austria's trade partners, Germany is still the most important partner by far, accounting for a share of close to 30% of Austria's total goods exports. Next in the ranking are Italy, the U.S.A., Switzerland and France. On balance, the share of shipments destined for euro area countries has been on a steady decline since the mid-1990s (1995: 63%). At the same time, exports to the CESEE countries and the dynamic Asian economies – China, India and Korea – have been on the rise, with the CESEE share increasing from 14% in 1995 to 22% in 2014. Importantly, Austria's foreign trade is highly diversified in terms of goods categories. With a share of 39% of total exports, machinery and transport equipment constitute the single largest export item. Furthermore, manufactured goods, chemicals as well as commodities and transactions not classified elsewhere together account for some 47% of exports.

With goods exports accounting for 72% of total exports, Austria's export performance is largely driven by goods, but services also play a significant role: Take tourism, which has traditionally been an important pillar of the Austrian economy. Yet Austria has also gained strength in technology-driven service exports. According to the technology balance of payments, Austria is a net exporter of technology and know-how transfers of about EUR 3 billion or 1% of GDP, which

Chart 8

Regional pattern of Austrian goods exports 1980–2014

% of total nominal exports of goods



Source: Statistics Austria.

Note: Asia: CN, JP, KR;
EU-12: BE, DK, FI, FR, GR, IE, LU, NL, PT, ES, SE, UK;
CESEE countries: BG, EE, LV, LT, PL, RO, SK, SI, CZ, HU, AL, BA, HR, ME, RS, BY, MD, RU, UA.

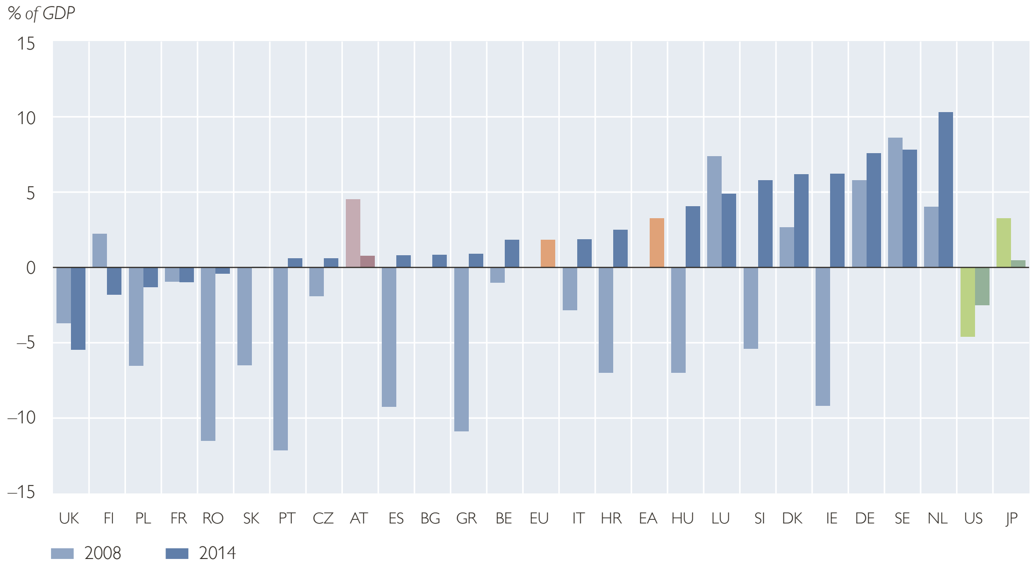
puts Austria ahead of Finland, Germany and Japan. The fastest growing export category is computer services, which have replaced services provided by architects and engineers as the leading technology industry. Research and development services have also been growing dynamically in the long term, yet subject to severe setbacks following the financial, fiscal and economic crisis in recent years. Apart from IT services providers, manufacturing companies are the key players in the international transfer of technological know-how, above all companies working in the electronics industry and in the field of machinery construction. In a regional perspective, Austria is a net exporter of technology-related know-how to Germany, Switzerland, Russia and China, whereas it imports know-how on balance from the U.S.A. and the U.K.

Current account surpluses confirm Austria's international competitiveness

Austria has been logging current account surpluses every year since 2002, i.e. exports of goods and services have since then exceeded imports. In 2014, Austria's current account showed a surplus of 0.8% of GDP, compared with 3.2% for the euro area and 1.8% for the EU. Austria is forecast to continue to post current account surpluses.

Chart 9

Current account



Source: Eurostat.

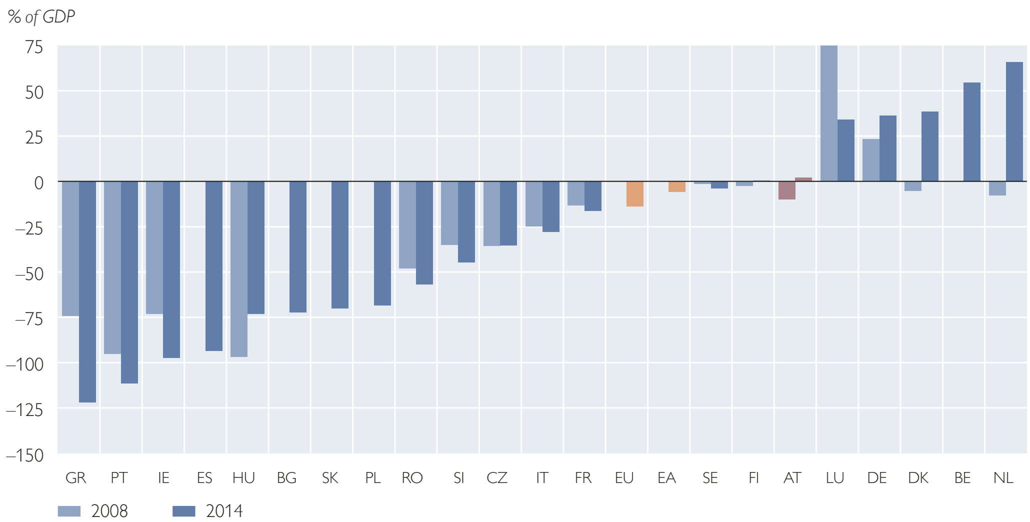
Note: BPM6; Data LU and PL: 2013, IE: 2007, GR: 2009; US and JP 2013: Ameco.

Steady improvement of Austria's international investment position

Due to its sustained current account surplus, Austria closed the international investment position (IIP) gap in recent years, reporting a positive net IIP of EUR 7.05 billion (2.1% of nominal GDP) in 2014. This compares with a net negative IIP for the euro area of 5.9% and 13.8 (2013) for the EU.

Chart 10

Net international investment position



Source: Eurostat, ECB (SDW).

Note: EU without HR and UK, DK, LU, PL and EU: 2013; LU 2008: 173%.

1.3 Austria’s general government deficit and debt ratios are below the euro area averages

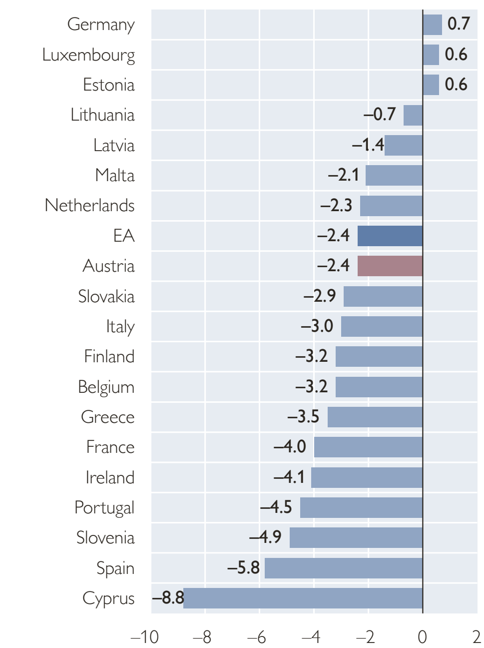
Like all other EU Member States, Austria recorded an increase in its general government deficit during the economic and financial crisis, but it was back on track to meet the Maastricht limit of 3% of GDP in 2011. In 2014, the general government budget deficit increased to 2.4% of GDP due to capital transfers to the nationalized Hypo Alpe Adria group. The outlook for 2015 implies a marked improvement of the budgetary position.

Chart 11

Budget balances of EU Member States in 2014

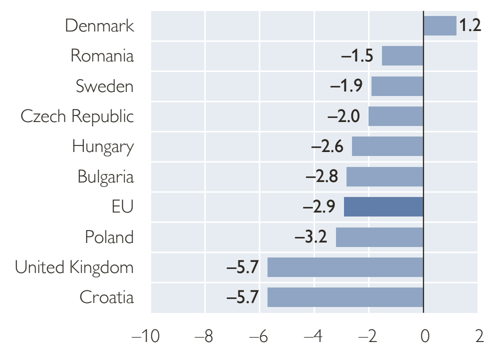
Euro area countries

% of GDP



Non-euro area countries

% of GDP



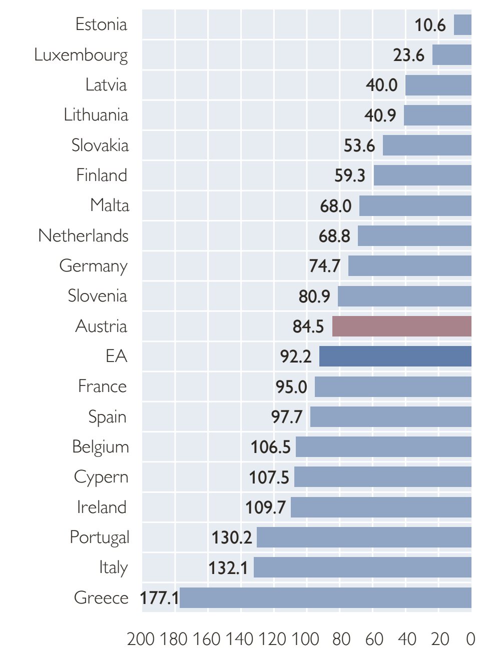
Source: Eurostat.

Chart 12

Public debt of EU Member States in 2014

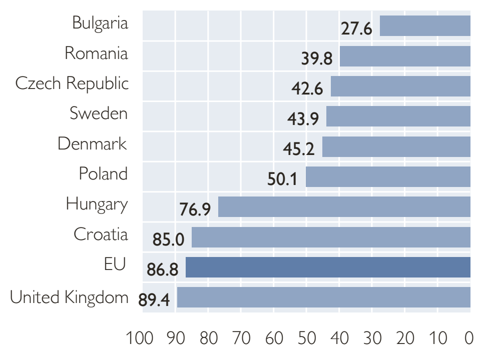
Euro area countries

% of GDP



Non-euro area countries

% of GDP



Source: Eurostat.

The ESA 2010 revision had a considerable impact on Austria's general government debt ratio. Based on ESA 2010 data, Austria recorded a general government debt ratio of 64.8% of GDP (ESA 1995: 60.2%) in 2007 before the crisis, a crisis-related increase to 82.4% (ESA 1995: 72.5%) in 2010 and a decrease thereafter to 81.2% (ESA 1995: 74.5%) in 2013. Further capital transfers to nationalized banks in 2014 drove up the public debt ratio, to 84.5% of GDP.

Box 1

Tax reform measures adopted in 2015 and their effects on GDP and the budget balance

In March 2015, the Austrian Council of Ministers adopted the major components of a tax reform to be implemented in 2016. The reform package consists of expansionary measures and compensatory measures to fund the former of slightly above EUR 5 billion each. The expansionary measures essentially consist of cuts in income taxation rates through lower marginal tax rates, higher tax credits and higher negative income tax rates. The compensatory measures largely consist of intensified efforts to combat tax fraud and selected tax increases. As a result of timing issues (for instance, tax returns are by definition filed after the end of a tax year) the expansionary and restrictive measures implemented in 2016 will not feed through to the budget for 2016 in their entirety. Moreover, it remains to be seen whether the compensatory measures will generate the intended revenue streams in the end.

Estimated impact of reform package

	2016	2017
	% of GDP	
Volume in simulation	–0.8	–0.7
	Deviation from baseline in pp	
GDP growth	0.4	0.1
Budget balance	–0.6	–0.4

Source: Austrian Council of Ministers, OeNB.

Overview of reform package

	EUR bn	*% of GDP*
Expansive measures	5.2	1.5
Cut in personal income tax	4.9	1.4
Other measures	0.3	0.1
Financing of expansive measures	5.2	1.5
Measures against (tax) fraud	1.9	0.5
Other tax measures	1.3	0.4
Expenditure cuts	1.1	0.3
„Self financing" of tax cuts	0.9	0.2

The OeNB has simulated the effects of the tax reform on GDP growth and the budget balance. This simulation is based on the assumption that the measures to combat tax fraud will generate 50% of the targeted amount, and the spending cuts some two-thirds of the intended amount. On these premises, the OeNB simulation yields a cumulated effect of about ½% on GDP growth, and a deterioration of the budget balance by about ½% of GDP (taking into account partial "self-financing" effects given the impact of higher output on the automatic stabilizers).

Austria achieved its medium-term budgetary objective ("preventive arm") in 2014

After deficits above 3% of GDP in 2009 and 2010, Austria recorded deficits below 3% of GDP in the period from 2011 to 2014. The excessive deficit procedure (EDP) for Austria was abrogated in spring 2014.

As Austria was subject to an EDP at the time when the operationalization of compliance with the debt criterion was enacted (end-2011), the new "1/20 rule," which states that debt in excess of 60% of GDP must be reduced by at least 1/20th per year on average, will fully apply only from 2017 onward. In the transition phase, Austria has to take measures to achieve a structural balance by 2016, which would be consistent with fulfilling the 1/20 benchmark. According to the European Commission, Austria is fully on track in this respect based on current information.

Table 1

EU fiscal governance requirements

	Release	2010	2011	2012	2013	2014	Source	Requirement
		% of GDP						
Budget balance	March 2015	–4.5	–2.6	–2.2	–1.3	–2.4	Statistics Austria, OeNB	>= –3% of GDP
Public debt	March 2015	82.4	82.1	81.5	80.9	84.5	Statistics Austria, OeNB	from 2017: Reduction of difference to 60% of GDP by 1/20 per year on average
Structural balance	March 2015	–3.0	–2.4	–1.8	–1.2	–0.5	EC[1], OeNB (2014)	Improvement by 0.6pp per year until MTO of –0.45% of GDP has been reached

Source: Statistics Austria, OeNB, European Commission (EC).

[1] *Until 2013 according to EC winter forecast 2015 (adjusted for later revisions of budget balances from 2011 to 2013).*

With the EDP having been abrogated, Austria is now subject to the rules of the preventive arm of the Stability and Growth Pact. According to OeNB estimates, Austria broadly reached its medium-term objective (MTO) for the structural balance of –0.45% of GDP in 2014, which implies that no additional major fiscal adjustments are necessary in 2015. However, the tax reform of 2016 may lead to a significant deviation from the MTO and generate new consolidation needs according to the OeNB's assessment. The target value of –0.45% of GDP has also been enshrined in national legislation for the period from 2017 onward.

Austria without marked scoreboard imbalances

Under the European semester of economic policy coordination, the European Commission started to compile annual Alert Mechanism Reports (AMR) in 2012 to detect and correct macroeconomic imbalances within the EU. Under this mechanism, countries are examined against a scoreboard of currently 11 economic

Table 2

Macroeconomic imbalance procedure scoreboard (2013)

Indicator	Threshold	Indicator for Austria	Austria above threshold
Average current account balance in % of GDP over the past 3 years	+6/–4	1.4	No
Net international investment position in % of GDP	–35	–0.2	No
Percentage change of real effective exchange rates over the past 3 years	+/–5 (EA) +/–11 (non-EA)	0.7	No
Percentage change of export market shares over the past 5 years	–6	–17.0	Yes
Percentage change of nominal unit labor costs over the past 3 years	+9 (EA) +12 (non-EA	6.4	No
Year-on-year changes in house prices relative to deflated house prices	6	2.9	No
Private sector credit flow in % of GDP	15	0.2	No
Private sector debt in % of GDP	160	125.5	No
General government sector debt in % of GDP	60	81.2	Yes
Average unemployment rate over the past 3 years	10	5.0	No
Year-on-year percentage change in total financial sector liabilities, unconsolidated	16.5	–3.6	No

Source: Eurostat.

indicators. A deviation from the thresholds defined for these indicators results in an in-depth qualitative review of the given economy by the European Commission, which will then issue economic policy recommendations. In the AMR of 2015, Austria received very good scores, putting Austria among the 10 EU member countries which have not been considered for an in-depth review.

Austria doing well compared with European peer countries

Austria remains one of the few euro area countries that have retained at least one AAA rating. Thus, countries with AAA ratings only have ceased to be an adequate peer group. The list of peer countries shown here consists of the three largest euro area economies – Germany, France and Italy – as well as six (euro area and non-euro area) economies which are comparable in size and structure with Austria: the Netherlands, Switzerland, Sweden, Belgium, Finland and the Czech Republic.

Based on the IMF spring outlook of April 2015, Austria lags behind most peer countries in terms of GDP growth in 2015 but is able to close this gap in 2016. As indicated above, one of the key reasons is that domestic growth is being held back by Austria's comparatively higher inflation. This effect is also evident from the IMF outlook, which expects Austria to record the highest inflation rate of all countries shown here. In contrast, Austria's unemployment rate is very low by international standards; only Switzerland and Germany are outperforming Austria in this respect. Furthermore, Austria's current account balance is slightly positive. This compares with higher surpluses for the Netherlands and Germany, as well as for Sweden, Switzerland and Italy, but current account deficits for France and Finland. The budget balance and government debt forecasts put Austria in the mid-ranks, with a striking lack of improvement of the budget balance from 2015 to 2016 on the negative side.

Table 3

Austria and peer European countries in comparison

	DE	FR	IT	NL	CH	SE	BE	AT	FI	CZ
	Real GDP growth, annual change in %									
2015	1.6	1.2	0.5	1.6	0.8	2.7	1.3	0.9	0.8	2.5
2016	1.7	1.5	1.1	1.6	1.2	2.8	1.5	1.6	1.4	2.7
	Consumer price index, annual change in %									
2015	0.2	0.1	0.0	–0.1	–1.2	0.2	0.1	1.1	0.6	–0.1
2016	1.3	0.8	0.8	0.9	–0.4	1.1	0.9	1.5	1.6	1.3
	Unemployment rate, in % of employees									
2015	4.9	10.1	12.6	7.2	3.4	7.7	8.4	5.1	8.7	6.1
2016	4.8	9.9	12.3	7.0	3.6	7.6	8.2	5.0	8.5	5.7
	Current account balance, in % of nominal GDP									
2015	8.4	–0.1	2.6	–1.9	5.8	6.3	2.3	1.9	–0.3	1.6
2016	7.9	–0.3	2.5	–0.7	5.5	6.3	2.4	1.8	–0.3	0.9
	Budget balance, in % of GDP									
2015	0.3	–3.9	–2.6	–1.4	–0.4	–1.3	–2.9	–1.7	–2.4	–1.4
2016	0.4	–3.5	–1.7	–0.5	–0.2	–0.6	–2.1	–1.7	–1.8	–1.2
	Government debt, in % of GDP									
2014	69.5	97.0	133.8	67.5	45.9	41.1	106.6	88.8	61.7	42.0
2019	66.6	98.1	132.9	65.6	45.6	39.6	106.2	87.4	62.8	42.0

Source: IMF (World Economic Outlook), April 2014.

2 Significant challenges persist for Austrian banks – harmonized supervisory regime is taking shape

2.1 The main risks for financial stability have remained the same – capital and liquidity ratios continue to improve

Business environment remains challenging for Austrian banks

European banks continued to operate in an environment of weak economic growth, low profitability, high credit risk provisions, low interest rates and hence lower profits in 2014. The outlook for growth remains subject to downside risks both for the euro area and economies in CESEE. Geopolitical tensions involving Russia and Ukraine had repercussions above all on CESEE and hence on the activities of Austrian banks as well.

Net results of Austrian banks back in positive territory in 2014

The consolidated net result of Austrian banks (including foreign subsidiaries) returned to positive territory in 2014 (EUR 1.4 billion), following a first-time loss in 2013 (–EUR 1.0 billion). These figures translated into a return on assets of 0.1%. The 2014 result does not reflect the losses of Hypo Alpe Adria International, though, which has been put into resolution. The most important components of operating income – net interest and fee-based income – exceeded 2013 results. This improvement reflects a moderate increase in interest margins as well as a decline in the risk aversion of investors. Lower write-downs reported by one bank also had a positive impact. Credit risks provisions, while continuing to remain at elevated levels, declined in 2014. However, this decline is the result of the adjustment of credit risk provisions for the share of Hypo Alpe Adria International following the restructuring of the latter. Hence, asset quality continues to be weak.

The negative net result recorded in 2013 had reflected above all writedowns of goodwill at banking subsidiaries in CESEE and losses of Hypo Alpe Adria International. Adjustments for goodwill, which drove some banks into negative territory also 2014, reflect above all weaker growth outlooks and weaker macroeconomic conditions in CESEE.

The main risks identified have remained the same: the comparatively weak profitability performance of domestic business, the exposures to Central, Eastern and Southeastern Europe (CESEE) and the heightened concentration of profits in

Table 4

Aggregated profit and loss account of Austrian banks

	2008	2009	2010	2011	2012	2013	2014
	EUR billion						
Net interest income	19.3	19.5	20.4	20.4	19.3	18.6	19.3
Fee and commission income	8.5	7.2	7.7	7.6	7.3	7.6	7.7
Trading income	–2.1	2.6	1.0	0.8	1.1	0.7	0.5
Operating profit	7.9	15.6	13.5	10.4	12.1	8.0	9.3
Net result after tax	0.6	1.5	4.6	0.7	3.0	–1.0	1.4

Source: OeNB.

Note: A structural break in consolidated reporting occurred in 2008.

a small number of CESEE countries, the relative size of the Austrian banking system, and capital positions that are below those of peer banks.

Bank capitalization is improving

Austrian banks have continuously strengthened their capital positions in recent years. At the end of 2014, the sector's tier 1 ratio amounted to 11.8%. This corresponds to an increase of more than 4 percentage points since the outbreak of the financial crisis in 2008. The core tier-1 capital ratio also averaged 11.8% at the end of 2014.

At the same time, the capital positions of Austrian banks continue to be lower than those of their international peers. This is also one of the outcomes of the comprehensive assessment conducted by the ECB. In view of the phasing in of more stringent capital requirements under Basel III and given the risk exposure of Austrian banks to CESEE and to outstanding foreign currency loans, Austrian banks will need to make further efforts to strengthen their risk resilience. This is all the more valid as improvements in capitalization came to a halt in 2014.

Table 5

Capital ratios of Austrian banks on a consolidated basis

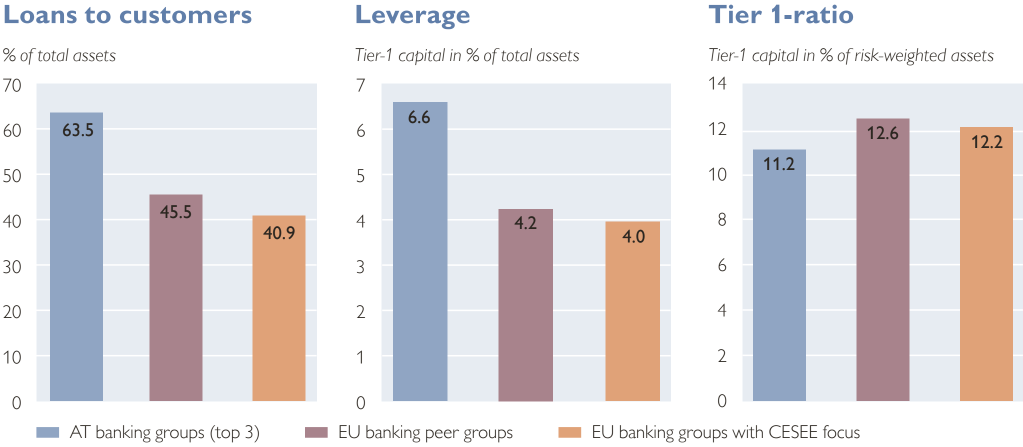
	2008	2009	2010	2011	2012	2013	2014
	% of risk-weighted assets						
Total capital adequacy ratio	11.0	12.8	13.2	13.6	14.2	15.4	15.6
Tier-1 capital ratio	7.7	9.3	10.0	10.3	11.0	11.9	11.8
Core tier-1 capital ratio (Core equity tier-1 as from 2014)	6.9	8.5	9.4	9.8	10.7	11.6	11.8

Source: OeNB.

Note: A structural break in consolidated reporting occurred in 2008. Capital ratios are based on CRD IV definitions from 2014 onward, which limits the comparability with earlier measures.

In contrast, the leverage ratios of Austrian banks are more favorable than those of their European peers, reflecting the focus of Austrian banks on a more traditional loan business, i.e. their higher share of loans as a percentage of total assets.

Chart 13



Source: OeNB, BankScope.

Note: The data are weighted averages as of June 2014.

Box 2

Hypo Group Alpe Adria and HETA Asset Resolution AG – key milestones since 2014

The domestic statutory framework for the resolution of Hypo Alpe-Adria-Bank International AG (HBInt) was adopted by the Austrian Council of Ministers on June 11, 2014. This framework provided for splitting the bank's assets into core and noncore assets, with the intention of transferring the latter onto a "bad bank," which would serve as a wind-down vehicle without a banking license. This framework was implemented in the fall of 2014, by which time the legal basis for setting up a bad bank had been created. On October 30, 2014, the Austrian Financial Market Authority (FMA) issued the administrative decision providing for the deregulation of the bank. At the same time, Hypo Alpe-Adria-Bank International AG was renamed HETA Asset Resolution AG. Deregulation lifted the requirement for HETA to meet minimum regulatory capital requirements.

In parallel, the core banking assets intended for sale were removed from the bank and transferred to Hypo SEE-Holding, which has an Austrian banking license and has since been renamed Hypo Group Alpe Adria AG. This makes Hypo Group Alpe Adria AG the new parent of the banking subsidiaries of the former Hypo Alpe-Adria-Bank International AG in Southeastern Europe (SEE), which need to be sold off by the end of 2015 under the restructuring plan approved by the European Commission. On December 23, 2014, HETA Asset Resolution AG reported to have signed a deal on the sale of its SEE network of subsidiaries to a group of bidders, consisting of a U.S. fund (Advent International) and the EBRD (European Bank for Reconstruction and Development). This transaction is scheduled to be closed by mid-2015.

On February 27, 2015, HETA informed the supervisory authorities as well as its owner, the Republic of Austria, that it was running the risk of insolvency according to preliminary figures of the asset quality review. In its response, the finance minister declined to provide additional public funding to support ongoing capital and liquidity needs (under the Financial Market Stability Act). Therefore, the FMA in its capacity as the Austrian resolution authority under the Federal Act on the Recovery and Resolution of Banks (BaSAG, i.e. the act transferring the new EU banking resolution regime into national law) issued an administrative decision initiating the resolution of HETA.[1]

The administrative ruling published by the FMA on March 1, 2015,[2] *provides for a temporary moratorium on the liabilities of HETA against its creditors until May 31, 2016, in accordance with BaSAG, in order to enable HETA to draw up a resolution plan which conforms with the aims of the new EU resolution regime for banks.*

[1] *Resolution versus insolvency: The triggers for resolution rather than insolvency are the assessment that a bank is failing or likely to fail and the finding that resolution is in the public interest. A bank may be considered to be likely to fail if it must be expected, based on objective judgment, to be unsustainably in debt or unable to meet its payment obligations in the near future. In contrast, banks can be put into an insolvency procedure only after they have indeed failed to meet their payment obligations or once they have become unable to sustain their debt payments. While the role of insolvency is to realize assets to meet as many claims of creditors as possible while respecting the principle of equal treatment, the rationale of resolution is to enable the bank to stay open for business and to continue to provide critical functions, to avoid significant adverse consequences for the rest of the financial system, and to protect taxpayer money and depositor assets. Moreover, the regime requires that no creditor will be left worse off than they would have been if the bank had been placed into an insolvency proceeding..*

[2] *For more details see https://www.fma.gv.at/en/about-the-fma/media/press-releases/press-releases-detail/article/fma-ordnet-per-bescheid-die-abwicklung-der-heta-asset-resolution-ag-gemaess-dem-bundesgesetz-z.html.*

2.2 Austrian banks' operations remain committed to CESEE

Austrian banks are significant foreign banks in CESEE

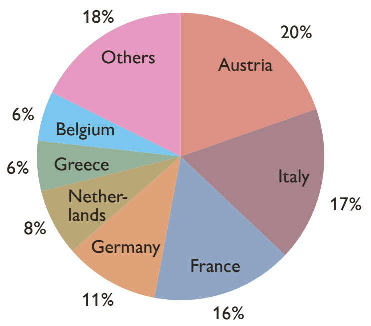
At the end of 2014, the consolidated foreign claims of majority Austrian-owned banks totaled approximately EUR 288 billion, with cross-border funding provided to CESEE accounting for EUR 185 billion.

Changes in bank profitability, asset quality, overall exposure and credit expansion reflect the heterogeneity of developments in CESEE observed since the out-

Chart 14

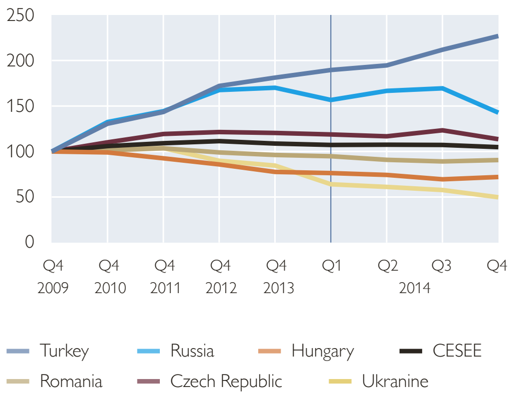
EU-15 banks’ shares in total exposure to CESEE

Q3 14



Austrian banks’ exposure to CESEE

End-2009 = 100



Source: OeNB, BIS.

Table 6

Austrian banks’ consolidated foreign claims (immediate borrower basis)[1]

As at December 31, 2014

Vis-à-vis	*EUR billion*
CESEE & CIS	**184.8**
Euro area countries	**31.9**
Estonia	0.1
Latvia	0.1
Slovakia	26.3
Slovenia	5.5
Other EU countries	**124.7**
Bulgaria	3.5
Croatia	18.9
Lithuania	0.1
Poland	16.7
Romania	25.9
Czech Republic	44.2
Hungary	15.5
Non-EU countries	**28.1**
Albania	1.7
Belarus	1.6
Bosnia and Herzegovina	3.4
FYR Macedonia	0.3
Montenegro	0.4
Serbia	3.6
Russian Federation	12.1
Turkey	1.0
Ukraine	2.8
Rest	1.2
Selected Western European countries	
Germany	30.6
France	9.3
Greece	0.2
Ireland	1.1
Italy	5.7
Netherlands	6.0
Portugal	0.4
Sweden	1.5
Switzerland	5.1
Spain	2.6
United Kingdom	11.9

Source: OeNB.

[1] *In majority domestic ownership.*

break of the global financial crisis in 2008. In recent years, Austrian banks have expanded their exposure to Russia and Turkey at a comparatively strong rate, among other things also in the consumer loan segment. At the same time, Austrian banks have reduced their exposure to Ukraine through the sale of banking subsidiaries or through deleveraging measures.

In recent years, the CESEE economies felt the impact of the euro area debt crisis. The conflict between Ukraine and Russia that erupted in 2014 and the related economic sanctions have added to uncertainty and weakened the economic outlook for the region. Nonetheless, the CESEE economies have a higher growth potential than Western European economies because GDP per capita levels are comparatively lower in the region. Before the economic crisis hit the region in 2009, its growth differential vis-à-vis the euro area had risen to more than 3%. Following a setback to approximately 0.5% in the crisis years 2009 and 2010, it has since been fairly stable within a range from 1% to 2%.

CESEE business is a major profit contributor despite shrinking profits

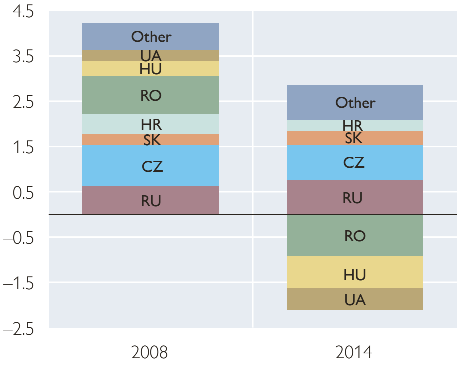
The activities of Austrian banks' subsidiaries in CESEE remain an important business area, even though their higher profits come with higher risks in some markets. In recent years, profits were increasingly concentrated in the Czech Republic and Slovakia as well as in Russia and Turkey, which are subject to higher volatility. This shift underlines the necessity of a sustainable growth strategy for the region.

The net result for 2014 generated by Austrian banks' subsidiaries in CESEE was below the 2013 result, which can be explained above all with the higher need for risk provisions in Romania and measures related to foreign currency lending in Hungary. Moreover, the profits of Austrian banks' subsidiaries in CESEE suffered from tensions surrounding Russia and Ukraine, losses in Ukraine increased, and the net result achieved in Russia declined owing to the weaker economic conditions *(see the section on Russia below)*.

Chart 15

Distribution of net profits of Austrian banks' subsidiaries in CESEE

EUR billion



Source: OeNB.

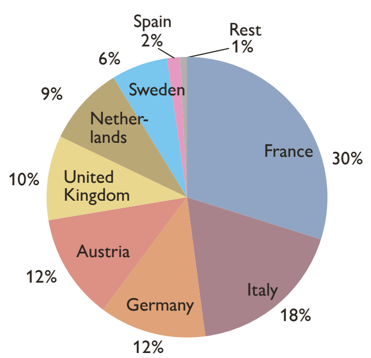
Consequently, the net result of Austrian banking subsidiaries in CESEE shrank by 66% year on year during 2014, to EUR 0.7 billion (including the joint venture of a bank in Turkey). The outlook for CESEE for 2015 remains weak and is likely to add increasing pressure on asset quality and profitability. Stronger currency depreciation effects, as observed in the case of the Russian ruble in late 2014, limit the predictiveness of profitability figures and the internal capital generation capacity. Furthermore, transition economies such as Turkey are subject to the risk of capital outflows in the event of an abrupt "normalization" of monetary policy.

Chart 16

Foreign claims of EU-15 countries on Russia

Q3 14

Total foreign claims on Russia: EUR 126 billion



Source: BIS, OeNB.

Exposure of banks in majority domestic ownership toward Russian-based banks and nonbanks.

Profit outlook of Austrian banks in Russia subject to geopolitical tensions

In Russia, Austrian banks' subsidiaries have a market share of about 3%, which is close to 40% of the aggregate market share of foreign banks in Russia. Business in Russia was very profitable for Austrian banks operating in CESEE in recent years, given high credit growth rates and low risk costs. While the profits generated in Russia in 2014 were 28% below the results for 2013, the Russian market continues to be one of the key sources of profit after the Czech Republic (EUR 760 million in 2014 Q4, or 26% of the positive net result in CESEE).

First signs of an economic downturn in Russia became apparent in 2012, with the uncertainty surrounding the Russia-Ukraine conflict having accelerated the slowdown. In view of this conflict, the EU adopted a series of restrictive measures against Russia in 2014. These measures are intended to restrict access to EU capital markets for Russian state banks (with the exception of EU subsidiaries of Russian state-owned banks) as well as access for Russian energy and defense companies. On top of these restrictive measures, the Russian economy was hit by a sharp drop in oil prices. The general deterioration of the business environment, declining investor and saver confidence, rising capital outflows, higher refinancing and credit risk costs, weaker credit growth as well as the projected economic setback ultimately triggered a significant depreciation of the Russian ruble in late 2014. Market observers even expect the banking sector as a whole to close 2015 with a loss.

Given these developments, the profit outlook of Austrian banks in Russia is subject to high uncertainty, notwithstanding the fairly high profits generated in 2014. The heightened risks for profitability reflect above all the general decline in profitability of Austrian banks' in CESEE, the relative weak profitability of domestic operations and the increased concentration of profits in a few markets in CESEE.

2.3 Enhanced macroprudential regime contributes to financial stability

Macroprudential supervision is gearing up

The latest financial crisis has shown that, left by its own devices, microprudential supervision, which focuses on the safety and soundness of individual financial institutions, and a monetary policy aimed at maintaining price stability do not suffice to safeguard the stability of the financial system.

To close the gap between microprudential supervision and monetary policy, macroprudential supervision was given a new institutional framework in Austria in 2014: The mandate of identifying and analyzing risks to the stability of the Austrian financial system in a forward-looking manner was assigned to a new coordinating body, the Financial Market Stability Board (FMSB; under Articles 13–13b of the Financial Market Authority Act). In this sense, macroprudential supervision was added as an additional pillar of banking supervision in the Austrian Banking Act (Section V, Articles 22–24a).

The FMSB was established to strengthen cooperation in the field of macroprudential supervision and to promote financial market stability. FMSB members represent the Ministry of Finance, the Fiscal Advisory Council, the FMA and the OeNB, with a finance ministry representative serving as the chair.

FMSB discussions underway to address systemic risks

In its third meeting in February 2015, the FMSB discussed the use and calibration of systemic risk buffers and of buffer requirements for systemically important institutions with a view to addressing structural risks in the Austrian banking system.[2] The discussion built on the detailed analysis of systemic risks underlying banking in Austria, which the FMSB had acknowledged in its second meeting.

[2] *For more information, see http://www.fmsg.at/en.*

For Austria, the FMSB has identified the following major systemic risks to financial stability: the above-average size of the domestic banking sector, given that Austria is a small, open economy; the large exposures of the banking industry to emerging European economies; the low capital ratios of domestic banks compared with banks with similar business models; and existing ownership structures, with their limited capacity of owners to recapitalize banks in the event of a crisis. Systemic risk buffers may be imposed on banks with heightened exposures to structural systemic risks, with a view to increasing their crisis resilience. The FMSB expects systemic risk buffers to lead to a more risk-adequate pricing of credit risk, without adversely affecting the supply of credit. This enhances the stability of the financial system. The FMSB Secretariat has been tasked with submitting for the fourth meeting of the FMSB a draft FMSB recommendation for applying systemic risk buffers.

Macroprudential measures set in Austria in the past

The FMA and the OeNB have been cautioning against the risks arising from foreign currency loans and loans with an accompanying repayment vehicle for more than ten years *(see box 3 on changes in foreign currency lending)*. A framework of guidelines for granting and managing loans with repayment vehicles was first published by the FMA in 2003 ("minimum standards"). In 2006, banks were encouraged to join in and support a financial literacy initiative, based on a leaflet illustrating the risks of borrowing in foreign currency. In the fall of 2008, the FMA launched its recommendation to stop granting foreign currency-denominated loans to households. In 2010, Austrian banks made a commitment to stop extending foreign currency loans associated with high levels of risk, in line with supervisory guidance provided to this effect ("guiding principles"). The FMA's minimum standards were expanded in 2010 and revised in 2013, among other thing with a view to taking recommendations since published by the ESRB on board (including the application of those standards on a consolidated basis and cross-border cooperation regarding reciprocity, to limit regulatory arbitrage).

Box 3

Prudential measures to limit foreign currency loans have been effective, but legacy risks remain

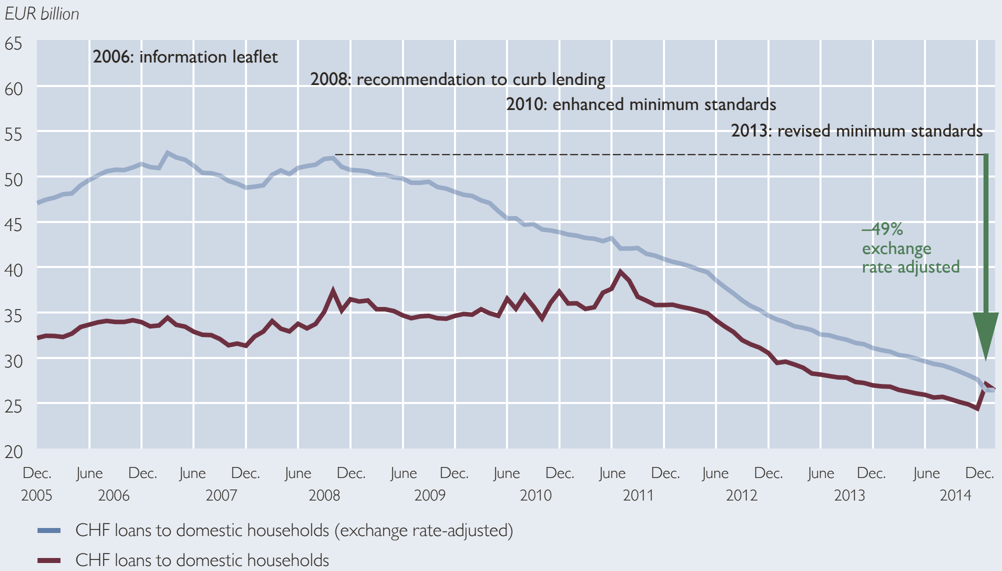
On January 15, 2015, the Swiss National Bank (SNB) announced the surprise removal of its 1.20 floor on the Swiss franc against the euro. Thereafter, the Swiss franc appreciated by approximately 15%. The SNB's decision is of significant relevance for financial stability in Austria, as banks continue to have high volumes of outstanding Swiss franc loans in their books. At the same time, Austria's exchange rate-adjusted volume of foreign currency loans has halved since 2008, reflecting in particular the freeze on new foreign currency lending to households.

Outstanding foreign currency loans and loans involving repayment vehicles have gone down in Austria and CESEE

As in previous years, the volume of foreign currency loans went down further in 2014. Outstanding Swiss franc loans totaled close to EUR 35 billion in February 2015, with loans taken out by households accounting for EUR 26 billion thereof. Roughly three-quarters of those loans are due on maturity and to be repaid on the basis of an accompanying repayment vehicle. Since the FMA recommendation of October 2008 to Austrian banks to stop granting foreign currency loans to households without matching foreign currency income streams, the volume of outstanding foreign currency loans has almost halved (adjusted for exchange rate effects). This decline notwithstanding, foreign currency loans continue to constitute a risk for households and for the stability of the Austrian financial system.

Chart A

Swiss-franc denominated loans to domestic households

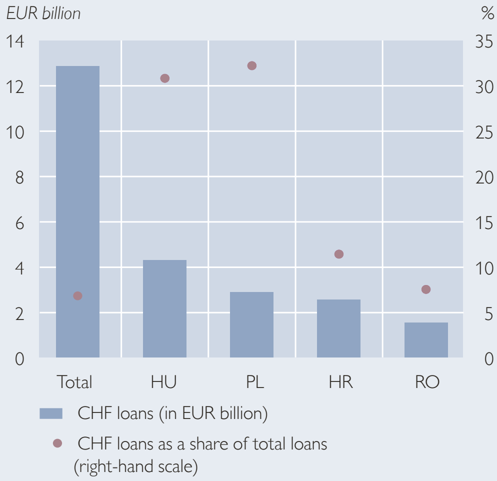


Source: OeNB.

In CESEE, Austrian banks had approximately EUR 118 billion foreign currency loans outstanding at the end of June 2014. Thereof, they had granted EUR 79 billion indirectly through banking subsidiaries in CESEE and another EUR 39 billion through direct loans extended by the parent banks. Most of these loans are denominated in euro. The FMA's minimum standards and the guiding principles have encouraged Austrian banks' subsidiaries in CESEE to bring down their volume of outstanding foreign currency loans by EUR 10 billion or 11% since mid-2012. In mid-2014, the outstanding volume of Swiss franc loans granted by Austrian banks' subsidiaries in CESEE totaled roughly EUR 14 billion. Those loans were concentrated in Hungary, Poland, Croatia and Romania. U.S. dollar-denominated loans were outstanding mostly in Russia and Turkey (totaling EUR 23 billion at the end of June 2014). Swiss franc loans were mostly taken out by households, U.S. dollar-denominated loans above all by businesses.

Chart B

CESEE countries with substantial volumens of loans denominated in Swiss francs
Q2 14



Source: OeNB.

OeNB and FMA expand analysis to identify risks arising from foreign currency lending

Given the high relevance that foreign currency loans and loans with an accompanying repayment vehicle continue to have for the Austrian financial market, the FMA and the OeNB are conducting a survey among a representative set of Austrian banks in the first quarter of 2015. This survey covers the performance of the saving plans serving as repayment instruments and the major risk indicators of foreign currency loans extended to domestic borrowers. This survey complements the OeNB's regular survey on systemic risks arising from foreign currency lending in CESEE.

Sustainability package for large banks' business models

Another macroprudential measure is the supervisory guidance for large internationally active Austrian banks that the Austrian supervisory authorities adopted in March 2012 ("sustainability package"). Among other things, the measures are aimed at strengthening the relevant banking groups' capital positions further and at ensuring that exposed banking subsidiaries rebalance their refinancing structures. The above measures are in line with the Vienna Initiative[3] and promote a sustainable growth model with strengthened capitalization, while at the same time

[3] *The European Bank Coordination "Vienna Initiative" is a platform for cooperation and discussion of home and host country supervisors, the European Commission, international financial institutions like the IMF, and banks active in CESEE. It was launched at the height of the first wave of the global financial crisis in January 2009 and played a key role in stabilizing the situation in the CESEE region. It helped to prevent a systemic banking crisis in the region and ensured that credit kept flowing to the real economies during the crisis.*

avoiding pronounced credit cycles. At the end of the third quarter of 2014, all monitored Austrian banking subsidiaries had a sustainable local funding model (based on year-on-year comparisons).

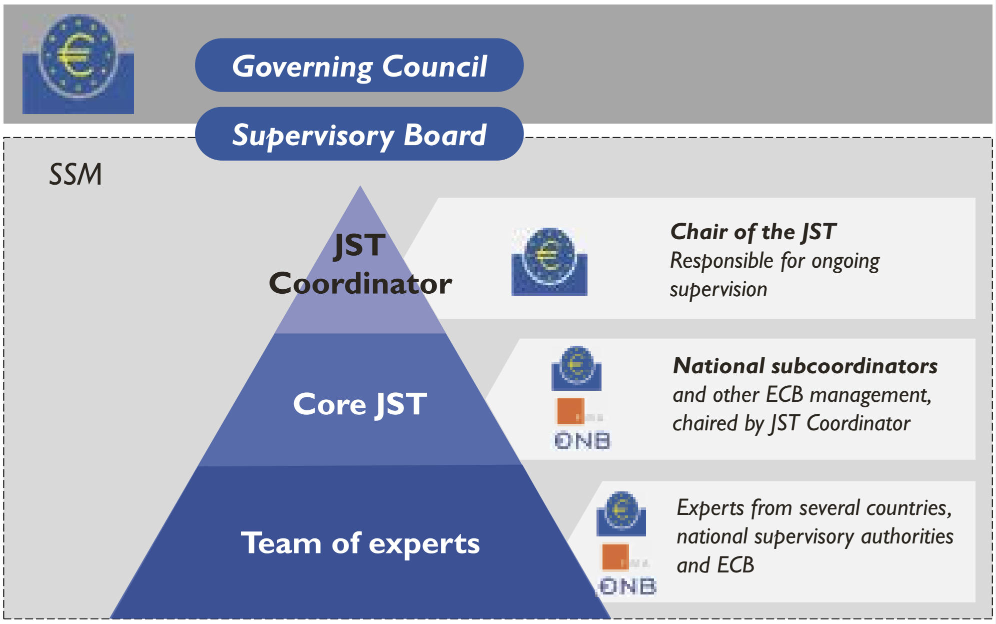
2.4 Substantial progress in the establishment of the EU banking union

Box 4

Cooperation within Joint Supervisory Teams

Within the framework of the Single Supervisory Mechanism (SSM), Joint Supervisory Teams (JSTs) have been established for all significant institutions, which share the responsibility for the ongoing supervision of those banks. Each JST comprises a coordinator at the ECB and national subcoordinators representing the supervisory authorities of the SSM countries in which the credit institutions are established (in Austria: one subcoordinator each from the FMA and the OeNB). A team of ECB experts and experts from the national supervisory authorities completes the JSTs.

Structure of a Joint Supervisory Team (JST)



Team members are responsible for one or more risk categories, depending on the size of the team. This matrix structure provides for clear thematic responsibilities and actively fosters the exchange of supervisory practices and approaches among the supervisory authorities represented in the JSTs. The division of labor between the FMA (legal evaluation) and the OeNB (economic evaluation) follows established practice that has worked well in the past.

The main tasks of the JSTs are monitoring the economic performance of banks, conducting annual capital and liquidity adequacy assessments, analyzing resolution plans, supervising and validating models on an ongoing basis, reviewing requests submitted by banks and preparing decision-making by the SSM Supervisory Board. Thus, the JSTs are responsible for operationalizing all supervisory decisions, covering both the economic and the legal component of supervisory activities.

Single Resolution Mechanism is taking shape

The Single Resolution Mechanism (SRM), which complements the Single Supervisory Mechanism (SSM), has been operational since January 1, 2015. In future, this setup will strike a balance between control and liability issues, and it has created the preconditions for breaking the link between banks and sovereigns. The pillars of the SRM are a new institutional framework and a common funding framework which provides for harmonized rules, powers and tools for the reconstruction and resolution of banks.

Institutional preconditions for a central decision-making and funding mechanism

The EU regulation establishing a Single Resolution Mechanism (SRM Regulation) envisages a centralized European decision-making and financing mechanism for the resolution of banks, for which it established two new core features, a Single Resolution Board (SRB) and a Single Resolution Fund (SRF). The SRB has already been set up. Its initial task is to prepare the ground for the development of resolution plans, gather information and work out the details for cooperation with the national resolution authorities. The SRB will become fully operational, i.e. start taking decisions and setting measures for actual resolution cases, on or after January 1, 2016.

As the second core feature, the SRF constitutes the funding element of the resolution mechanism. The resolution fund is owned and administered by the SRB. It is financed by contributions from the banking industry, with the level of individual contributions depending on an institution's size and risk profile. The SRF will be built up over an eight-year period starting on January 1, 2016. In 2024, the SRF volume is scheduled to reach EUR 55 billion. This amount has been defined to correspond to at least 1% of the amount of covered deposits of all credit institutions.

Like under the SSM, there is a division of tasks and responsibilities between the competent body at the European level and the respective national authorities. The SRB is responsible for those institutions that are directly supervised by the ECB, for cross-border groups, and for banks that receive SRF funding. The national resolution authorities (in Austria, the FMA) are responsible for all other institutions. In performing its tasks, the SRB cooperates closely with the national resolution authorities. The practical arrangements for this cooperation will be laid down in a yet to be formulated framework regulation.

BRRD creates harmonized rules and provides for the bail-in of owners and creditors in the event of resolution

The Bank Recovery and Resolution Directive (BRRD), which Member States had to write into national law by December 31, 2014, provides uniform rules for the recovery and resolution of banks and addresses three core issues: the prevention of bank failures, early intervention and resolution. The core element of the harmonized legal framework is the bail-in of shareholders and creditors. The BRRD requires resolution authorities to apply the bail-in tool as from January 1, 2016, but Member States may determine an earlier date upon which the instrument becomes available. The bail-in tool cannot be applied, however, to deposits protected under deposit guarantee schemes, collateralized claims and liabilities to employees of the failing institution.

BRRD enacted in Austrian law with the Federal Act on the Recovery and Resolution of Banks (BaSAG)

Austria implemented the BRRD by adopting the Federal Act on the Recovery and Resolution of Banks (BaSAG), thereby creating a national legal framework for how to deal with banks that are failing or likely to fail. The respective provisions have been effective since January 1, 2015, and relate to the following three areas and stages:

1. prescribing the production of recovery plans[4] by banks and the production of resolution plans by the resolution authorities, including powers to remove obstacles to resolution (prevention);
2. enabling supervisory authorities to intervene at an early stage, including related additional powers to intervene (early intervention); and
3. forming the basis for the establishment of a national resolution authority and for entrusting the authority with the necessary powers and tools (resolution).

The BaSAG installs the FMA as the competent resolution authority that cooperates with the OeNB on specific issues; this arrangement follows the dual approach pursued in supervision. The resolution authority is entrusted with far-reaching powers and resolution tools, including in particular the bail-in of shareholders and creditors of an institution, which has been a binding resolution tool since January 1, 2015. The bail-in tool cannot be applied, however, to deposits protected under deposit guarantee schemes, collateralized claims and liabilities to employees of the failing institution. Other resolution tools and powers available to the resolution authorities are the sale of the institution under resolution, the transfer of assets to a bridge institution (which must have a bank license), and the transfer of assets to an asset management vehicle ("bad bank").

Harmonized deposit guarantee schemes

The third pillar of the European banking union is aimed at harmonizing the national systems of deposit insurance. The relevant Deposit Guarantee Scheme Directive was adopted in spring 2014 after years of negotiations and had to be enacted in national law by early July 2015. This directive ensures a harmonized coverage level EUR 100 000 per depositor and bank to protect the savings of taxpayers in all EU countries. Further key elements of this directive are the conversion of contributions from an ex post-funded to a mandatory ex ante-funded system and the reduction of the period for the repayment of deposits from 20 to 7 working days.

[4] *The obligation to produce recovery plans and resolution plans as well as the FMA's power of early intervention were incorporated into the Austrian Banking Intervention and Restructuring Act (BIRG) and the Austrian Banking Act even before the adoption of the BaSAG. The relevant provisions of the latter two acts were adapted to the BRRD and integrated into the BaSAG.*

3 Annex of tables

Table 1

(Eurosystem and OeNB forecasts, December 2014)

Real GDP[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Annual change in %										
Austria	3.4	3.6	1.5	–3.8	1.9	3.1	0.9	0.2	0.3	0.9	1.6
Euro area	3.2	3.0	0.5	–4.5	2.0	1.6	–0.8	–0.5	0.9	1.5	1.7
EU	3.4	3.1	0.5	–4.4	2.1	1.7	–0.5	0.0	1.3	1.8	1.9

Consumer price indices[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Annual change in %										
Austria	1.7	2.2	3.2	0.4	1.7	3.6	2.6	2.1	1.5	1.1	1.5
Euro area	2.2	2.1	3.3	0.3	1.6	2.7	2.5	1.4	0.4	0.1	1.0
EU	2.2	2.3	3.7	1.0	2.1	3.1	2.6	1.5	0.6	0.0	1.2

Unemployment rates[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of labor force										
Austria	5.3	4.9	4.1	5.3	4.8	4.6	4.9	5.4	5.6	×	×
Euro area	8.4	7.5	7.6	9.5	10.0	10.1	11.3	12.0	11.6	11.1	10.6
EU	8.2	7.2	7.0	9.0	9.6	9.6	10.4	10.8	10.2	×	×

Current account balances[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of GDP										
Austria	3.3	3.8	4.5	2.6	2.9	1.6	1.5	0.9	0.8	1.9	1.8
Euro area	0.3	0.3	–0.7	0.3	0.4	0.5	1.9	2.4	2.8	3.3	3.1
EU	–0.3	–0.5	–1.3	–0.1	0.0	0.2	0.9	1.4	1.6	2.2	2.0

Budget balances[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of GDP										
Austria	–2.5	–1.3	–1.4	–5.3	–4.5	–2.6	–2.2	–1.3	–2.4	–1.7	–1.7
Euro area	×	×	×	×	×	–4.1	–3.6	–2.9	–2.7	–2.3	–1.7
EU	×	×	×	×	×	–4.5	–4.2	–3.2	–2.9	–2.6	–1.8

Government debt ratios[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of GDP										
Austria	67.0	64.8	68.5	79.7	82.4	82.1	81.5	80.9	84.5	88.8	87.4
Euro area	×	×	×	×	×	85.8	89.1	90.9	91.9	93.5	92.4
EU	×	×	×	×	×	80.9	83.7	85.5	86.8	87.7	86.8

Source: Eurostat, OeNB, ECB.

[1] The data for 2015 to 2016 are based on the IMF spring forecast (April 2015, strictly confidential).

Note: The forecast for the Austrian unemployment rate is not meaningful due to historical data revisions. X = data not available.

Table 2

General government interest payments[1]

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	% of GDP									
Austria	3.2	3.1	3.1	3.0	3.2	2.9	2.8	2.6	2.5	2.4

Source: Statistics Austria.

[1] *According to the EDP notification (Maastricht), including swap transactions.*

Table 3

Household debt

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	% of disposable net income									
Austria	×	88.8	88.6	90.2	90.4	93.5	93.5	89.8	89.4	88.2
Euro area	×	107.3	110.6	111.7	115.2	118.0	118.3	118.4	116.1	114.3
	% of GDP									
Austria	×	53.1	52.4	53.0	54.3	55.4	53.9	52.6	51.5	50.9
Euro area	×	64.3	65.2	66.2	70.6	70.8	70.6	70.3	68.8	67.5

Source: ECB, OeNB.

Table 4

Corporate debt[1]

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	% of gross operating surplus[2]									
Austria	×	199.3	209.6	218.1	230.3	231.3	227.5	233.5	237.0	239.4
Euro area	×	223.6	230.1	242.2	257.8	254.7	251.4	257.8	252.2	253.1
	% of GDP									
Austria	×	84.3	89.3	91.1	92.4	93.6	92.7	93.1	93.2	93.4
Euro area	×	94.4	98.0	102.2	105.5	105.3	104.0	105.2	102.7	102.5

Source: ECB, OeNB.

[1] *Short- and long-term loans, money and capital market instruments.*
[2] *Including mixed income of the self-employed.*

Table 5

Residential property price index

	2010	2011	2012	2013	2014	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14
	Index 2000=100									
Austria excluding Vienna	121.1	124.0	137.4	141.1	145.4	140.1	143.3	147.3	146.5	144.5
Vienna	143.9	156.1	180.7	196.3	204.6	202.3	204.6	207.3	202.2	204.4
	Annual change in %									
Austria excluding Vienna	5.5	2.3	10.8	2.7	3.1	1.6	2.2	4.3	2.6	3.2
Vienna	7.8	8.5	15.7	8.7	4.2	9.1	8.1	5.8	2.2	1.0

Source: OeNB, Austria Immobilienbörse, Vienna University of Technology, Institute for Urban and Regional Research.

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Publisher and editor — *Oesterreichische Nationalbank*
Otto-Wagner-Platz 3, 1090 Vienna
PO Box 61, 1011 Vienna, Austria
www.oenb.at
oenb.info@oenb.at
Phone (+43-1) 40420-6666
Fax (+43-1) 40420-046698

Coordination — *Matthias Fuchs*

Content — *Gabriele Stöffler, Klaus Vondra, Daniela Widhalm*

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