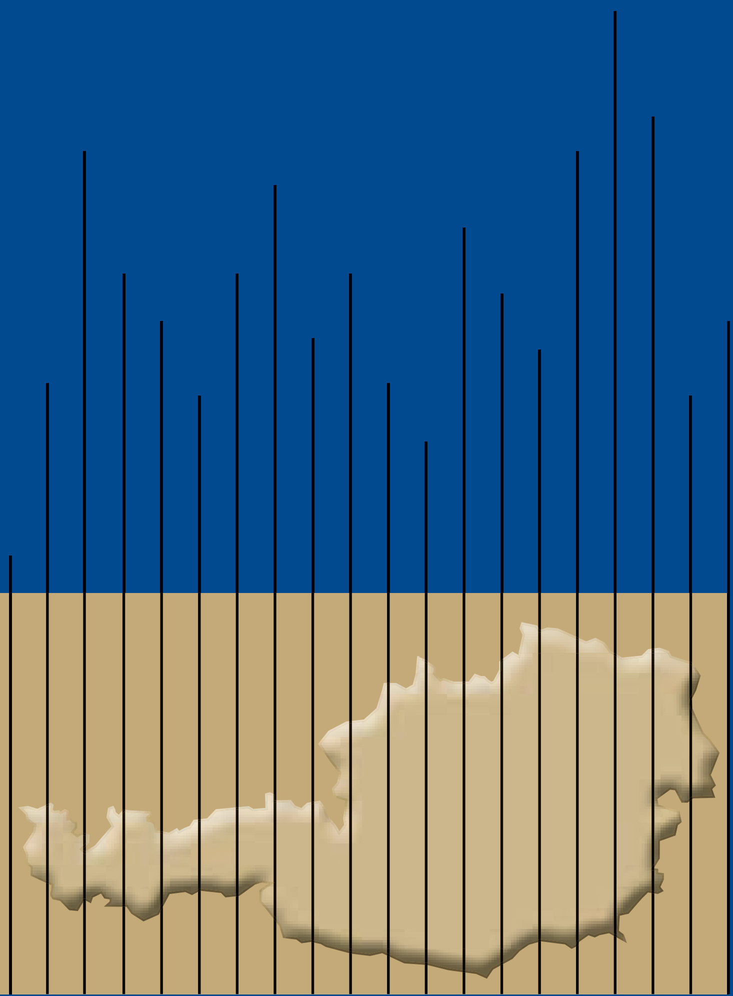
OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

FACTS ON AUSTRIA AND ITS BANKS



Stability and Security.

December 2014

Contents

All data based on ESA 2010.

Cut-off date for data: December 5, 2014.

The next issue of Facts on Austria and Its Banks will be published in April 2015.

Key Indicators for the Austrian Economy

Cut-off date for data: December 5, 2014.

Economic Indicators

(OeNB forecast, December 2014)

	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	2013	2014	2015	2016
Economic activity	*EUR billion (four-quarter moving sums)*								
Nominal GDP	321.3	322.7	324.7	326.8	328.7	322.7	329.8	337.5	347.6
	Change on previous period in % (real)								
GDP	0.2	0.3	0.1	0.1	–0.1	0.3	0.4	0.7	1.6
Private consumption	0.1	0.1	0.1	0.1	0.1	–0.2	0.5	0.7	1.3
Public consumption	0.2	0.2	0.2	0.2	0.2	0.4	1.0	1.4	1.3
Gross fixed capital formation	0.5	0.2	0.5	–0.3	–0.8	–1.0	–0.1	0.8	2.3
Exports of goods and services	–0.1	0.1	0.5	–0.4	–0.8	1.2	0.8	2.4	4.6
Exports of goods	0.1	0.2	0.7	0.7	0.0	0.0	1.7	2.2	4.5
Imports of goods and services	1.0	0.1	0.0	0.4	0.1	–0.1	0.5	2.5	4.7
Imports of goods	1.4	0.4	–1.2	–0.3	–0.4	–0.6	–0.6	1.3	4.8
	% of nominal GDP								
Current account balance	0.0	0.0	0.0	0.0	0.0	1.0	0.4	0.6	0.8
Prices	*Annual change in %*								
HICP inflation	2.0	1.6	1.5	1.6	1.5	2.1	1.5	1.4	1.5
Compensation per employee	2.1	2.0	1.9	1.9	1.9	2.2	2.0	1.5	2.2
Unit labor costs	2.5	2.4	2.3	2.3	2.4	2.6	2.4	1.3	1.2
Productivity	–0.5	–0.4	–0.4	–0.4	–0.5	–0.4	–0.4	0.2	1.0
Income and savings	*Annual change in %*								
Real disposable household income	0.6	0.5	–0.7	–0.3	0.1	–2.0	0.1	1.1	1.4
	% of nominal disposable household income								
Saving ratio	×	×	×	×	×	7.3	6.8	7.1	7.2
Labor market	*Change on previous period in %*								
Payroll employment	0.2	0.2	0.2	0.2	0.1	0.8	0.7	0.4	0.6
	% of labor supply								
Unemployment rate (Eurostat)	5.0	5.0	5.0	5.0	5.2	4.9	5.1	5.3	5.3
Public finances	*% of nominal GDP*								
Budget balance	×	×	×	×	×	–1.5	–2.4	–1.8	–1.4
Government debt	×	×	×	×	×	81.2	85.4	84.6	82.9

Source: OeNB, Eurostat, Statistics Austria.

Note: The data for 2014 to 2016 are based on the OeNB's December 2014 forecast.

Financial Indicators

	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	2010	2011	2012	2013
Austrian banking system	*Consolidated in EUR billion*								
Total assets	1,109	1,090	1,074	1,072	×	1,131	1,166	1,164	1,090
Equity capital[1]	88.8	89.0	91.3	90.5	×	86.2	88.1	88.2	89.0
Exposure to CESEE[2]	205.5	201.8	199.8	197.5	×	209.4	216.1	209.8	201.8
Structural indicators	*Consolidated in %*								
Total capital adequacy ratio[1]	15.0	15.4	15.7	15.6	×	13.2	13.6	14.2	15.4
Tier-1 capital ratio[1]	11.6	11.9	12.1	11.9	×	10.0	10.3	11.0	11.9
Leverage[3]	6.4	6.5	5.2	5.4	×	5.8	5.8	6.1	6.5
Credit growth and quality (AT)	*EUR billion*								
Flow of loans to nonbanks	–0.4	–0.4	–0.2	–0.2	0.5	0.5	2.3	0.4	–0.4
	Share of loans to nonbanks in %								
Share of foreign currency loans	12.9	12.3	12.1	11.8	11.6	18.3	17.4	14.4	12.3
Loan loss provision ratio	3.4	3.5	3.7	3.6	3.6	3.2	3.2	3.3	3.5
Profitability	*Consolidated in EUR billion*								
Net result after tax	2.4	–1.0	1.1	–0.6	×	4.6	0.7	3.0	–1.0
	Consolidated in %								
Return on assets	0.3	–0.04	0.5	–0.1	×	0.5	0.1	0.3	–0.04
Cost-to-income ratio	63.8	73.0	63.7	77.7	×	57.9	66.4	61.7	73.0
Subsidiaries in CESEE[4]	*%*								
Loan-to-deposit ratio	101.2	95.8	100.3	100.9	×	108.1	105.8	99.4	95.8
Return on assets	1.1	0.8	0.9	0.7	×	0.8	0.7	0.8	0.8
Cost-to-income ratio	52.5	52.7	54.3	54.9	×	49.7	50.1	52.4	52.7
Loan loss provision ratio	8.1	8.0	7.7	7.6	×	6.5	7.3	7.6	8.0
Households and nonprofit institutions serving households	*EUR billion*								
Financial assets	552.3	557.2	561.2	566.4	×	524.5	528.0	548.0	557.2
Financial liabilities (loans)	165.7	165.0	164.1	164.9	×	162.2	165.6	165.8	165.0
of which foreign currency loans	*29.5*	*28.4*	*27.8*	*27.2*	*×*	*40.0*	*38.7*	*32.9*	*28.4*
of which foreign currency housing loans	*22.2*	*21.5*	*21.0*	*20.6*	*×*	*28.5*	*27.7*	*24.3*	*21.5*
Nonfinancial corporations	*EUR billion*								
Financial assets	410.5	415.6	415.7	418.6	×	367.6	391.9	400.5	415.6
Financial liabilities	637.5	640.6	638.0	643.9	×	591.1	609.0	630.2	640.6
of which loans and securities (other than shares and other equity)	*289.3*	*289.0*	*287.3*	*290.0*	*×*	*271.9*	*288.8*	*291.6*	*289.0*
of which shares and other equity	*294.3*	*295.5*	*294.1*	*296.8*	*×*	*270.6*	*268.3*	*283.9*	*295.5*
	EUR billion (four-quarter moving sums)								
Gross operating surplus and mixed income	72.9	72.3	72.6	72.4	×	69.5	73.9	74.2	72.3

Source: OeNB, Statistics Austria.

[1] *As of 2014 figures are calculated according to CRD IV requirements. Therefore comparability with previous figures is limited.*
[2] *CESEE exposure of majority Austrian-owned banks (BIS definition).*
[3] *Definition up to 2013: Tier-I capital after deduction in % of total assets. Definition as of 2014 according to Basel III.*
[4] *From 2014 onward, these figures include the pro-rata data 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 latest growth rates have been below that of the euro area, though.*
- *The Austrian economy is well diversified and its sectoral structure is well balanced.*
- *As measured by the European Innovation Scoreboard, Austria exceeds the EU average in terms of innovation performance, which is a key long-term driver of productivity.*
- *Given high employment and low unemployment rates as well as a low strike frequency, Austria maintains a high degree of social stability.*
- *Austrian HICP inflation averaged 1.93% from 1999 to 2013. Since September 2012, domestic rates have significantly exceeded euro area inflation and inflation 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 some 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 (2013: 7.3%) is below the euro area average. The large stock of financial assets held by the household sector totaled EUR 557 billion (or 173% of GDP) in 2013, serving as an important refinancing source for other economic sectors.*
- *Austria's household debt ratio (2014 Q2: 87.8% of net income) has decreased significantly in recent years; both this ratio and Austria's corporate debt ratio (2014 Q2: 226.7% of gross operating surplus or 88.9% of GDP) are below the corresponding euro area ratios.*
- *High employment growth given labor hoarding during the crisis and the delayed opening of the labor market to CESEE EU citizens coupled with moderate output growth have caused Austria to lose ground in both unit labor costs and productivity per employee relative to the euro area.*
- *Austria's foreign trade in goods is well diversified both by region and by product type. In 2013 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 (2013: 1.0%) confirms the international competitiveness of the Austrian economy and enabled Austria to again come within close reach of a balanced international investment position (–0.2% of GDP or EUR 580 million) in 2013.*
- *With the introduction of ESA 2010, Austria's public debt ratio for 2013 jumped by 7 percentage points to 81.2% of GDP, reflecting a slight decrease by 0.5 percentage points against 2012. 2014 is expected to see a significant increase of the public debt ratio, to 85.4%, driven above all by the reorganization of Hypo Alpe Adria group. In 2015, the tide is expected to turn, with projections indicating a decreasing ratio until 2016.*
- *On the back of somewhat declining capital transfers to banks and positive one-off receipts, the general government budget deficit came down to 1.5% of GDP in 2013. The excessive deficit procedure (EDP) for Austria was abrogated in spring 2014. A sharp increase in capital transfers following the reorganization of the nationalized Hypo Alpe Adria group will markedly widen the deficit in 2014. Given lower capital transfers to banks in the years ahead, the deficit is projected to decrease again thereafter, to 1.8% in 2015 and to 1.4% in 2016.*
- *Interest payable on outstanding gross government debt is below the euro area average, in line with Austria's lower debt burden. At the same time, the investment income generated by Austria's sizeable public financial assets lies above the euro area average.*
- *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: December 5, 2014.*

Austrian Banks are Still Operating in a Challenging Environment

- *European banks are still operating in an environment characterized by weak economic growth, low profitability, increased credit risk provisioning and low interest rates. These developments are also mirrored in the Austrian banking system's net result after tax: In the first half of 2014, the consolidated net result after tax amounted to –EUR 0.59 billion, which corresponds to a decrease of EUR 1.7 billion compared to the first half of 2013. In addition to the continuing low interest rate environment, a planned sale of foreign subsidiaries of Hypo Alpe Adria group as well as high risk provisioning at another bank burdened consolidated profitability.*
- *The CESEE-related activities of Austrian banks continued to be a major contributor to aggregate profits. However, the revenues generated in the region coincide with higher risks. In recent years, profits have been increasingly concentrated on the Czech Republic, Slovakia, Russia and Turkey. This highlights the need for a cautious and sustainable growth strategy in the region.*
- *The aggregated net profit after tax of Austrian subsidiaries in CESEE came to EUR 1.0 billion in 2014 H1, decreasing by 26% compared to the same period in the previous year. The main drivers for this decrease were the activities of Austrian subsidiaries in Romania and Hungary.*
- *The capitalization of Austrian banks, while having improved since 2008, still remains below the corresponding measures of international peers. A further improvement in capitalization is necessary given the current risk profile (e.g. high exposure of Austrian banks to CESEE, foreign currency loan volume, ratio of banking sector assets to GDP), the generally challenging environment, higher market expectations with respect to capitalization as well as higher regulatory requirements.*
- *The exposure of domestically owned Austrian banks to CESEE amounted to around EUR 198 billion or two-thirds of Austrian GDP at the end of June 2014.*
- *In the long term, CESEE will be the region with the best growth prospects in Europe. While the growth differential of the CESEE EU Member States (versus the euro area and the EU) declined to values slightly above zero during the economic crisis in 2009 and 2010, it rebounded to levels of around 1 to 1 ½ percentage points in 2011 and 2013. The IMF projected this differential to persist until 2019 in its World Economic Outlook of October 2014.*
- *Foreign currency lending by Austrian banks has declined in Austria as well as in CESEE, which can be attributed to supervisory initiatives by the Austrian authorities. However, the risks stemming from the relatively high volumes outstanding still prevail.*
- *Austrian banks' overall liquidity situation has improved further. The increase in deposit volumes in CESEE contributed to strengthening the funding base of Austrian banks' subsidiaries. This development is in the spirit of the supervisory guidance provided by the Austrian regulators with a view to strengthening the sustainability of the business models of large and internationally active Austrian banks.*
- *The creation of a banking union is the most significant step of economic and institutional integration in Europe since the launch of the euro. It establishes the prerequisites for a stable financial system, founded on three pillars: a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM) and harmonized Deposit Guarantee Schemes (DGS). The relevant legal frameworks will ensure that strong supervisory standards are homogenously applied across the euro area and the EU (Single Rulebook). Although the practical implementation represents a huge challenge for the participating institutions and staff, the banking union will make crises less likely and will enable supervisors to better identify emerging risks.*

1 The Austrian Economy Is Robust

1.1 Economic Growth in Austria Predominantly Higher than Euro Area Growth

Growth and Economic Welfare on the Rise in Austria

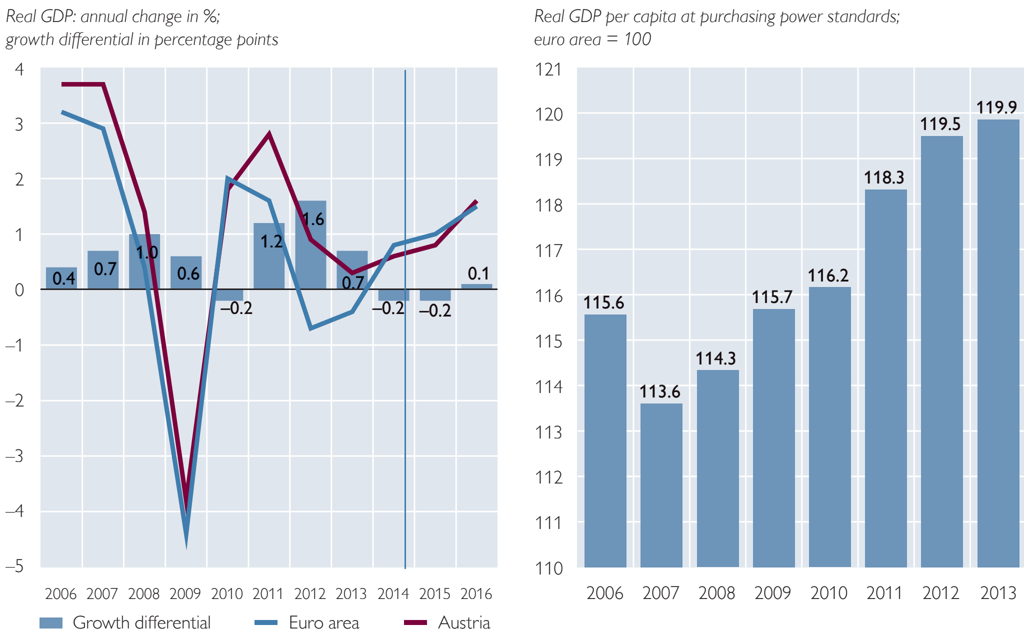
Between 2002 and 2013, Austria held a consistent edge in real GDP growth over the euro area with the exception of 2010. Looking ahead, the OeNB and Eurosystem forecasts of December 2014 indicate that euro area GDP growth will, however, exceed annual GDP growth in Austria in 2014 and 2015.

According to the OeNB economic outlook of December 2014, the Austrian economy will grow below the historical average in Austria in 2014 and 2015 and not revert to its long-term average growth rate before 2016. In absolute numbers, the OeNB projects a subdued recovery to 0.4% annual growth for 2014, a slight acceleration to 0.7% for 2015, and a return to 1.6% for 2016.

Compared with the euro area, Austria reports above-average and increasing levels of wealth in terms of per-capita GDP at purchasing power standards. With the euro area average normalized to 100, the welfare level was 20% above euro area standards in Austria in 2013.

Chart 1

Growth Differential between Austria and the Euro Area | **Welfare Differential between Austria and the Euro Area**



Source: Eurostat, ECB, OeNB.

Note: Data for 2014 to 2016: OeNB and Eurosystem forecasts of December 2014.

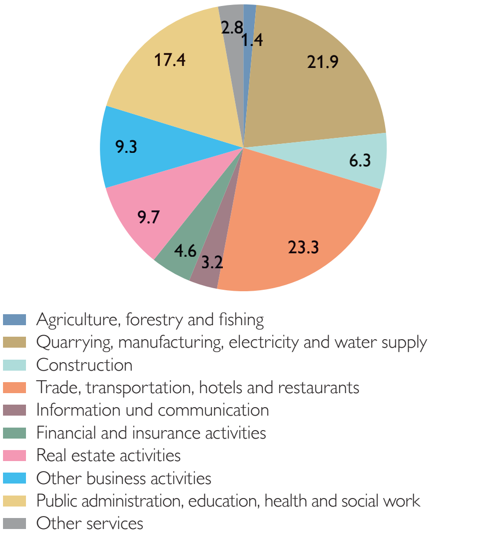
The Sectoral Structure of the Austrian Economy Is Well Balanced

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 indus-

Chart 2

Gross Value Added in Austria in 2013

% of total gross value added, at current prices



Source: Statistics Austria.

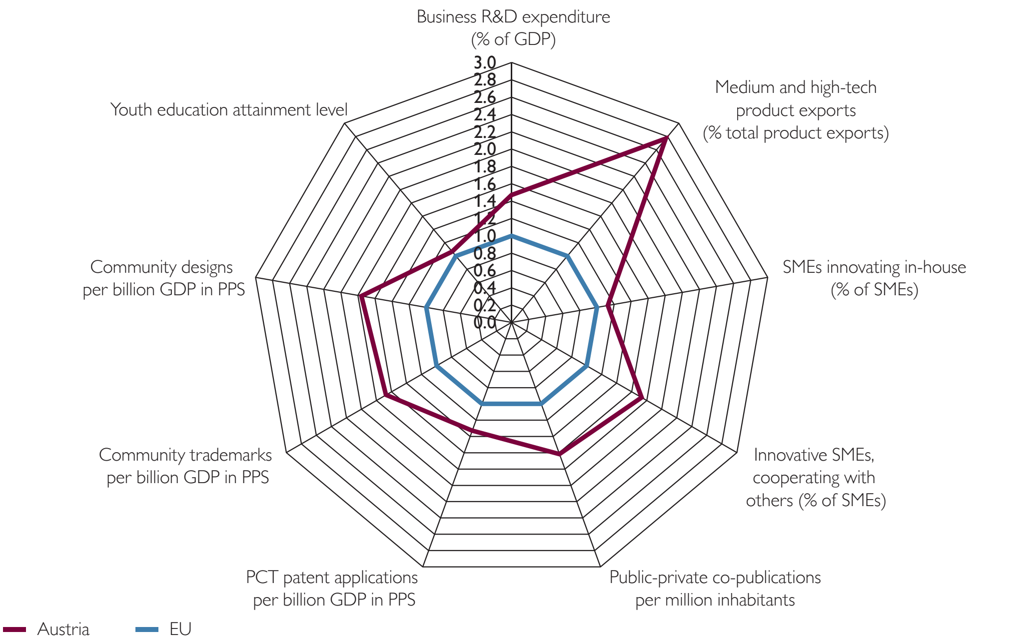
tries. The construction sector's contribution to gross value added (some 6.5%) is relatively low by international standards.

Austria's Innovation Indicators Bode Well for Future Growth

Innovation performance and R&D activities are good indicators of a country's growth prospects. The European Innovation Scoreboard is a Europe-wide tool that enables multi-level comparisons of innovation performance. Austria's key innovation indicators have outperformed the EU average in recent years. For instance, R&D expenditures of businesses in Austria accounted for 1.95% of GDP in 2012, those of EU-based businesses for 1.31%. In Chart 3, the EU value is normalized to 1; this translates into a relative value of 1.49 for Austria vis-à-vis the EU (=1.95/1.31).

Chart 3

Innovation Performance: Austria Visibly Exceeds EU Average



Source: Eurostat.

Note: Depending on the reference period, the data refer to 2010, 2011 or 2012.

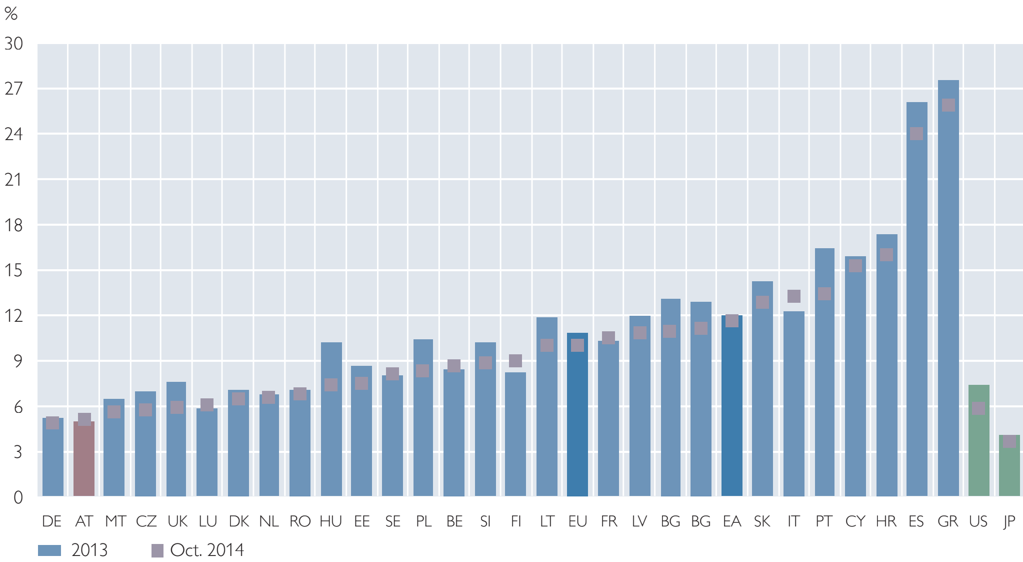
Austria Records the Second-Lowest Unemployment Rate in the EU

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 2012/13. Yet during 2014, employment growth deteriorated markedly. Both unemployment numbers and unemployment rates have been rising since mid-2011; in autumn 2014, Germany took the lead in the list of EU countries with the lowest unemployment rate. In general, the Austrian labor market has benefited 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).

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

Chart 4

Unemployment Rates



Source: Eurostat.

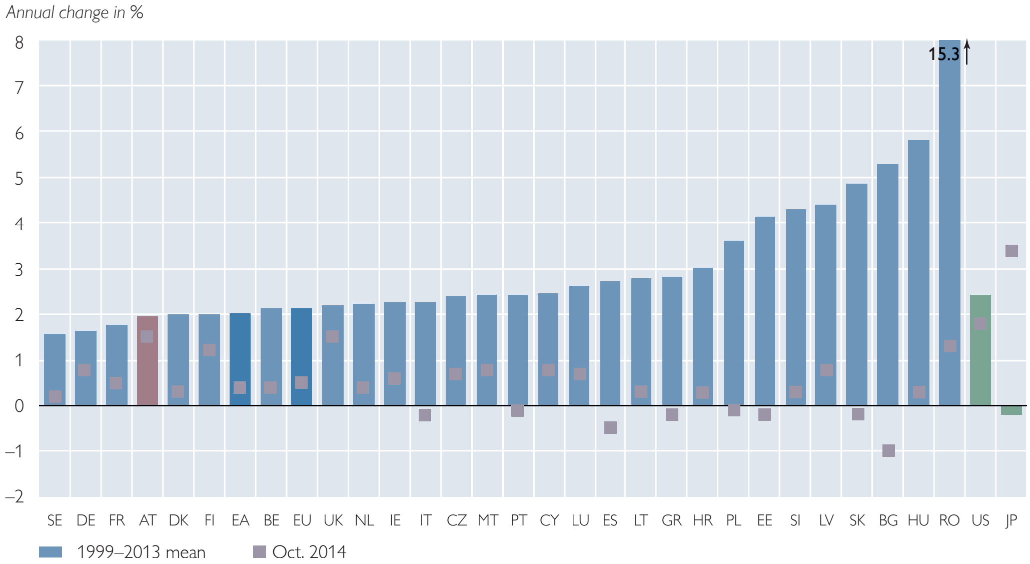
Note: GR, UK: August 2014; EE, LV, HU, JP: September 2014.

Inflation in Line with the Price Stability Target over the Medium Term

Austria looks back on a decade of stable price developments. In the decade preceding the introduction of the euro (1988 to 1998), the domestic inflation rate averaged 2.2%. From 1999, when the euro was introduced, up until October 2014, the average inflation rate was 1.93% in Austria, thus remaining slightly below the euro area inflation rate of 1.94%. Since September 2012, HICP inflation in Austria has exceeded euro area inflation. This reversal can be explained with domestic developments (related to the service sector) as well as with the downward correction in prices, and even negative inflation rates, in some euro area countries, which suppresses the inflation measure for the euro area as a whole.

Chart 5

HICP Inflation Rate



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

Note: The figures for the U.S.A. and Japan relate to the CPI and are from Sept. 2014.

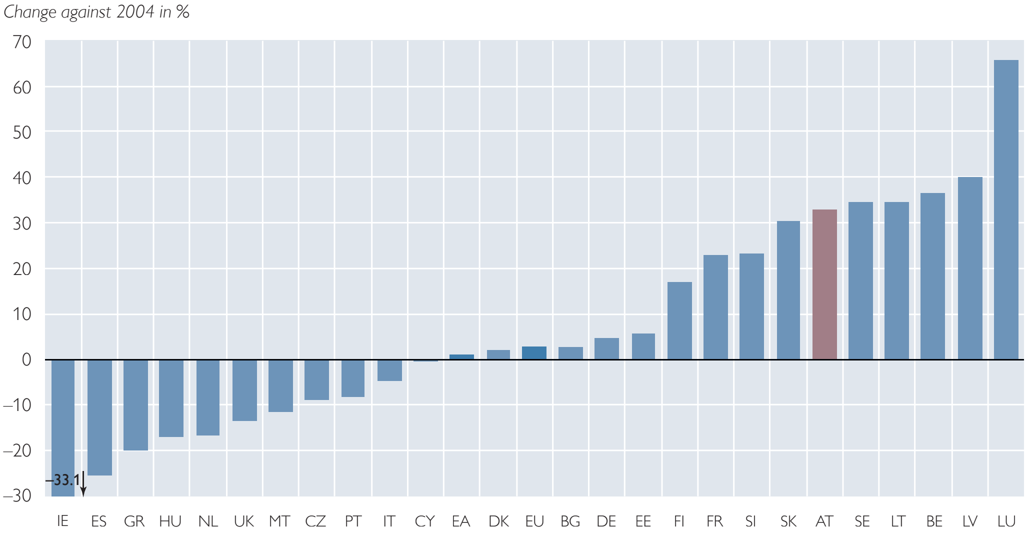
Austrian Real Estate Market: Price Increases but No Bubble

In the period from 2004 to 2013, real estate prices in Austria rose at a clearly stronger pace than prices in the euro area and the EU (comparable data at the EU level are only available from 2004 onward). However, unlike other EU countries (like Spain, Ireland and Cyprus) Austria did not experience the development and, ultimately, bursting of real estate price bubbles.

The OeNB closely monitors price developments on the housing market and launched a fundamentals indicator for residential property prices in January 2014.

Chart 6

Real House Prices in EU Member States, 2004–2013



Source: ECB.

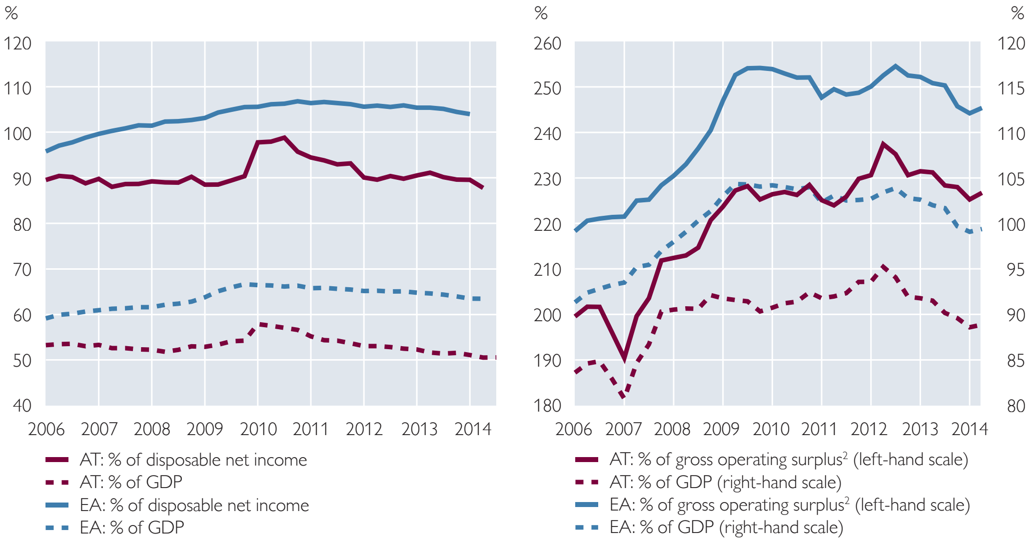
Note: HU 2004–2011; CZ, PL 2004–2012; CY 2006–2013; SK 2005–2013; no data for PL, RO.

Substantial Financial Assets, Household and Corporate Debt in Austria Lower than in the Euro Area

In 2013, households including nonprofit institutions serving households saved about 7.3% of their net disposable income. With total financial assets coming to

Chart 7

Household Debt / Corporate Debt[1]



Source: ECB, OeNB.

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

Note: EA = euro area.

some EUR 557.2 billion (173% of GDP) at the end of 2013, the household sector is a key supplier of capital to other sectors in Austria.

Austrian household debt is also below the respective euro area average: As a percentage of GDP, household debt totaled 50.6% in the second quarter of 2014, which is significantly below the euro area average of 63.5%. At 226.7% of the gross operating surplus or 88.9% of GDP, corporate debt in Austria in the second quarter of 2014 was also below the euro area average of 245.3% (relative to gross operating surplus) and 99.4% (relative to GDP).

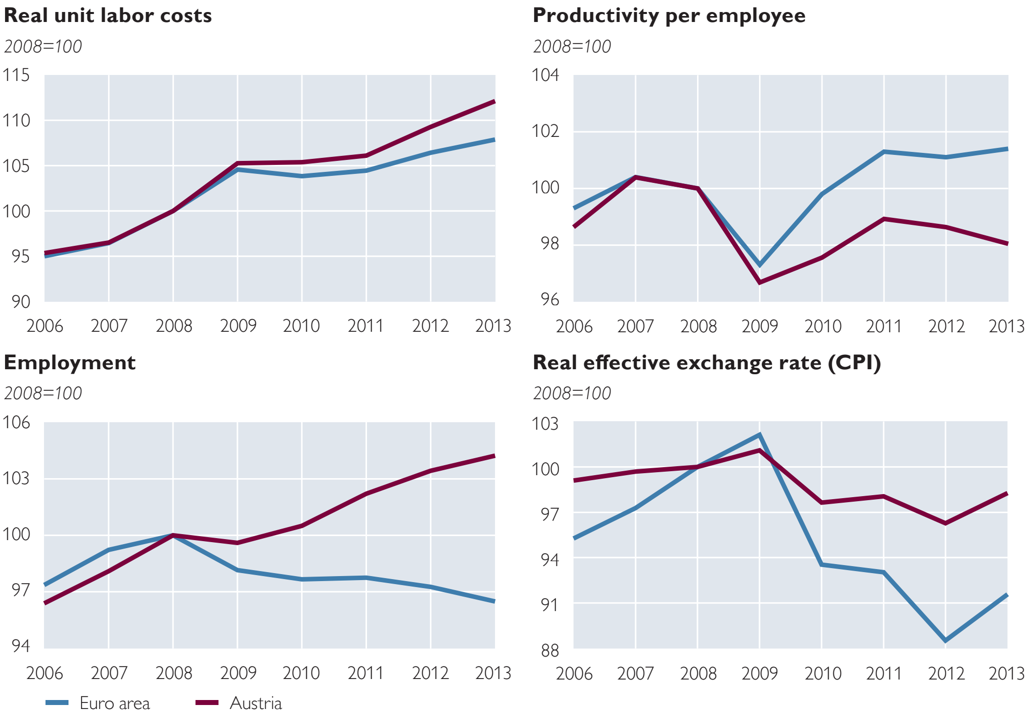
1.2 The Austrian Economy Is Highly Competitive

Favorable Development of Employment Dampened Development in Productivity

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, stronger GDP growth in 2011–12 and the later opening of the domestic labor market were causing headcount employment to increase at a visibly stronger pace in Austria than in the euro area, against the backdrop of weak output growth since 2012. 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

Chart 8

International Competitiveness



Source: Eurostat.

the euro area. 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 dampen Austria's competiveness position in the coming years.

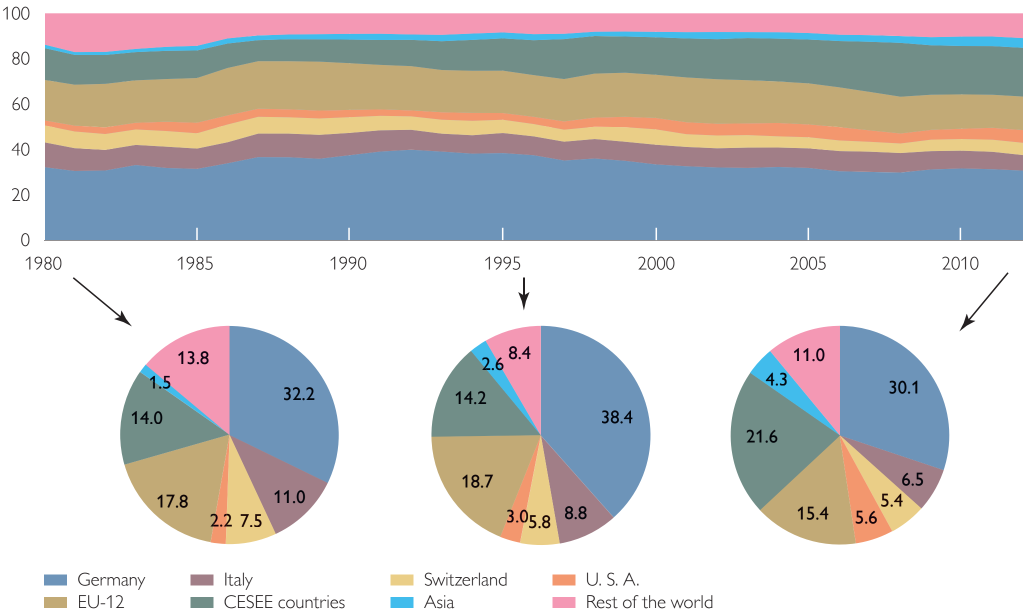
Austria's External Trade Is Regionally Diversified, Exposure to Foreign Exchange Risk Is Low

In 2013, about half of Austria's goods exports went to euro area countries, thus remaining unaffected by the euro's exchange rate changes. Among Austria's trade partners, Germany is still the most important partner by far, accounting for a share of around 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 2013. 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.

Chart 9

Regional Pattern of Austrian Goods Exports 1980–2013

% 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: BG, EE, LV, LT, PL, RO, SK, SI, CZ, HU, AL, BA, HR, ME, RS, BY, MD, RU, UA.

Box 1

Economic and Financial Ties with Russia and Effects of EU Restrictive Measures

In response to Russia's annexation of Crimea and deliberate destabilization of a neighboring sovereign country, the EU imposed restrictive measures against Russia in several steps in 2014. These sanctions include:

- *diplomatic measures against Russia*
- *restrictive measures against individual persons and entities*
- *restrictions for Crimea and Sevastopol*
- *economic sanctions such as:*
  - *financial restrictions with regard to the provision of credit to major state-owned Russian banks*
  - *trade embargo on arms and related materials*
  - *export embargo on dual use goods and technology for military use as well as certain energy-related equipment and technology*

Russia retaliated with a trade embargo against agricultural products from the EU. Austria, which has long-standing economic ties with Russia, is affected in various ways:

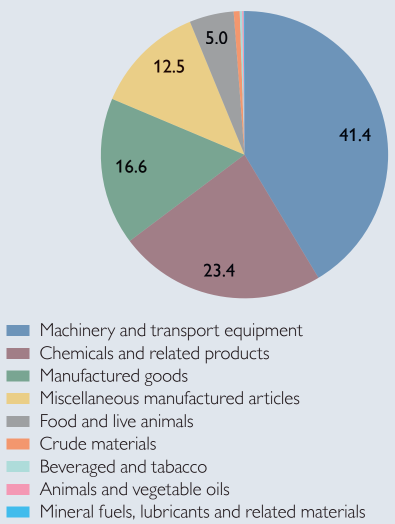
In 2013, Russia was Austria's 10th most important trading partner for goods, with a share of 2.8% in total goods exports (source: Statistics Austria) and its 11th most important trading partner for services exports, with a share of 2.3% in total services exports (source: balance of payments statistics). Exports of machinery and transport equipment accounted for more than 41%, and chemical products and other manufactured products for 52% of total goods exports from Austria to Russia. Summing up all potential export goods on the embargo list, the maximum loss is estimated to total EUR 478 million.

Austria is also affected by Russia's countersanctions: According to first estimates, the maximum loss caused by a one-year embargo against food products could amount to around EUR 50 million.

Sectoral Structure of Austrian Exports to Russia (2013)

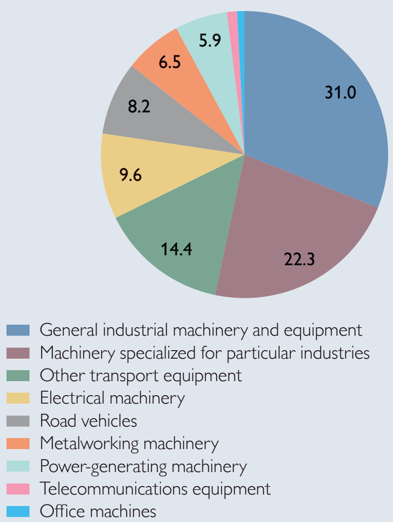
Sector shares (SITC 0-9)

%



Sector shares (SITC 7)
(machinery and transport equipment)

%



Source: Statistics Austria.

The macroeconomic effects of the economic sanctions against Russia and its countersanctions against EU countries are summarized in the table below. The trade effect on the Austrian GDP, with a loss of 0.1 percentage point vis-à-vis the baseline scenario, is clearly manageable. The simulation neither includes negative confidence effects that will affect consumption and investment behavior nor the effect of weakening export demand from Russia and the Ukraine on account of shrinking economies.

This analysis was completed before the oil price dropped markedly and the ruble depreciated significantly. The increase of the interest rate to 17% by the Russian central bank occurred after the cut-off date (December 5, 2014).

Macroeconomic Effects of EU Export Sanctions against Russia and Russian Countersanctions on the Austrian Economy

	EUR million	*% of total value added*
Total value added	–236	–0.08
	headcount	*% of total employment*
Employment	–2,742	–0.06

Source: OeNB calculations.

The latest intensification of the restrictive measures of September 2014 included a strengthening of restrictions on Russia's access to EU capital markets. EU nationals and companies may no longer provide loans to five major Russian state-owned banks. At the same time, trade in new bonds, equity or similar financial instruments with a maturity exceeding 30 days, issued by the same banks, has been prohibited. The same restrictions have been extended to three major Russian defense companies and three major energy companies. The prohibition also extends to the provision of services related to issuing such financial instruments, e.g. brokering services. EU subsidiaries of Russian state-owned banks are, however, not covered by the restrictions.

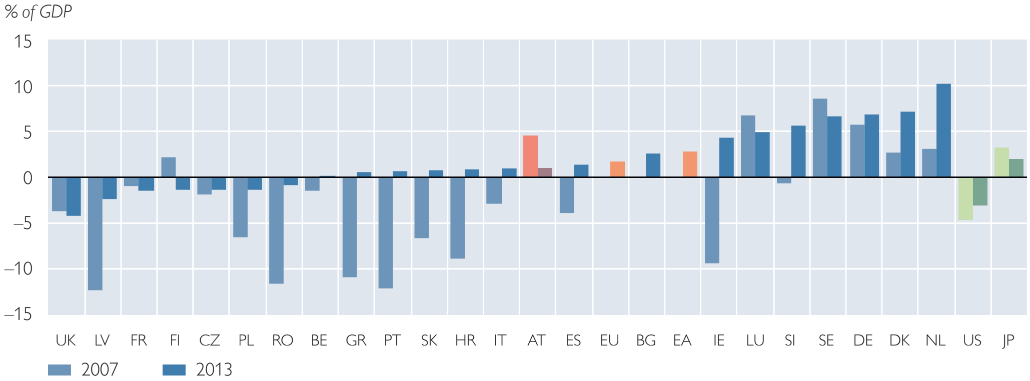
The financial ties between Austrian banks and Russia are much tighter than ties with Ukraine. Austrian banks' subsidiaries in Russia held total assets of EUR 36 billion at the end of June 2014, corresponding to 13% of Austrian CESEE subsidiaries' total assets. While the exposure to Russia has risen rather briskly since 2008, the exposure to Ukraine has declined significantly due to deleveraging processes and sales of subsidiaries.

In terms of total assets and profitability, Russia is one of the key markets for Austrian banks in CESEE. In the first half of 2014, profits generated by the Russian subsidiaries of Austria-based banks active in Russia have so far remained at a relatively high level. However, higher loan provisions as well as slower growth in lending are expected to put significant pressure on the profitability of Austrian subsidiaries in Russia. These risks to profitability must be considered in particular in light of the declining aggregated profitability of Austrian subsidiaries in CESEE and the increased concentration of their profits on a few countries – like the Czech Republic, Russia, Slovakia and Turkey. (For further information, see the section entitled "Austrian Banks' Operations Remain Committed to CESEE")

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 2013, Austria's current account showed a surplus of 1.0% of GDP, while the euro area recorded 2.8% and the EU 1.7% (both without SK). Austria is forecast to continue to post current account surpluses.

Chart 10

Current Account



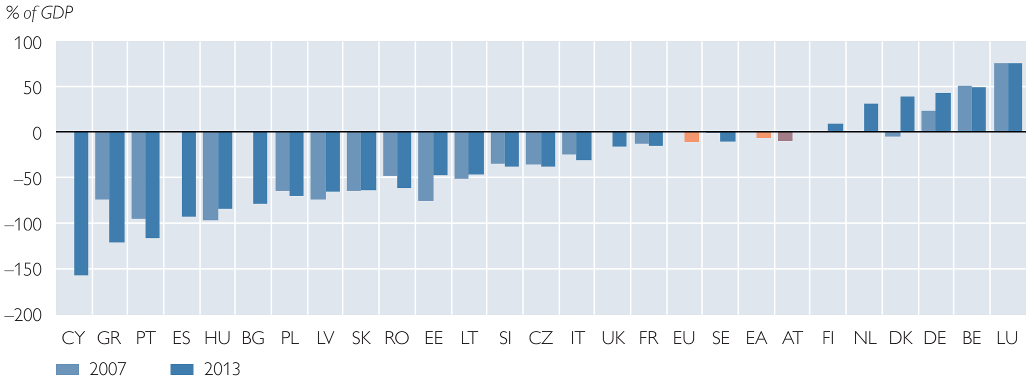
Source: Eurostat.

Note: SK, US and JP: BPM5, all others BPM6; EA and EU without SK; Data for GR, ES and SI: 2009 and 2013.

Reversal of Austria's Negative International Investment Position
Due to its sustained current account surplus, Austria came within close reach of a balanced international investment position (IIP) in recent years, reporting a net negative IIP of 0.2% of nominal GDP in 2013. This compares with a net negative IIP of 10.9% for the EU (without IE, MT and HR) and a net negative IIP of 6.4% for the euro area (without IE and MT) in 2013.

Chart 11

Net International Investment Position



Source: Eurostat, ECB (SDW).

Note: EA without MT and IE, EU without MT, IE and HR; LU: 2008: 173%, 2013: 216%.

1.3 Austria's General Government Deficit and Debt Ratios Are below the Euro Area Averages

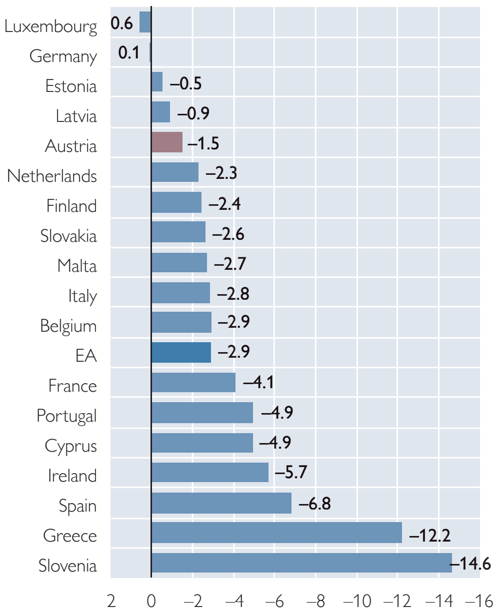
Like all other EU Member States, Austria recorded an increase in its general government deficit during the economic and financial crisis, but it was back on track to meet the Maastricht limit of 3% of GDP in 2011. On the back of somewhat declining capital transfers to nationalized banks and positive one-off receipts, the general government budget deficit came down to 1.5% of GDP in 2013, thus remaining below the Maastricht limit of 3%. Yet the reorganization of the nationalized Hypo Alpe Adria group will drive the Maastricht deficit back up to around 2.5% in 2014.

Chart 12

Budget Balances of EU Member States in 2013

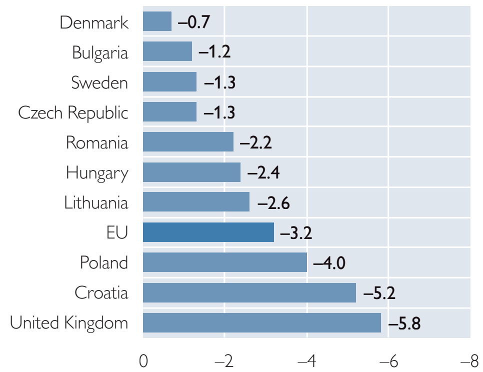
Euro area countries

% of GDP



Non-euro area countries

% of GDP



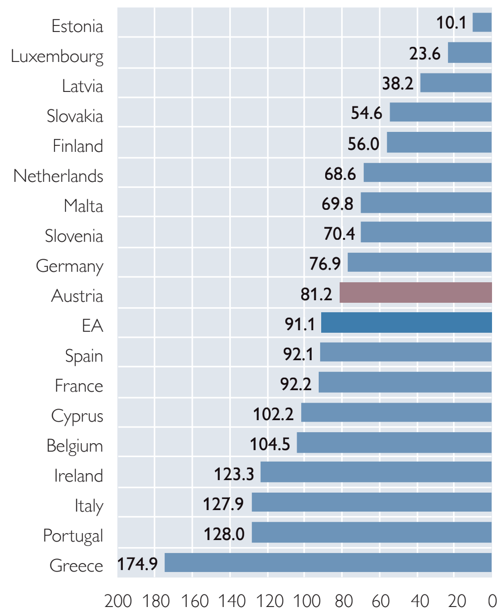
Source: Eurostat.

Chart 13

Public Debt of EU Member States in 2013

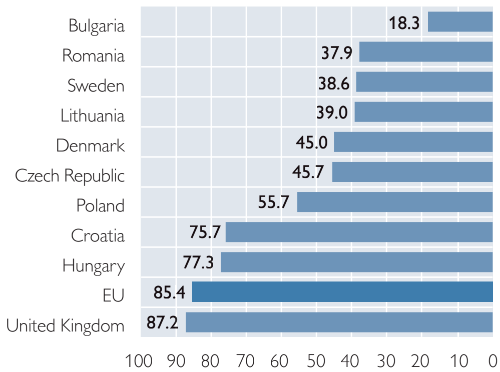
Euro area countries

% of GDP



Non-euro area countries

% of GDP



Source: Eurostat.

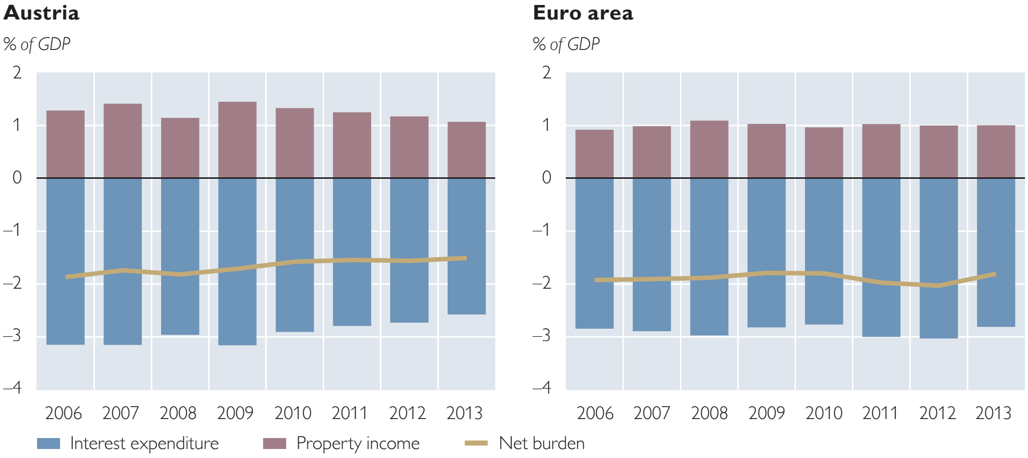
The ESA 2010 revision had a considerable impact on the development of the general government debt ratio. Based on ESA 2010 data, Austria recorded a general government debt ratio of 64.8% of GDP (ESA 1995: 60.2%) before the crisis, a crisis-related increase to 82.4% (ESA 1995: 72.5%) in 2010 and a decrease thereafter to 81.2% (ESA 1995: 74.5%) in 2013.

Comparatively Low Net Burden on the General Government Budget

Since 2011, gross government debt has increased in the euro area, while it stayed broadly stable in Austria. Thus, interest payable as a percentage of GDP is currently below the corresponding euro area average. At the same time, the investment income generated by Austria's sizeable public financial assets lies above the euro area average. These assets include loans extended to and equity invested in, for instance, the Austrian state holding company ÖIAG, energy providers and municipal utilities. By extension, property income (i.e. interest, profit distribution, withdrawal of earnings, lease income) lies above the euro area average.

Chart 14

Interest Expenditure and Property Income



Source: Statistics Austria, Eurostat.

Austria Is Compliant with Stability and Growth Pact (SGP) Rules on Headline Deficit and Debt, but Needs Further Adjustments to Comply with the Preventive Arm

After deficits above 3% of GDP in 2009 and 2010, Austria recorded deficits below 3% of GDP in 2011 to 2013 and is expected to do so in 2014 as well. 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 the debt criterion was enacted (end-2011), the 1/20 rule will only fully apply 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.

With the EDP having been abrogated, Austria is now subject to the rules of the preventive arm of the SGP. As Austria has a public debt ratio of above 60% of GDP and as it is – according to Commission estimates – in a "normal" cyclical position,

Table 1

EU Fiscal Governance Requirements

	Release	2010	2011	2012	2013	2014	2015	Source	Requirement
		% of GDP							
Budget balance	Dec 2014	–4.5	–2.6	–2.3	–1.5	–2.4	–1.8	Statistics Austria, OeNB	>= –3% of GDP
Public debt	Dec 2014	82.4	82.1	81.7	81.2	85.4	84.6	Statistics Austria, OeNB	from 2017: Reduction of difference to 60% of GDP by 1/20 per year on average
Structural balance	Dec 2014	–3.0	–2.5	–1.8	–1.3	–0.5	–0.7	EC, OeNB (from 2014)	Improvement by 0.6pp per year until MTO of –0.45% of GDP has been reached

Source: Statistics Austria, OeNB, European Commission.

it has to improve its structural balance by 0.6 percentage points per year until the medium-term objective of –0.45% of GDP has been reached. According to Commission estimates, Austria needs further adjustments to comply with this requirement.[2] 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

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	2.5[1]	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	4.5	No
Year-on-year percentage change in total financial sector liabilities, unconsolidated	16.5	–3.6	No

Source: Eurostat.

[1] *Estimated value.*

[2] *Note, however, that there can be only sanctions in the preventive arm of the SGP when the deviation from the required adjustment path is above 0.5% of GDP (over 1 year and/or cumulatively over 2 years).*

to detect and correct macroeconomic imbalances within the EU. Under this mechanism, countries are examined against a scoreboard of 11 economic 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; currently, it exceeds two indicative thresholds but the data do not imply imbalances that would require an in-depth review and recommendations by the European Commission.

Austria Is Performing as Well as AAA-Countries

Under the impact of the financial and economic crisis, the range of the top-rated economies (AAA ratings only) has shrunk to 12 countries (Standard & Poor's ratings on November 27, 2014). Austria has been performing very well compared with those 12 countries, as selected key macroeconomic indicators in the table below indicate (the table excludes the small countries Hong Kong, Singapore, Luxembourg and Liechtenstein; countries are ranked by 2013 GDP in U.S. dollars). All data are based on the IMF's World Economic Outlook of October 2014.

Table 3

Austria and "AAA Only" Countries in Comparison

	DE	UK	CA	AU	CH	SE	NO	AT	DK
	Real GDP growth, annual change in %								
2014	1.4	3.2	2.3	2.8	1.3	2.1	1.8	1.0	1.5
2019	1.3	2.4	2.0	3.0	1.8	2.4	2.1	1.3	2.0
	Consumer price index, annual change in %								
2014	0.9	1.6	1.9	2.7	0.1	0.1	2.0	1.7	0.6
2019	1.7	2.0	2.0	2.5	1.0	2.0	2.5	1.7	2.0
	Unemployment rate, in % of employees								
2014	5.3	6.3	7.0	6.2	3.4	8.0	3.7	5.0	6.9
2019	5.3	5.5	6.6	5.7	2.9	7.1	3.7	4.4	5.3
	Current account balance, in % of nominal GDP								
2014	6.2	–4.2	–2.7	–3.7	13.0	5.7	10.6	3.0	7.1
2019	5.0	–1.4	–2.0	–3.7	10.2	5.5	8.5	3.4	7.3
	Budget balance, in % of GDP								
2014	0.3	–5.3	–2.6	–3.3	0.5	–2.0	10.8	–3.0	–1.4
2019	0.4	–0.2	–0.8	0.2	0.9	1.5	6.9	–0.5	–0.8
	Government debt, in % of GDP								
2014	75.5	92.0	88.1	30.6	47.2	42.2	29.5	80.1	45.1
2019	60.5	84.9	83.1	26.2	38.9	30.4	29.5	71.8	45.6

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

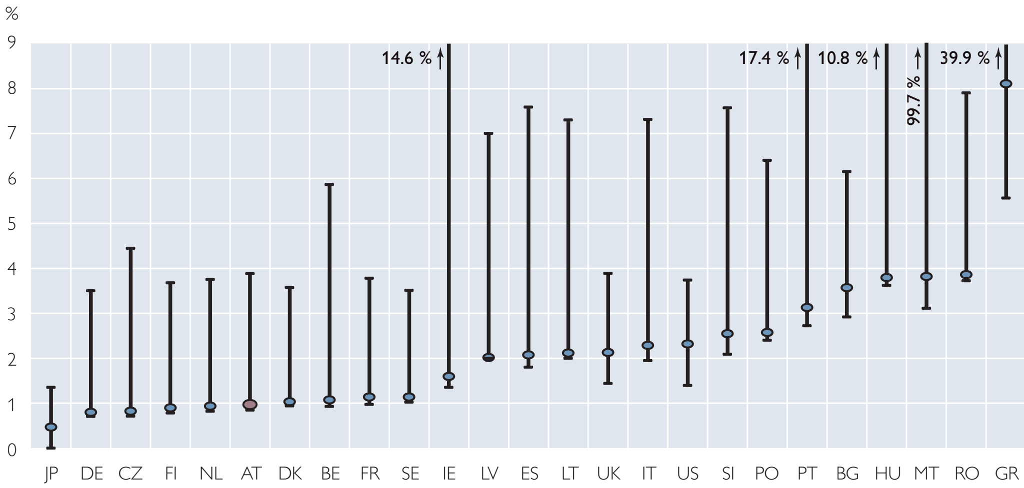
Comparing the continental European countries, the IMF expects similar GDP growth rates in 2014/15. Inflation in Austria is currently higher than in its European peers, whereas its unemployment rate is one of the lowest in this international comparison. With the exception of the United Kingdom, Canada and Australia, all countries with AAA ratings post current account surpluses – as does Austria, yet at a comparatively moderate level. Out of these AAA-countries only the United Kingdom posts a higher budget deficit than Austria, which is, however, among the countries with the highest debt ratios in this list, alongside the United Kingdom and Canada.

Austria's Creditworthiness Is High – Hence It Pays Low Interest Rates on Government Bonds

Notwithstanding a downgrading by Standard & Poor's, Austria has retained its AAA rating with Moody's and Fitch, and international investors continue to have high confidence in the Austrian economy. Among the euro area countries, Austria pays the fourth-lowest interest rates for government bonds (0.97% in November 2014) following Germany, Finland and the Netherlands. A comparison of the differentials between the maximum and minimum yields in the period from January 2011 to early-December 2014 (based on daily data) shows that Austrian government bond yields have remained broadly stable, exhibiting a comparatively low degree of volatility, in that period.

Chart 15

10-Year Government Bond Yields: Minimum and Maximum Values since Early 2011 and March 2014 Averages



Source: Thomson Reuters.

Note: Bars show minimum and maximum daily values from January 2011 to December 2014; data points indicate average daily values observed in November 2014.

2 The Austrian Banking System Operates in a Challenging Environment

2.1 Austrian Banks' Profitability is Still under Pressure – Capitalization and Liquidity Conditions Improve Further, However

Profitability Continued to Be Pressured in the First Half of 2014

European banks are still operating in an environment characterized by weak economic growth, low profitability, increased credit risk provisioning and low interest rates. The growth outlook for the euro area as well as for the CESEE region continues to be subject to downside risks mainly due to geopolitical tensions, which negatively influence economic growth prospects in CESEE.

These developments are also mirrored in the net result after tax of the Austrian banking system: In the first half of 2014, the consolidated net result after tax amounted to –EUR 0.59 billion, which corresponds to a decrease of EUR 1.7 billion compared to the first half of 2013. In addition to the continuing low interest rate environment, a planned sale of foreign subsidiaries of Hypo Alpe Adria group as well as high risk provisioning at another bank burdened consolidated profitability. Without considering Hypo Alpe Adria group, the consolidated net result of the Austrian banks would have amounted to EUR 1.08 billion. Against the backdrop of current developments and challenges in the economic surroundings, downside risks to the profitability of Austrian banks remain.

Table 4

Aggregated Profit and Loss Account of Austrian Banks

	2007	2008	2009	2010	2011	2012	2013	Q2 14
	EUR billion							
Net interest income	18.0	19.3	19.5	20.4	20.4	19.3	18.6	9.1
Fee and commission income	8.2	8.5	7.2	7.7	7.6	7.3	7.6	3.7
Trading income	0.9	–2.1	2.6	1.0	0.8	1.1	0.7	0.5
Operating profit	11.1	7.9	15.6	13.5	10.4	12.1	8.0	2.9
Net result after tax	6.8	0.6	1.5	4.6	0.7	3.0	–1.0	–0.6

Source: OeNB.

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

Capitalization Improves Further

Since 2008, the aggregated capitalization of Austrian banks has increased steadily, but it remains low in an international comparison. A further improvement in capitalization is necessary, given the current risk profile (e.g. high exposure of Austrian banks to CESEE, outstanding foreign currency loans, total banking sector assets to GDP), the generally challenging environment, higher market expectations with respect to capitalization as well as higher regulatory requirements. In addition, well capitalized banks are more attractive for investors, contributing to better funding conditions. In mid-2014, the banking system's overall solvency ratio stood at 15.6%, while the tier-1 capital ratio came to 11.9%.

On the other hand, Austrian banks have a more favorable leverage ratio than international peers. This is due to their more traditional business model, as Austrian banks have a higher share of loans relative to their total assets.

Table 5

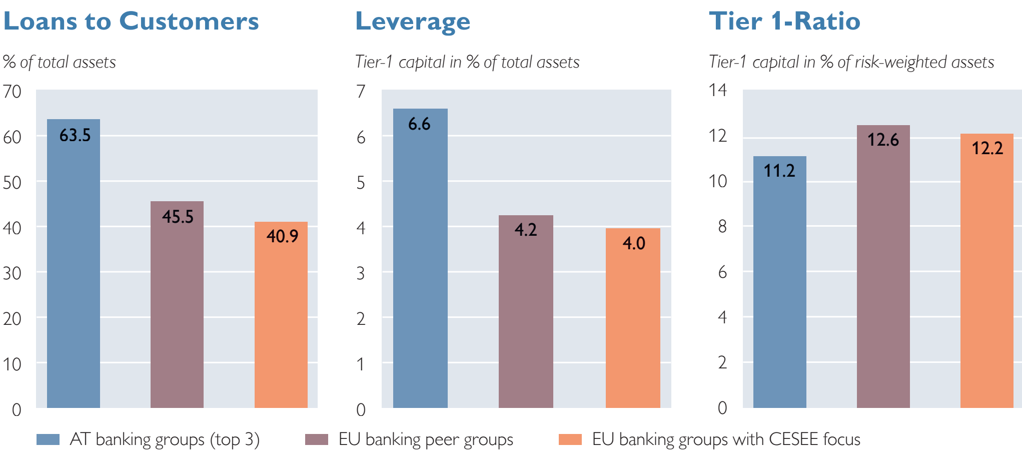
Capital Ratios of Austrian Banks on a Consolidated Basis

	2008	2009	2010	2011	2012	2013	Q2 14
	% 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	11.9
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. As from 2014 figures are calculated according to CRD IV requirements. Therefore comparability with previous figures is limited.

Chart 16



Source: OeNB, Bankscope.

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

Furthermore, the deposits of domestic nonbanks are an important funding source for Austrian banks, amounting to approximately EUR 360 billion (increase by 0.9% year on year) in mid-2014.

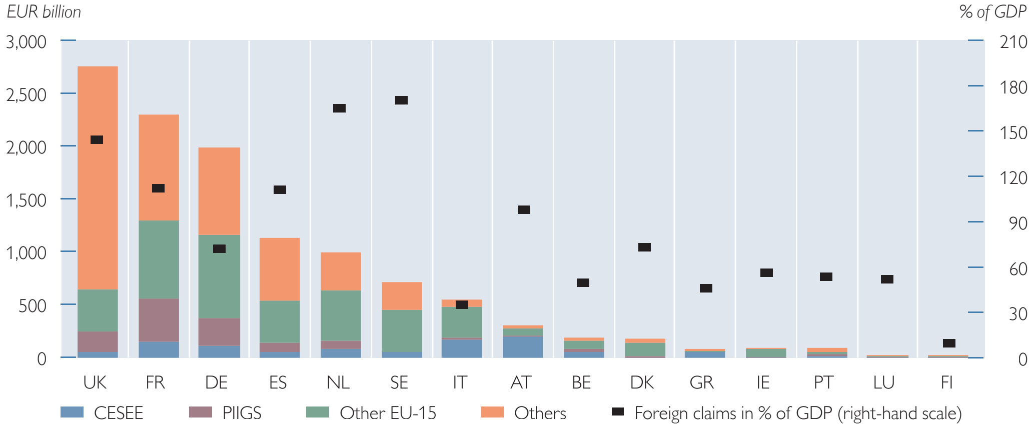
2.2 Austrian Banks' Operations Remain Committed to CESEE

Austrian Banks' Total International Exposure Is Relatively High

In mid-2014, Austrian banks' total international exposure (claims) amounted to approximately EUR 306 billion or nearly 100% of the Austrian GDP. This corresponds approximately with the level of the French and Spanish banking system and was lower than the level of the U.K., Sweden and the Netherlands.

Chart 17

Consolidated Foreign Claims of the EU-15 Banking System



Source: OeNB, BIS, ECB.

Note: The data refer to Q2 2014. PIIGS = Portugal, Ireland, Italy, Greece and Spain.

Exposure of Austrian Banks Is Concentrated on CESEE

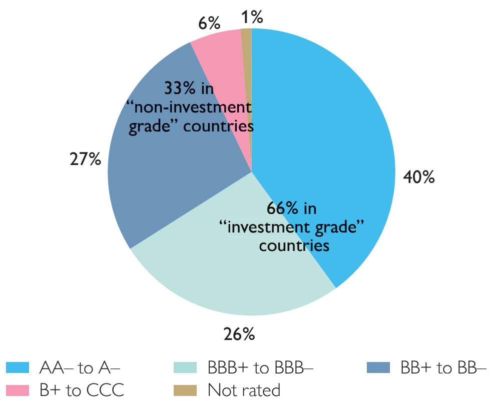
At the end of June 2014, the consolidated foreign claims[3] to the CESEE region of Austrian banks in majority domestic ownership amounted to EUR 198 billion. The integration of the Austrian banking sector with the region continues to be broadly based, and approximately 66% relates to countries that are rated investment grade.

The total assets of the CESEE subsidiaries of Austrian banks reached EUR 284 billion at the end of June 2014. Compared to the previous year, total assets reported a slight decline by –3% in the first half of 2014 due to reduced activities in some countries like Hungary and Ukraine.

Chart 18

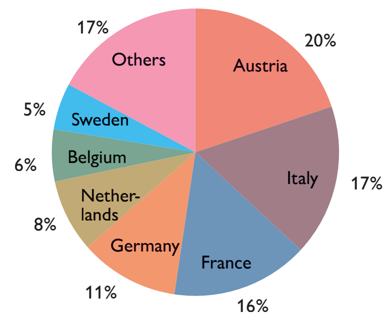
Austrian Banks' Exposure to CESEE pursuant to sovereign ratings

Q2 14



EU-15 Banks' Shares in Total Exposure to CESEE

Q2 14



Source: OeNB, BIS, S&P.

[3] *In this context, consolidated foreign claims or exposure is defined as the exposure of Austrian banks in majority domestic ownership to CESEE-based credit institutions and nonbanks.*

Table 6

Austrian Banks' Consolidated Foreign Claims (immediate borrower basis)[1]

As at June 30, 2014

Vis-à-vis	*EUR billion*
CESEE & CIS	**197.5**
Euro area	**33.0**
Estonia	0.1
Latvia	0.1
Slovakia	25.9
Slovenia	6.9
Other EU countries	**131.7**
Bulgaria	3.5
Lithuania	0.2
Poland	17.7
Romania	26.4
Czech Republic	45.5
Hungary	17.0
Croatia	21.4
Other non-EU countries	**29.4**
Azerbaijan	0.3
Bosnia and Herzegovina	3.9
Kazakhstan	0.2
Montenegro	0.9
FYR Macedonia	0.3
Serbia	4.8
Turkey	1.0
Ukraine	3.5
Russian Federation	14.6
Selected Western European countries	
Germany	30.4
France	8.1
Greece	0.1
United Kingdom	14.2
Ireland	1.0
Italy	9.4
Netherlands	6.5
Portugal	0.5
Sweden	1.3
Switzerland	5.1
Spain	3.4

Source: OeNB.

[1] *In majority domestic ownership.*

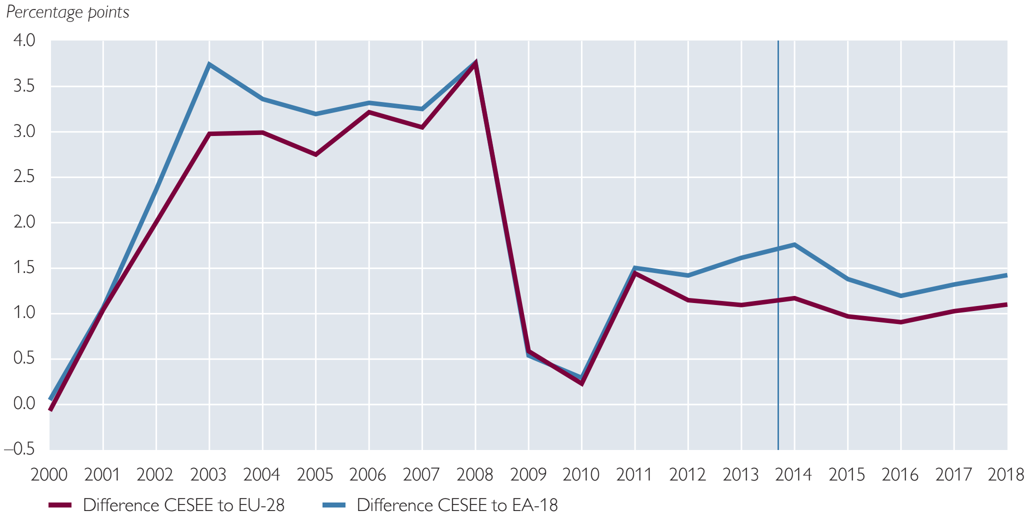
CESEE Is the Region with the Best Long-Term Growth Prospects in Europe

Many CESEE countries have gone through a remarkable economic catching-up process over the past two decades, but their macroeconomic indicators have not yet reached the levels seen in most of the euro area countries. These differentials imply a great potential for above-average growth, not only for the CESEE region, but also for the countries with which the region maintains close relations. Thanks to its geographical proximity and its traditionally strong ties with the region, Austria and its economy (including the banking sector) are in an excellent position to benefit particularly from this growth process.

Owing to the slump in growth in the CESEE region caused by the global financial crisis, the previously very large growth differential between the CESEE EU Member States and the euro area (the EU) dropped to a mere 0.5 (0.6) percentage points in 2009. Until 2013, the differential increased again, to 1.6 (1.1) percentage points. The IMF projected this growth differential to persist until 2019 in its World Economic Outlook of October 2014. Hence, the growth differential has contracted to half of the precrisis differential.

Chart 19

Growth Differential of CESEE EU Member States vis-à-vis the EU-28 and the Euro Area (EA-18)



Source: Eurostat, IMF.

Note: 2014–2019 IMF forecast (World Economic Outlook) of October 2014: Estonia, Latvia, Slovakia and Slovenia are included in the CESEE EU Member States aggregate as well as in the EA-18 aggregate and the EU-28 aggregate.

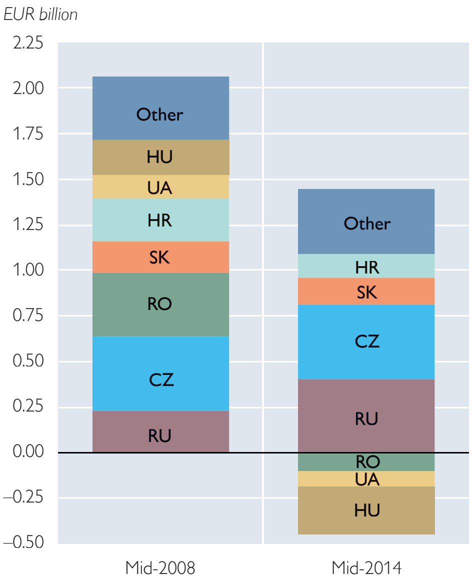
Profits from CESEE Operations Are Important for Overall Results

CESEE operations continue to be an important contributor to the profitability of Austrian banks, even though they also coincide with higher risks. The aggregated net profit after tax of Austrian subsidiaries in CESEE came to EUR 1.0 billion in 2014 H1, decreasing by 26% compared to the same period in the previous year, amounting to a return on assets of approximately 0.7% (down from 1.0%). The main drivers for this development were the activities of Austrian subsidiaries in Romania and Hungary. While in Romania the net profit after tax turned negative in 2014 H1 due to one-off effects, losses faced by Austrian subsidiaries in Hungary widened in a year-on-year comparison in the wake of a tough local operating environment.

In recent years, profits have increasingly concentrated on the Czech Republic, Slovakia, Russia and Turkey. This highlights the need for a cautious and sustainable growth strategy in the region. In particular, recent turmoil surrounding Russia and Ukraine has underlined the fragility of the earnings situation of Austrian banks in these

Chart 20

Distribution of Net Profits from Austrian Subsidiaries in CESEE



Source: OeNB.

markets. In the second half of 2014, profits stemming from Austrian subsidiaries in Russia were still substantial, but lower by 19%. Losses made by subsidiaries in Ukraine increased markedly.

Foreign Currency Loans in Austria and CESEE Declining

Foreign currency loans of domestic households and nonfinancial corporations have decreased by 43% since autumn 2008, which reflects the success of the initiatives of the Austrian supervisory authorities – most recently the revised minimum standards on risk management and new lending in foreign currency from early 2013. At the end of August 2014, foreign currency loans outstanding from Austrian banks to domestic nonbanks totaled EUR 39 billion, corresponding to a share of foreign currency loans of 12% (mainly in Swiss francs).

The foreign currency loan volume of Austrian banks' subsidiaries in CESEE amounted to EUR 78.9 billion in June 2014 (aggregate share of foreign currency loans in total loans: 42%) and was mainly denominated in euro. Foreign currency loans to nonfinancial corporations as well as to households registered a decrease of 6% year on year, taking into account exchange rate effects.

Strengthening the Sustainability of Large Austrian Banks' Business Models

In March 2012, the OeNB and the Financial Market Authority (FMA) provided supervisory guidance[4] with a view to strengthening the sustainability of the business models of large and internationally active Austrian banks, in order to ensure that they increase their capital buffers, rebalance the funding position of their exposed subsidiaries and prepare recovery and resolution plans for potential crisis situations.

These measures reflect the spirit of the Vienna Initiative[5] and promote a sustainable growth model underpinned by strengthened capitalization, while at the same time proactively preventing pronounced boom-bust cycles. They strengthen the retail business model of large Austrian banks. Monitoring results from the end of the first half of 2014 indicate that a large majority of subsidiaries have sustainable business models (on a year-on-year basis).

2.3 Enhanced Supervisory Framework Contributes to Financial Market Stability

Macroprudential Supervision, the Right Key Lesson from the Financial Crisis

The objective of macroprudential supervision is to contribute to the stability of the financial system as a whole, which requires strengthening the resilience of financial intermediaries and of the financial infrastructure, and limiting the buildup of systemic risks in the economy (e.g. house price bubbles). Ultimately, macroprudential

[4] *For further information see http://www.fma.gv.at/de/ueber-die-fma/presse/pressemitteilungen/pressemitteilungen-detail/article/nachhaltigkeitspaket-fuer-oesterreichs-banken-soll-finanzmarktstabilitaet-staerken.html*

[5] *The European Bank Coordination "Vienna Initiative" is a platform for cooperation and discussion of all the relevant public and private sector stakeholders of EU-based cross-border banks active in emerging Europe, such as home and host country supervisors, the European Commission, international financial institutions like the IMF, and banks. 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.*

supervision aims at safeguarding the sustainable contribution of the financial sector to economic growth.

On January 1, 2014, the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR) introduced EU-wide macroprudential supervision by offering a new set of instruments and an elaborate institutional framework to proactively address system-wide risks in the banking sector. In Austrian legislation, the macroprudential regulations of CRR and CRD IV were enacted in Articles 23 to 24a of the Austrian Banking Act. At this stage, macroprudential supervision mainly encompasses tools to address systemic risks in the banking sector. Systemic risks can be cyclical and structural in nature. Amongst the latter, macroprudential supervision is also concerned with fundamental incentive problems in the financial system (e.g. moral hazard).

The new supervisory activity involved a substantial extension of the OeNB's financial stability tasks: In addition to the ongoing analysis of financial market developments and the identification of systemic risks, the OeNB is now also charged with issuing recommendations and expert opinions on specific supervisory action. These findings are addressed to the Financial Stability Committee (FMSG), which was created in 2014 to implement macroprudential supervision and consists of representatives of the ministry of finance (two representatives incl. the chair), of the Fiscal Advisory Council (two representatives), of the FMA (one representative) and of the OeNB (one representative). The committee meets four times a year; the first meeting took place in September 2014. The FMSG is accountable to parliament and required to report on its activities on a yearly basis. The FMSG can initiate macroprudential measures by providing respective recommendations to the FMA, the designated authority to implement macroprudential measures.

The OeNB provides the secretariate for the FMSG and is in charge of preparing the meetings. As such, it is responsible for the prospective identification of systemic risks and the development of suitable measures; it supports the committee's work by compiling the underlying reports as well as providing expert opinions and recommendations. Finally, it is responsible for preparing the FMSG's external communication.

Box 2

Banking Union, a Milestone of European Integration

The banking union is the most significant step of economic and institutional integration in Europe since the launch of the euro: it creates the necessary prerequisites for a stable financial system that make crises less likely and enables supervisors to better identify emerging risks. Moreover, it reduces the fragmentation of financial markets in the euro area and weakens the link between sovereign and banking risk. These developments will benefit above all smaller countries with strong cross-border bank activities, like Austria.

*The banking union is founded on three pillars: A **Single Supervisory Mechanism (SSM)**[1] contributes to more effective supervision and better cross-border cooperation and coordination among the participating countries by pooling supervision of the most significant, i.e. systemically most important banks in the euro area (EU Member States outside the euro can opt in.). A **Single Resolution Mechanism (SRM)** enables the competent authorities to intervene earlier, and to restructure and wind down banks in difficulties. Further harmonization of national **Deposit Guarantee Schemes (DGS)** guarantees the same level of protection for savings to all depositors in the EU.*

The relevant legal frameworks are a single set of directly applicable prudential rules for banks based in the EU (Single Rulebook) and a harmonized approach to banking supervision and inspection among all Member States participating in the SSM (SSM Manual). The Single Rulebook essentially reflects the enhanced capital and liquidity adequacy requirements as well as the new rules for strengthening the capital structure of banks (Basel III and CRR/CRD IV). The SSM Manual is to ensure a uniform and coherent implementation of supervisory tasks and processes.

1. Single Supervisory Mechanism – SSM

Under the SSM, the European Central Bank (ECB) assumed full responsibility for the prudential supervision of all banks in the euro area on November 4, 2014, under a system of decentralized supervision that is based on a division of labor between the ECB and the national competent authorities (NCAs). The basis for the division of labor is the distinction between significant and less significant institutions, with significance being measured in terms of size, economic relevance and extent of cross-border activity.

Significant institutions are subject to direct supervision by the ECB. This means that they are supervised by joint supervisory teams consisting of staff members of the ECB and the national supervisory authorities (in Austria, the Austrian Financial Market Authority and the Oesterreichische Nationalbank). In Austria, 8 banking groups[2] are currently classified as significant, out of 120 in the euro area. Including UniCredit Bank Austria – which participates in the SSM as part of its Italian parent – almost 60% of total domestic consolidated banking assets are thus subject to direct supervision by the ECB (euro area: 83%).

The national supervisory authorities continue to be responsible for the less significant institutions, subject to overall supervision by the ECB, which ensures uniform standards and best practices. Given this decentralized design, both the Oesterreichische Nationalbank and the Austrian Financial Market Authority retain far-reaching responsibilities.

Planning and executing the supervisory tasks conferred to the ECB is the responsibility of the Supervisory Board that has been installed as the body managing the SSM. Decisions drafted by the Supervisory Board and submitted to the Governing Council of the ECB – which is the highest decision-making body of the SSM – will be deemed to be accepted when the latter does not object (non-objection procedure).

[1] *In line with Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.*

[2] *Promontoria Sacher Holding N.V. ("BAWAG"), Erste Group Bank AG, Österreichische Volksbanken AG, Raiffeisen-Holding Niederösterreich-Wien reg.Gen.m.b.H., Raiffeisenlandesbank Oberösterreich AG, Raiffeisen Zentralbank Österreich AG, Sberbank Europe AG, and VTB Bank (Austria) AG.*

Before the SSM became fully operational, all banks initially identified as significant were subject to a comprehensive assessment by the ECB with close involvement of the national supervisory authorities. This mandatory assessment, which was conducted from November 2013 to October 2014, comprised an asset quality review (AQR) based on year-end 2013 data and a stress test covering the years 2014 to 2016. The results of this assessment were published in late October 2014. Out of the 6 reviewed Austrian credit institution groups, 5 performed well in the assessment and have sufficient capital buffers even under the most severe stress scenario. For Österreichische Volksbanken-AG (ÖVAG), which is known to be in the midst of a fundamental restructuring process, the stress test confirmed the national supervisor's analyses and showed a capital shortfall of EUR 865 million for 2016 if no restructuring measures are taken. ÖVAG is, however, meeting the regulatory requirements at present.

The aim of this exercise was to achieve more transparency about banks' balance sheets and reinforce market confidence in the banking system. Any capital gaps identified in the AQR and in the baseline stress test scenario must be filled within six months after publication, and within nine months for shortfalls under the adverse stress scenario.

2. Single Resolution Mechanism – SRM

As a necessary counterpart to the SSM, the SRM provides a centralized European decision-making mechanism for the resolution of banks. The SRM, which applies only to Member States participating in the SSM, is based on two pillars: the harmonization of tools and rules through the Bank Recovery and Resolution Directive (BRRD),[3] and the definition of the institutional and funding architecture for applying those rules provided by the underlying regulation (SRM-R).[4] This framework creates the precondition for winding down insolvent banks without threatening the stability of the financial system. At the same time, it provides for coordinated and effective decision-making in the participating countries, thus ensuring more efficient action particularly in the case of cross-border banking failures than a network of national authorities.

Components of the Single Resolution Mechanism

Under the SRM, nonviable banks will be resolved by a central decision-making body, the Single Resolution Board (SRB). Funding to enable banks under reconstruction to continue operating will be provided through a Single Resolution Fund (SRF).

The SRB, which will be fully active by January 1, 2015, is composed of a full-time Chair, a Vice-Chair and four other full-time members, representatives of the Member States representing the national resolution authorities and two observers from the European Commission and the ECB, respectively. Further observers may be invited. One of the main tasks of the SRB and the national resolution authorities is to draw up resolution plans and to assess the resolvability of banks. In addition, the SRB will compile resolution schemes in the event of an actual liquidation.

The Single Resolution Fund will be financed through contributions from all credit institutions authorized to do business in the participating countries, with individual contributions varying with size and risk profiles. The target level has been defined at 1% of the amount of covered deposits of all credit institutions authorized in the respective country. This sum is to be built up within eight years, starting in 2016. Thus, the volume of the SRF is supposed to amount to EUR 55 billion by 2024.

The SRM Regulation was published in the Official Journal of the EU on July 30, 2014, and shall apply from January 1, 2016. This regulation is complemented by an intergovernmental agreement specifying the transfer and progressive mutualization of national contributions into a single resolution fund. The intergovernmental agreement was signed on May 21, 2014, and should also apply from January 1, 2016, provided that the national ratification processes are completed before December 1, 2015.

[3] *Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.*

[4] *Regulation (EU) No 806/2014 of the European Parliament and the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.*

Uniform Rules and Instruments for Recovery and Resolution

The Bank Recovery and Resolution Directive (BRRD) offers a harmonized legal framework for preventing banking failures, early intervention and resolution. Specifically, banks have to draw up ex ante recovery plans and define measures for responding to a deterioration of their financial situation. In turn, the resolution authorities have to draw up resolution plans for orderly resolution or restructuring measures. For effective intervention, they have moreover been endowed with a broad range of powers of intervention, enabling them to take timely action in response to a probable violation of the rules rather than acting retroactively in the event of a breach of the rules. Among other things, they have been given the power to enforce the allocation of more capital or restructuring measures at banks as defined in the latters' recovery plans.

Resolution will become applicable only if the set of prevention and early intervention measures turn out to be inefficient. In such case, the resolution authorities will have specific tools for winding down banks in an orderly manner, namely sale of business, bridge institutions, asset separation and bail-in. The bail-in tool is the heart of the system, ensuring that the owners and creditors of the bank will bear the losses in the first line. The bail-in tool becomes mandatory from January 1, 2016, but Member States are free to determine an earlier date.

The Member States had to implement this directive, which has already taken effect, in national law by December 31, 2014, in order to make the requirements applicable on a national basis from January 1, 2015. Particularly noteworthy innovations introduced by the corresponding Federal Law on the Reorganization and Liquidation of Banks, with which the BRRD was enacted in Austrian law, are the establishment of the resolution authority (Financial Market Authority), the establishment of a resolution financing mechanism and the introduction, already from January 1, 2015, of the bail-in tool.

3. Deposit Guarantee Scheme – DGS

The third pillar aims to harmonize national systems of deposit insurance and ensures that deposits will continue to be guaranteed up to EUR 100.000 per depositor and bank in all Member States. After years of negotiations the recast Deposit Guarantee Scheme Directive[5] was completed in spring 2014. This directive is to be enacted in national law by July 3, 2015.

Further key elements of this directive are the conversion of contributions from an ex-post funded to a mandatory ex-ante based funded system (0.8% of covered deposits) to be met within nine years, and the acceleration of pay-out of protected deposits from 20 to 7 days.

[5] *Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast).*

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	3.5	3.5	1.1	–3.2	1.9	3.3	0.7	0.3	0.4	0.7	1.6
Euro area	3.2	3.0	0.4	–4.5	2.0	1.8	–0.6	–0.4	0.8	1.0	1.5
EU	3.4	3.1	0.5	–4.4	2.1	1.7	–0.4	0.0	×	×	×

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	1.4	1.5
Euro area	2.2	2.1	3.3	0.3	1.6	2.7	2.5	1.4	0.5	0.7	1.3
EU	2.2	2.3	3.7	1.0	2.1	3.1	2.6	1.5	×	×	×

Unemployment Rates[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of labor force										
Austria	4.7	4.4	3.8	4.8	4.4	4.2	4.4	4.9	5.1	5.3	5.3
Euro area	8.3	7.5	7.6	9.6	10.1	10.1	11.3	11.9	11.6	11.2	10.9
EU	8.2	7.2	7.0	8.9	9.6	9.6	10.4	10.8	×	×	×

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	2.4	2.7	0.6	0.8
Euro area	×	×	–1.7	–0.3	–0.2	–0.2	1.4	2.0	2.1	2.2	2.4
EU	–0.3	–0.5	–1.3	–0.1	0.0	0.2	1.0	1.4	×	×	×

Budget Balances[1]

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	% of GDP										
Austria	–2.5	–1.3	–1.5	–5.3	–4.5	–2.6	–2.3	–1.5	–2.4	–1.8	–1.4
Euro area	×	–0.6	–2.1	–6.2	–6.1	–4.1	–3.6	–2.9	–2.6	–2.5	–2.2
EU	×	×	×	×	–6.4	–4.5	–4.2	–3.2	×	×	×

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	81.7	81.2	85.4	84.6	82.9
Euro area	×	64.9	68.5	78.3	83.6	85.4	88.7	90.6	91.8	91.8	91.9
EU	×	×	×	×	78.2	80.8	83.5	85.4	×	×	×

Source: Eurostat, OeNB, ECB.

[1] *The data for 2014 to 2015 are based on Eurosystem forecasts of December 2014.*

Table 2

General Government Interest Payments[1]

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	% of GDP									
Austria	3.0	3.2	3.1	3.1	3.0	3.2	2.9	2.8	2.7	2.6

Source: Statistics Austria.

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

Table 3

Household Debt

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	% of disposable net income									
Austria	×	×	88.8	88.6	90.2	90.4	95.7	93.2	89.8	89.6
	% of GDP									
Austria	×	×	53.1	52.4	53.0	54.3	56.6	53.7	52.5	51.6
Euro area	×	×	60.7	61.6	62.8	66.7	66.3	65.5	65.1	64.0

Source: ECB, OeNB.

Table 4

Corporate Debt[1]

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
	% of gross operating surplus[2]									
Austria	×	×	196.1	211.9	220.7	225.2	228.5	229.8	230.6	228.0
Euro area	×	×	221.4	228.4	240.5	254.1	252.1	248.7	252.5	245.7
	% of GDP									
Austria	×	×	82.9	90.3	92.1	90.3	92.4	93.6	91.9	89.6
Euro area	×	×	93.2	97.0	101.3	104.0	104.0	102.6	102.8	99.7

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

	2009	2010	2011	2012	2013	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14
	Index 2000=100									
Austria excluding Vienna	114.8	121.1	124.0	137.4	141.1	142.8	140.1	143.3	147.3	146.5
Vienna	133.5	143.9	156.1	180.7	196.3	197.8	202.3	204.6	207.3	202.2
	Annual change in %									
Austria excluding Vienna	2.9	5.5	2.3	10.8	2.7	3.9	1.6	2.2	4.3	2.6
Vienna	6.4	7.8	8.5	15.7	8.7	6.1	9.1	8.1	5.8	2.2

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

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