CONCLUDING STATEMENT

Austria: Staff Concluding Statement of the 2021 Article IV Mission

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Washington, DC – June 15, 2021:

Austria entered the pandemic with strong macroeconomic indicators and a healthy financial sector but suffered a sharp decline in economic activity in 2020 despite robust government support efforts. A recovery is expected in 2021-22, but at a somewhat slower pace than in many other EU countries. The fiscal deficit jumped due to lower activity and pandemic support spending, but the fiscal situation remains manageable, with the deficit set to fall to near pre-crisis levels in the medium-term. The government's recovery package appropriately focuses on boosting investment, greening the economy, and fostering digitalization, but it could be expanded further to aid the recovery and limit scarring. Austria has ambitious goals to reduce greenhouse gas emissions, but additional steps will be required to bring that objective within reach, including carbon pricing, more support for improving the thermal efficiency of buildings and a faster transition to clean transport. The financial sector has weathered the downturn well, with profitability remaining positive and non-performing loans low. Continued vigilance will be important, as corporate sector weakness may still affect banks. Corporate equity support measures could mitigate this risk and facilitate the recovery.

Economic outlook

Austria entered the pandemic from a strong position, but was hit hard by the crisis. Pre-crisis growth was above the euro area average and unemployment was falling, the banking sector was well capitalized, the fiscal position was strong, and public debt was on a declining path. Once the pandemic hit, real GDP contracted by 6.3 percent in 2020, affected by waves of lockdowns which disrupted economic activities. Unemployment rose, but job losses were mitigated by strong support from the short-time work scheme (STWS).

A modest and uneven recovery is expected in 2021 with potential scarring in the medium term. IMF staff anticipate growth of around 3½ percent this year, as renewed lockdowns and a weak winter tourism season have weighed on economic activity early in the year. This GDP forecast still represents a weaker recovery than in most partner countries.

Several sectors (e.g. tourism, hospitality), are expected to recover more slowly than others (e.g. industry, construction). In 2022, growth should accelerate further to 4½ percent and GDP will surpass its pre-crisis level. Thereafter, growth is forecast to gradually settle back to its medium-term potential of around 1¾ percent. Nonetheless, the real GDP level is projected to remain below its pre-COVID trend by about 1¼ percent in 2026. Inflation is expected to rise to around 2 percent in 2021, reflecting temporary factors pushing up prices.

Crisis Response and Fiscal Policy

The public sector deficit rose sharply due to the pandemic, but fiscal sustainability is still strong. The deficit rose to 8.9 percent of GDP in 2020 and is expected to be around 6½ percent of GDP in 2021. Debt will rise from 70½ percent of GDP before the crisis to an expected peak of 86 percent of GDP in 2022 before falling again in the medium term. Despite this sharp rise, debt servicing costs have continued to decline, and the maturity of public debt has risen. IMF staff expect that once the pandemic emergency measures are ended, the deficit should fall below 1 percent of GDP in the medium-term and the debt-to-GDP ratio will begin to fall even without consolidation measures.

The authorities' response to the pandemic has been strong, with fiscal policy support totaling around 13 percent of GDP. Measures included increased health spending, tax reductions and deferrals, direct financial support and loan guarantees to businesses hit by the crisis, a sharp expansion of the STWS, and expanded support for the unemployed. Together, these measures amounted to 7¼ percent of GDP in 2020 and played crucial role in cushioning the effects of the crisis on households and firms. In light of continued waves of infection, key support measures were appropriately increased in the revised 2021 budget, with additional spending and forgone revenue of over 5 percent of 2020 GDP. IMF staff recommend continuing flexible emergency support as long as needed, while progressively targeting it on the most affected sectors and households.

The authorities have put a package in place to foster the recovery and minimize scarring, but there is room to do more. The strategy foresees some 6 percent of GDP in new spending and lower taxation over 2021–24, frontloaded during the first two years. We support the key priorities of this initiative: to support the transition to a greener economy, boost private investment—particularly in digitalization, innovation, and climate—and strengthening human capital. However, given the relatively weak recovery expected and favorable fiscal conditions, IMF staff believe support could be expanded further. Specifically, the recovery would be strengthened by additional measures of ½-1 percent of GDP per year in 2021-24 in: (i) targeted hiring subsidies for young and disadvantaged workers, and enhanced skills and language training; (ii) a support scheme to boost equity in private firms (particularly SMEs) which would improve corporate balance sheets and spark additional investment; (iii) continuing to reduce the labor tax wedge by cutting income taxes on the second and third lowest income brackets (as foreseen in the pre-pandemic government program); iv) additional spending to accelerate digitalization; and (v) more resources for thermal conversion of buildings and a faster transition to emissions-free transport. We believe this additional stimulus would accelerate the recovery, reinvigorate growth, and bring GDP closer to its pre-crisis trend.

The mission welcomes the focus on the green transformation of the economy in the recovery plan, but additional strong policy action will be needed to achieve Austria's climate change objectives. Austria's recovery package includes needed measures on

climate change and environmental protection, including climate-friendly investment incentives, decarbonizing the public transport system, forest conservation, scaling-up renewables, and green renovation. Despite these measures, projections show Austria would remain far short of reaching its emissions reduction target. IMF staff analysis suggests that a phased introduction of higher carbon prices, starting with €25/mt per year in 2022 and increasing gradually to €100/mt per year by 2030, coupled with expanded energy efficiency measures would bring Austria closer to its climate goal. The resources raised from carbon pricing should be used to compensate low-income and vulnerable households from any additional costs and to boost spending on climate-friendly investment and employment generation. Some revenue could also be used to finance tax cuts in other areas. We also recommend adopting green budgeting practices in the federal, regional, and municipal governments to integrate climate considerations into the government's fiscal frameworks.

Structural Issues

While the labor market is showing signs of gradual improvement after pandemic job losses, policies to foster job-creation and support the reallocation of workers will help ensure a job-rich and equitable recovery. Austria's short-time work scheme provided crucial support to the labor market and absorbed a substantial fraction of the potential job losses. As the recovery takes shape, such support should become progressively targeted towards those who continue to be most affected by the crisis. While aggregate employment is gradually returning to pre-crisis levels, unemployment is still high and certain groups continue to be disproportionately impacted. Reviving employment prospects for these hardest-hit labor segments should be prioritized to prevent long-run unemployment and income scarring. To this end, staff recommends targeted hiring cost subsidies and job search assistance. This should be accompanied by policies that support the reallocation of workers and reduce regional and skill mismatches, such as German language training for migrant and refugee workers, re-skilling programs, and relocation assistance.

Stepping up efforts to expand digitalization will help boost productivity and raise Austria's growth potential, enabling a more ambitious "comeback." Austria lags behind the EU average in three of the five categories in the EU Digital Economy and Society Index (digital connectivity, use of internet services, and integration of digital technology). It also underperforms in terms of take-up rates on broadband and other digital services. Staff suggests additional spending on improving digital access and utilization to supplement the outlays currently envisaged. Such spending could include productivity-enhancing support to high-technology start-ups and funding for firms' digitalization projects as well as ICT-skills training to close the labor skills gap.

Measures are needed to lower long-term spending pressures from population aging. Austria's pension system is currently financially healthy, with past reforms helping to raise effective retirement ages and contain fiscal costs. The recent reform to tighten the early retirement schemes is a welcome step. However, Austria's effective retirement age and statutory retirement age are both still low by international standards, and labor force participation for those 55-64 is well below EU and OECD averages. In the future, further aging will generate increased pension and health care costs, while contributions will decline. Further actions to address this increasing liability would be advisable.

Corporate and Financial Sectors

Emergency support policies mitigated crisis-related liquidity challenges for corporates and households, but corporate solvency risks have increased. The STWS and loan-guarantee support helped absorb household and firm income losses and facilitated continued access to credit for these sectors. While corporates built up substantial liquidity buffers, their debt-to-income ratio surged by 13 percentage points in 2020:H1, presenting potential solvency challenges in the period ahead. IMF Staff analysis suggests that after policy support, Austria will have an equity gap of around 1–2 percent of GDP compared to pre-crisis levels. The mission recommends that the government introduce solvency support mechanisms to address this, consistent with EU state-aid rules. These mechanisms should include private sector participation to leverage private expertise in the selection and monitoring of beneficiaries—while allowing nonviable firms to exit. A notional tax deduction on equity could supplement such schemes. Enhancing debt restructuring mechanisms, including by providing tools and incentives for voluntary debt resolution, pre-emptively increasing court capacity and swiftly implementing the EU Restructuring Directive (Directive 2019/1023) could also help contribute to efficient capital reallocation.

The financial sector was generally healthy before the pandemic and has withstood the crisis well. Profitability has declined but has in aggregate remained positive. Due to strong financial support, non-performing loans (NPLs) have not risen much, although there has been a spike in loans classified under IFRS as Stage II, which could translate into higher NPLs in the future. Banks have accordingly built up provisioning, using the facilities under EBA and ECB guidelines. Under IMF staff simulations, Austrian banks would see only limited capital depletion due to by policy measures enacted since the crisis. However, as support policies are gradually unwound, asset quality could worsen, and the authorities should remain vigilant. Banks should also address persistently high underlying operating costs.

Vulnerabilities in the housing sector persist, with real estate prices continuing to increase. Prior to the pandemic, analyses pointed to an overvaluation of house prices in a range of 15–30 percent. During the pandemic, housing prices—particularly in the single-family segment—increased by a further 10 percent. The lending guidelines put in place by the Financial Market Stability Board have not curbed risky lending and we recommend the authorities consider imposing binding limits to contain risks once the acute phase of the crisis is past.

The authorities should continue strengthening bank supervision and regulation. The failure of two small banks in 2019 and 2020 pointed to the need for strengthening of supervision in less significant institutions, and a working group was tasked with drawing lessons from the episodes. The recommendations of that group should be put into effect as soon as possible. While the deposit guarantee system in Austria is robust and on track to meet the Deposit Guarantee Schemes Directive requirements for accumulating reserves by 2024, its fragmentation by the withdrawal of the Raiffeisen sector from the main scheme introduces potential inefficiencies into the system.

** * * We would like to thank our counterparts in the OeNB, the government, FMA, and the private sector for the excellent organization and fruitful discussions.*