



OESTERREICHISCHE NATIONALBANK

Stability and Security.

ANNUAL REPORT 2005



E U R O S Y S T E M



Time Line

OeNB/Austria		ESCB/Euro Area/EU
	2005	
OeNB information campaign is stepped up: "I work hard for my money. Good that every euro is worth it.", page 67	JANUARY	
	FEBRUARY	
	MARCH	Reform of the Stability and Growth Pact, page 35
	APRIL	
First presentation of the Klaus Liebscher Award at the 33 rd Economics Conference of the OeNB, page 33	MAY	ECB publishes the revised General documentation on Eurosystem monetary policy instruments and procedures, page 40
OeNB takes stock: 10 Years of Austrian EU Membership, page 38		Cyprus, Latvia and Malta join ERM II, page 33
OeNB euro bus takes its longest tour so far (until August), stopping in 89 towns and communities throughout Austria, page 65	JUNE	
IMF publishes the results of its review of Austria's economy, page 30	JULY	Lisbon agenda of the EU refocused on growth and employment, page 36
Deadline for exchanging the ATS 1,000 banknote featuring Bertha von Suttner expires, page 66	AUGUST	
	SEPTEMBER	
	OCTOBER	European Parliament adopts Basel II capital adequacy framework, page 47
OeNB organizes the Conference on European Economic Integration in cooperation with the ECB and the Center for Financial Studies, page 70	NOVEMBER	Slovakia joins ERM II, page 33
		National reform programs submitted under the new Lisbon strategy, page 37
Uniform online statistics covering selected indicators introduced in all euro area countries, page 53	DECEMBER	Governing Council of the ECB increases key interest rates for the first time since October 2000, lifting rates by 25 basis points across the board (e.g. the minimum bid rate on main refinancing operations is raised to 2.25%), page 23
OeNB issues new school information kit, page 69		ECB launches information kit for schools, page 69
		Allotment amount for longer-term refinancing operations is increased from EUR 30 billion to EUR 40 billion, page 40
		European Commission adopts a proposal for a directive on a new legal framework for payments, page 56
	2006	
New OeNB reporting system for cross-border statistics enters into force, page 55	JANUARY	Austria takes over EU Presidency on January 1, 2006; euro area enlargement is a top priority, page 38
	FEBRUARY	
	MARCH	Governing Council of the ECB increases key interest rates by 25 basis points across the board (e.g. the minimum bid rate on main refinancing operations is raised to 2.50%), page 23
	APRIL	

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Editorial close: April 27, 2006



THE DECISION-MAKING BODIES OF THE OENB

General Council, State Commissioner



President's Report

In the seventh year since the beginning of Stage Three of Economic and Monetary Union (EMU), economic developments in the euro area were characterized by moderate growth dynamics and increasing confidence on the part of businesses and households. The higher, but historically still very low, level of interest rates on the financial markets and the ongoing appreciation of the U.S. dollar against the euro improved the operational environment for the central banks of the Eurosystem.

In the reporting year, the Oesterreichische Nationalbank (OeNB) achieved profits which were higher than in 2004 and remained close to the long-term average. It has to be noted, however, that the above-average profits registered after the foundation of EMU have seriously limited future profit potential. It should also be called to mind that the OeNB is obliged to hold sufficient reserves to perform its tasks and to make adequate risk provisions – an obligation all national central banks within the European System of Central Banks (ESCB) have to fulfill to ensure Eurosystem credibility.

In 2005 the OeNB was once more actively involved in many different ESCB activities, most importantly joint efforts to address the challenges arising from EU enlargement. The year 2005 also saw great achievements in all of the OeNB's business areas: The OeNB further optimized its investment strategy and managed to successfully implement this revised strategy, although the overall investment environment remained challenging. Moreover, the OeNB con-

tributed significantly to the promotion of financial stability and the preparations for the Single Euro Payments Area (SEPA). In fulfilling its monetary policy tasks and ensuring the security of payment means, the OeNB once more put special emphasis on its communication with the Austrian public.

To be able to focus on its core competences, the OeNB decided to restructure its corporate holdings and sold its shares in Austrian Payment Systems Services (APSS) GmbH and A-Trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH (a provider of certification for electronic signatures). In this context, it should be emphasized that the OeNB's efforts to further enhance Austria's role as a financial center have significantly contributed to the development of an infrastructure for the use of digital signatures and smooth payment processing.

As the OeNB and its associated companies are committed to efficiency and cost awareness, operating processes were further optimized in 2005, building on corporate synergies. The allocation of resources was guided by the principle of efficiency, and the OeNB continued to cut costs in many areas. The consistently high degree of trust the OeNB enjoys as an institution proves that people acknowledge the OeNB's achievements, which provides a solid basis for the OeNB to continue its successful work within the Eurosystem.

President
Herbert Schimetschek

General Council (Generalrat), State Commissioner; on December 31, 2005

Herbert Schimetschek

President

*Chairman of the Board of Austria
Versicherungsverein auf Gegenseitigkeit*

Manfred Frey

Vice President

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

August Astl

*Secretary General of the
Austrian Chamber of Agriculture*

Bernhard Felderer

*Director of the Institute
for Advanced Studies (IHS)*

Philip Göth

*Certified public accountant/tax consultant
Partner of Deloitte Austria*

Elisabeth Gürtler-Mauthner

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

Manfred Hofmann

*Director
Head of the Austrian Federal Economic
Chamber's Department of Finance
and Accounting
CEO of Wirtschaftskammern
Pensionskasse AG
Director of the Austrian Federal Economic
Chamber's pension fund*

Herbert Kofler

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

Georg Kovarik

*Head of the Economics Division
of the Austrian Trade Union Federation*

Johann Marihart

*Chief Executive Director
of Agrana Beteiligungs-AG*

Werner Muhm

*Chief of the Chamber
of Labor of Vienna*

Gerhard Randa

*Executive Vice President
Magna International Inc.*

Walter Rothensteiner

*Chief Executive Director
of Raiffeisen Zentralbank Österreich AG*

Johann Zwettler

*Chief Executive Director
of BAWAG P.S.K.
Bank für Arbeit und Wirtschaft und
Österreichische Postsparkasse AG*

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

Thomas Reindl

Staff Council Chair

Martina Gerharter

Staff Council Deputy Chair

State Commissioner

Thomas Wieser
*Director General at the Federal
Ministry of Finance*

Deputy State Commissioner

Heinz Handler
*Austrian Institute
of Economic Research (WIFO)*



The General Council (Generalrat) from left to right:

A. Astl, H. Handler, W. Muhm, J. Zwettler, E. Gürtler-Mauthner, H. Schimetschek,
B. Felderer, M. Frey, M. Hofmann, W. Rothensteiner, G. Kovarik, H. Kofler

Not in this picture: P. Göth, J. Marihart, G. Randa, T. Wieser



Staff Council:
T. Reindl



M. Gerharter

Personnel Changes

between April 14, 2005, and April 27, 2006

General Council member **Christian Domany** resigned his seat on the General Council at the ordinary General Meeting of May 24, 2005. His successor is **Manfred Hofmann**, head of the Austrian Federal Economic Chamber's Department of Finance and Accounting. **Walter Rothensteiner**, whose term of office ended on the day of the General Meeting, was reappointed to the General Council.

With effect from April 1, 2006, **Alfred Lejsek**, head of the Financial Markets Directorate at the Federal Ministry of Finance, replaced **Heinz Handler** as Deputy State Commissioner.

Governing Board

Governor's Report

Global growth remained robust in 2005 and reached nearly 5% although oil prices continued to surge. At 1.3%, real growth in the euro area was comparatively low; in the second half of 2005, however, the euro area economy gathered steam.

Owing primarily to high energy and commodity prices, the annual inflation rate in the euro area remained elevated in 2005 (2.2%). In the course of the year, the signs for growing inflation risks increased, which is why an adjustment of the Eurosystem's monetary policy stance was called for. Thus, after having kept interest rates unchanged at a historically low level for two and a half years, the Governing Council of the European Central Bank (ECB) decided to raise the key ECB interest rates by 25 basis points on December 1, 2005, and then again on March 2, 2006. These steps ensure that inflation expectations – and consequently nominal interest rates and inflation itself – remain firmly anchored at a low level. Monetary policy thus safeguards the purchasing power of the euro and facilitates investment – both prerequisites for sustainable economic and employment growth.

To ensure the euro's long-term stability and its positive effect on growth and employment, the euro area needs sustainable, sound budget policies and further structural reforms targeted at facilitating adjustment processes and stimulating economic activity. The increased leeway granted by the reform of the Stability and Growth Pact in spring 2005 must not be abused for putting off necessary fiscal consolidation, but rather needs to be used for implementing sustainable reforms (e.g. of pension

systems) and for improving the structure of public finances with the aim of promoting long-term growth. The relaunched Lisbon strategy has to be implemented swiftly: the national reform programs should strengthen Member States' commitment to implementing reforms and promote benchmarking among the most successful growth-enhancing reforms. The completion of the single market (including services), would unleash significant growth and employment potential.

Austria's economic policy in 2005 was marked by continued reforms, coupled with growth-enhancing macroeconomic policies. At 1.9%, real economic growth in Austria was again 0.6 percentage point above the average euro area level in 2005; from the fourth quarter of 2005, growth began to quicken. These developments were favored by the reinforced economic ties with the new EU Member States – not least in the banking sector.

The government's tax reforms as well as its conjunctural, employment and growth packages increased the budget deficit to 1.5% of GDP (according to the Maastricht definition); the Austrian government should not lose sight of its explicit aim of achieving a balanced budget and a debt ratio below 60% by 2008 and reducing the tax burden to below 40% of GDP by 2010.

After recovering from the momentary shock caused by the negative outcome of the referendums held in France and the Netherlands on the ratification of the Constitutional Treaty, the European Union continued to pursue its integration course. April 2005 saw the signing of the EU



accession treaty for both Bulgaria and Romania, which are scheduled to join the EU in 2007, and in fall 2005 the EU decided to open accession negotiations with Croatia and Turkey. Four EU Member States joined the exchange rate mechanism II (ERM II) in 2005; the seven new EU Member States that currently participate in ERM II can introduce the euro as soon as they demonstrate sustainable compliance with all convergence criteria. On January 1, 2006, Austria took over the rotating presidency of the EU; within its competence, the Oesterreichische Nationalbank (OeNB) is assisting the Austrian government in fulfilling the responsibilities arising from the Council Presidency.

Globalization, European integration and the euro continue to offer

many opportunities. By ensuring stable monetary conditions and offering customer-oriented services, the OeNB strives to make the most of these opportunities and related challenges for Austria and the Eurosystem. Its activities are marked by a continued increase in efficiency, lean staff management and a high level of cost consciousness. In the interest of Austria's economy and citizens, the OeNB will nevertheless continue to further optimize its service portfolio by ensuring the highest-possible qualification level of its staff, promoting innovation and providing a well-functioning technical infrastructure.

Governor
Klaus Liebscher





*The Governing Board (Direktorium) from left to right:
P. Zöllner, K. Liebscher, W. Duchatzek, J. Christl*

Governing Board (Direktorium); on December 31, 2005

Klaus Liebscher
Governor

Wolfgang Duchatzek
Deputy Governor

Peter Zöllner
Executive Director

Josef Christl
Executive Director

See also www.oenb.at for additional information about the Governing Board of the OeNB.



THE YEAR 2005 AT A GLANCE

Economic and Financial Developments

Global Economy Still Going Strong

At nearly 5%, global growth in 2005 remained robust despite the impact of surging oil prices. The United States, Asia (in particular the highly dynamic economies of China and India) as well as the Central, Eastern and Southeastern European countries recorded growth rates around or considerably above 3%, and Japan's economy continued to recover.

Sluggish Growth in the Euro Area – Inflation at 2.2% – Interest Rates Raised Twice by 25 Basis Points

In the EU, real GDP growth was subdued in 2005 (+1.6%), especially in the euro area, where it only reached 1.3%. The rise in energy prices went hand in hand with an increase of inflation to 2.2%. As M3 growth was also strong, the Eurosystem slightly tightened its monetary policy stance to address risks to price stability: In December 2005 and then again in early March 2006, the Governing Council of the ECB raised the key interest rates by 25 basis points. The minimum bid rate on the main refinancing operations has stood at 2.50% since then.

Austria's Economy Expands by Nearly 2% – Inflation Slightly Above 2%

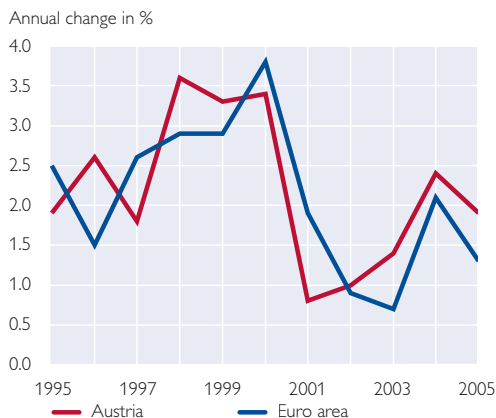
Austria's real GDP grew by 1.9% in 2005, mainly fueled by strengthened exports and the dynamic development of the industrial sector. The financial services sector expanded vigorously as well. Factors which favored economic growth were competitive labor costs, strong economic ties with Central, Eastern and Southeastern European markets and targeted economic policy measures. The average inflation rate in 2005 was 2.1%; toward the end of the year, however, inflation dropped considerably. In both January and February 2006, inflation stood at 1.5%; in March it fell to 1.3%. The labor market was characterized by increasing employment and labor supply, rising unemployment and more job vacancies. Owing to the government's growth and employment packages and the second stage of the tax reform, Austria's budget deficit widened somewhat to 1.5% of GDP in 2005, remaining still well below the euro area average of 2.4%, though.

High Profitability in the Financial Sector

2005 was a successful year for Austria's financial sector, i.e. banks and other financial intermediaries. In the banking sector, business at home and especially subsidiaries in Central, Eastern and Southeastern Europe developed favorably. At 11%, the increase in unconsolidated total assets reached a level last recorded in the boom year of 2000. Austrian banks posted annual profits totaling EUR 4 billion, to which Eastern European subsidiaries contributed about one-third. The increase in foreign currency loans in Austria makes it increasingly important for the OeNB and the Financial Market Authority to provide the public with in-depth information on related risks.

Chart 1

Real GDP



Source: Statistics Austria, Eurostat.

Chart 2

HICP Inflation

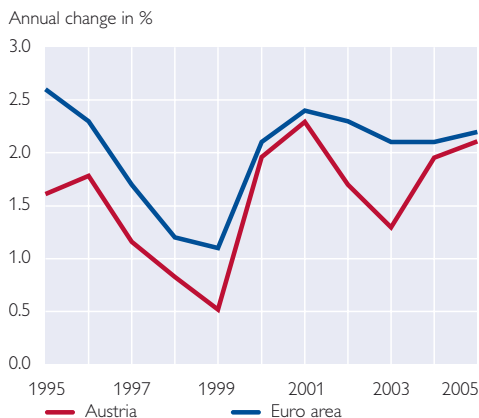
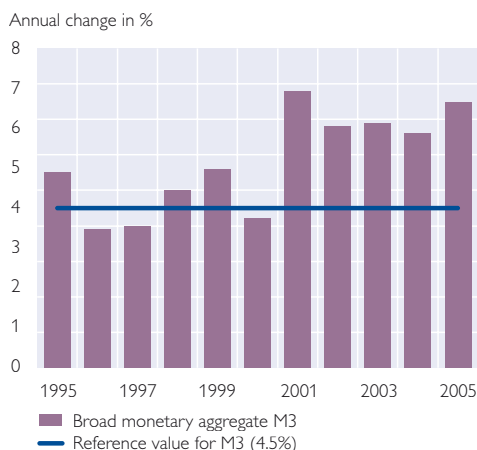


Chart 3

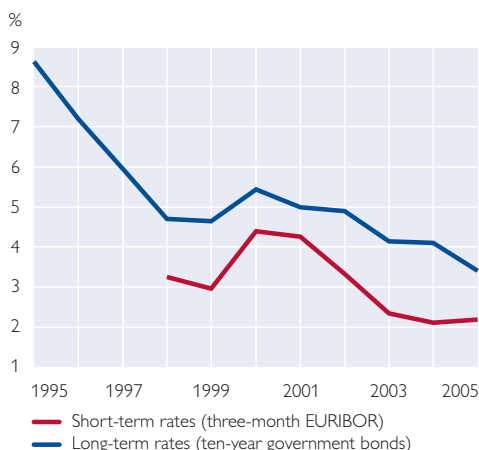
Monetary Aggregate M3 in the Euro Area



Source: ECB.

Chart 4

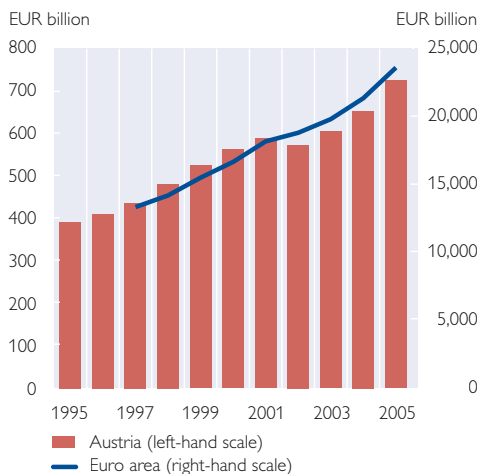
Euro Area Interest Rates



Source: Thomson Financial.

Chart 5

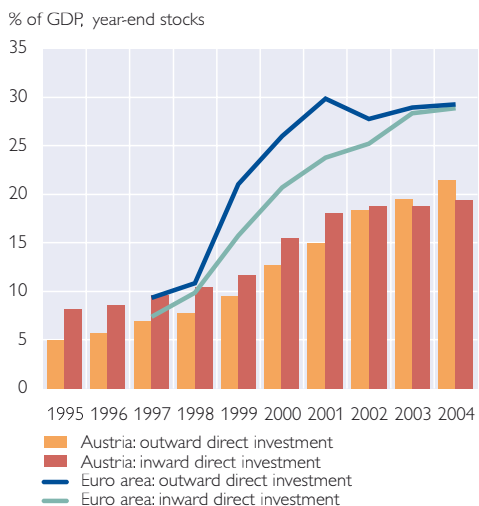
Bank's Total Assets



Source: OeNB, ECB.

Chart 6

Direct Investment



Source: OeNB, Eurostat.

The Year 2005 for the OeNB

Higher Operating Profit

The OeNB's financial statements for 2005 report an operating profit of EUR 488 million, up by 8.3% (or EUR 37 million) from 2004. The central government's share in this profit came to EUR 451 million (2004: EUR 421 million), composed of EUR 122 million of corporate income tax and a 90% profit share of EUR 329 million after taxes. The OeNB's profit for the year 2005 of EUR 37 million will be appropriated according to the General Meeting's decision.

Net Income Reaches More than EUR 700 Million

Net income in 2005 amounted to EUR 731 million (2004: EUR 662 million), breaking down into net interest income of EUR 451 million (2004: EUR 449 million), the net result of financial operations, writedowns and risk provisions in the amount of EUR 182 million (2004: EUR 215 million) and income from equity and participating interests equaling EUR 68 million (2004: EUR 21 million). Total expenses in 2005 were EUR 243 million (2004: EUR 212 million). Of these, EUR 105 million (2004: EUR 98 million) were attributable to staff cost, EUR 85 million (2004: EUR 90 million) to administrative expenses and EUR 16 million (2004: EUR 7 million) to the cost of banknote production services.

Net Currency Position Rises to EUR 12.2 Billion

The OeNB's net currency position includes on- and off-balance sheet assets and liabilities denominated in foreign currency. The OeNB's total net currency position as at December 31, 2005, was EUR 12.2 billion, of which EUR 4.2 billion were gold holdings and EUR 8.0 billion foreign currency holdings. The increase by EUR 1.4 billion from December 31, 2004, is mainly attributable to valuation gains, particularly on gold holdings.

Four Million Large-Value Payment Transactions¹

The OeNB operates one of the 16 real-time gross settlement (RTGS) systems in Europe. These RTGS systems and the ECB payment mechanism together form the Trans-European Automated Real-time Gross settlement Express Transfer system TARGET. Since the Austrian RTGS system ARTIS was launched in 1999, the number of payment orders has steadily increased from initially 1.4 million to approximately 4 million in 2005. Chart 10 shows a breakdown of these payment orders into incoming and outgoing TARGET payments (i.e. cross-border payments within the EU) as well as domestic RTGS payments (i.e. those effected within the Austrian financial market).

More Than One Billion Euro Banknotes Processed in 2005

Together with its cash logistics arm GELDSERVICE AUSTRIA (GSA), the OeNB plays a crucial role in Austria's cash cycle. Three to four times a year on average, each banknote returns to the OeNB and GSA, where high-security equipment is used to count and check banknotes and to shred unfit notes. Since the euro cash changeover in 2002, the number of banknotes processed by the OeNB and GSA has increased annually by an average of nearly 13%. In 2005, the number of processed banknotes for the first time exceeded 1 billion.

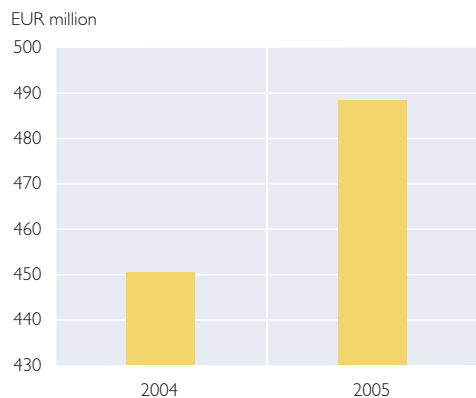
OeNB's Confidence Index Remains High

In a representative IFES survey conducted in 2005, an average of 76% of respondents once more expressed their confidence in the OeNB. Thus, the OeNB's confidence index has been at a stable, high level for years.

¹ Some of the terms used in this section are explained in the glossary and/or the abbreviations section.

Chart 7

The OeNB's Operating Profit



Source: OeNB.

Chart 8

The OeNB's Income/Expenses

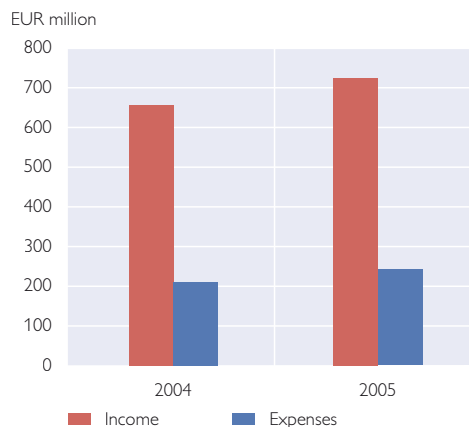
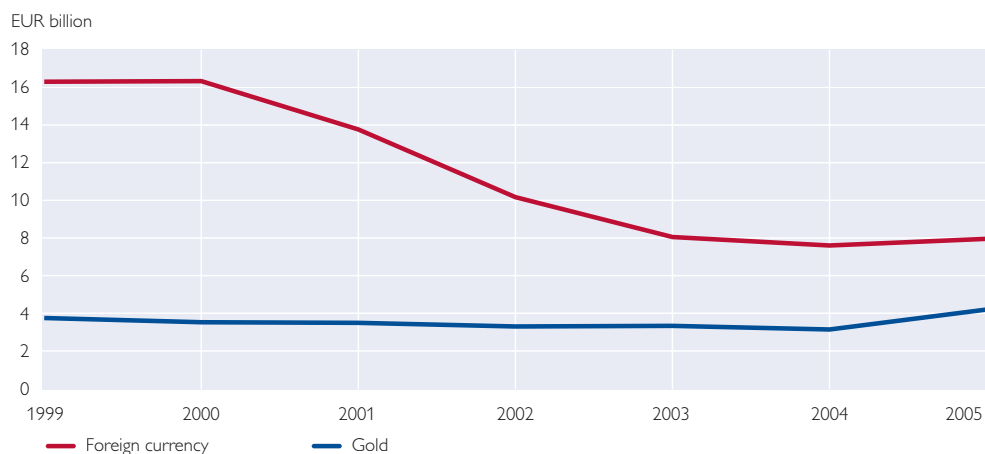


Chart 9

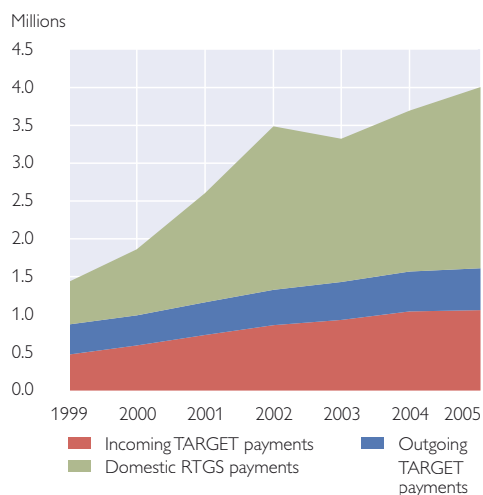
The OeNB's Net Currency Position



Source: OeNB.

Chart 10

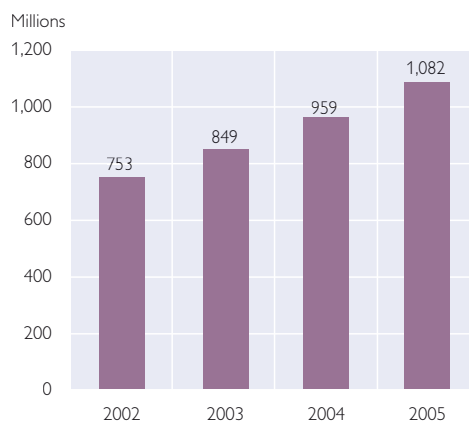
Number of ARTIS Transactions



Source: OeNB.

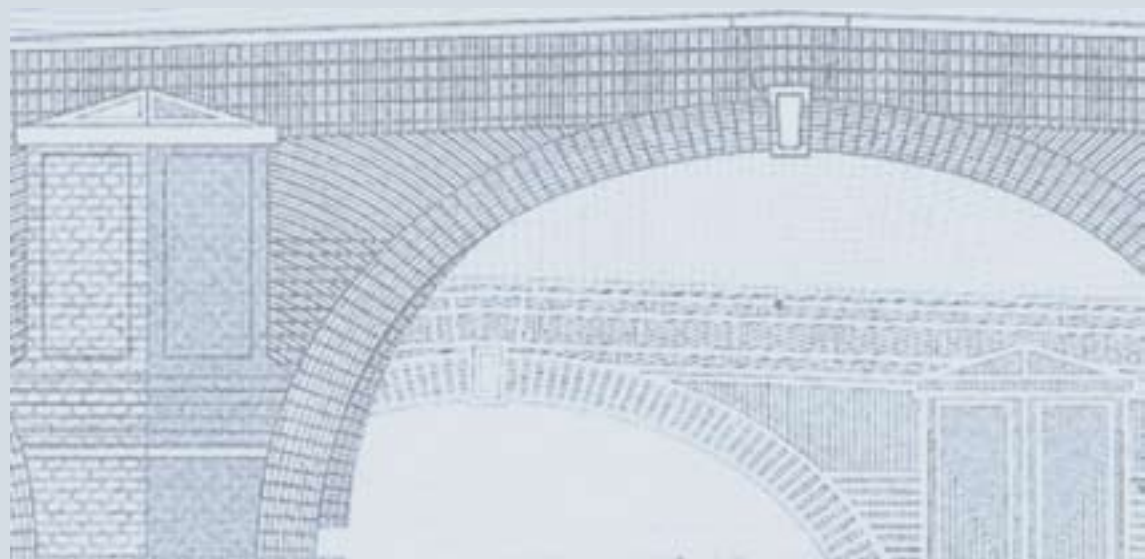
Chart 11

OeNB: Number of Processed Euro Banknotes





Report of the
Governing Board (Direktorium)
on the Financial Year 2005



Monetary Policy Response to Inflationary Risks

The success of Stage Three of Economic and Monetary Union (EMU), which began in 1999 with the introduction of the euro as the single currency, rests on three pillars: monetary stability, sound and sustainable public finances and a commitment to structural reforms. The monetary constitution laid down by the Maastricht Treaty ensures a high degree of independence for the Eurosystem and has established price stability as the primary objective of monetary policy. The federal structure of the Eurosystem, which consists of the European Central Bank (ECB) and currently 12 national central banks (NCBs) including the Oesterreichische Nationalbank (OeNB), is characterized by continuity and the smooth cooperation of its members. On this basis, the Eurosystem has gained broad acceptance with the population. As the main decision-making body of the ECB, the Governing Council of the ECB, which consists of the six members of the Executive Board of the ECB and the twelve presidents of the euro area NCBs, relies on the principle of “one person, one vote” and acts by simple majority. The first Governing Council meeting of the month is usually followed by a press conference at which the monetary policy decisions of the Governing Council of the ECB are communicated to the public.

The medium-term monetary policy strategy, which relies on the two pillars of economic and monetary analysis, has so far proved to be highly effective. Given the time lags in the transmission of monetary policy impulses to the price level, monetary policy cannot fine-tune inflation developments in the short term. It must therefore be forward-looking in order

to ensure medium-term price stability. The parallel analysis and cross-checking of macroeconomic and monetary indicators guarantee that the monetary policy strategy constitutes a robust foundation for decision-making by the Governing Council of the ECB even in the case of economic shocks and uncertainties about future cyclical developments. Medium- and long-term inflation expectations, in particular, must be kept anchored at levels consistent with the objective of price stability.

Despite a series of price shocks (oil price hike, animal diseases, terrorist attacks), the objective of price stability (Eurosystem definition: medium-term HICP inflation rates of below, but close to 2%) has been largely fulfilled since the beginning of Stage Three of EMU. Between 1999 and 2005, the inflation rate averaged 2.0%.

First Rise in Five Years in Eurosystem Key Interest Rates in 2005

After a period of economic weakness in the euro area (mid-2004 to mid-2005), economic growth began to regain momentum. The main reasons behind this upturn were robust global demand, healthy corporate profits and favorable financing conditions.

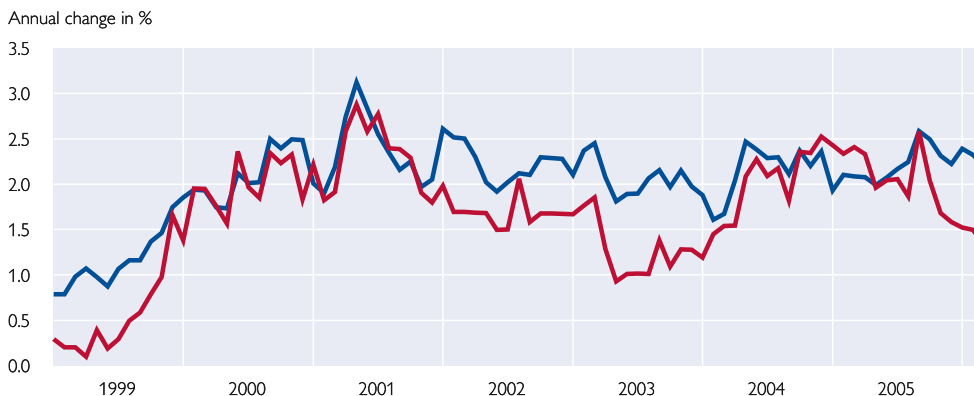
Despite the strong rise in commodity prices (above all in energy prices), inflationary pressure in the euro area remained moderate. The year 2005 saw a surge in the price of Brent crude oil to a historic high of USD 67.5 per barrel in September 2005, thus driving up euro area HICP inflation from 2.0% in the first half of 2005 to a peak value of 2.6% in September 2005. In the subsequent

HICP inflation rises above 2%

Chart 12

Inflation Developments

Overall HICP



HICP: Energy



Source: Eurostat.

Strong and accelerating monetary growth

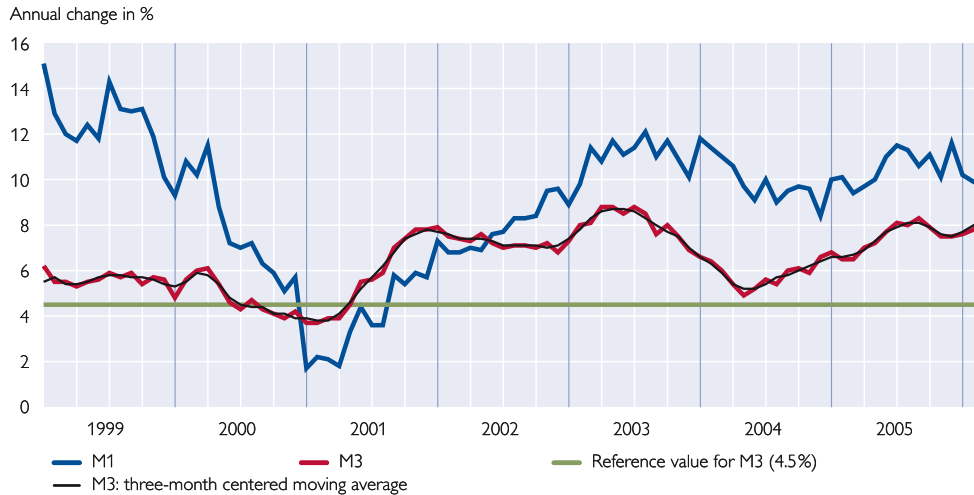
months, inflation at the consumer level also remained significantly above the 2% level (February 2006: 2.3%; March 2006: 2.2%). The average annual inflation rate in the euro area was 2.2% in 2005. The expected pattern of inflation was slightly corrected upward in the Eurosystem and ECB staff projections of December 2005 and March 2006,¹ as oil price developments, rises in administrative prices and possible second-round effects of the 2005 surge in oil prices continue to pose risks to price stabil-

ity. Oil prices continued to climb throughout the first four months of 2006, posting a new record high of nearly USD 75 per barrel on April 24, 2006.

The indicators of monetary analysis showed an ample supply of liquidity in the euro area economy. The expansion of monetary growth observed since mid-2004 accelerated to more than 8% in 2005 and continued to rise at the beginning of 2006. As a consequence of the low level of interest rates, growth in the monetary

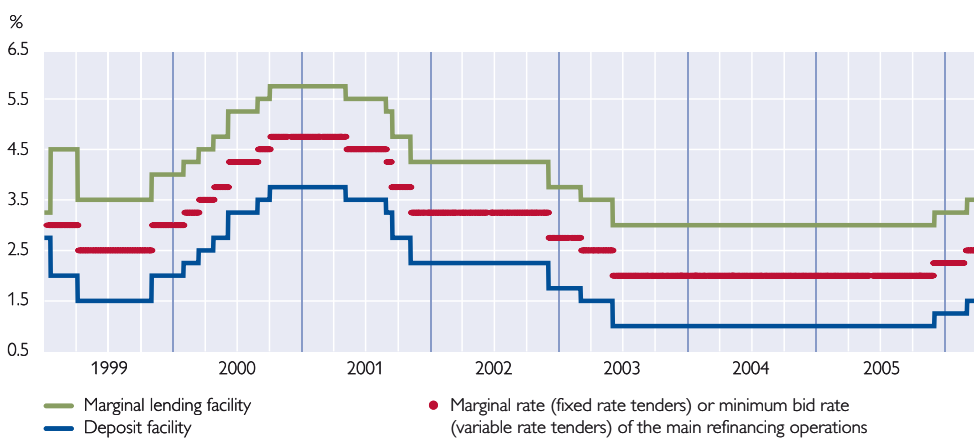
¹ Eurosystem staff projections for HICP inflation of early December 2005: 1.6% to 2.6% in 2006; 1.4% to 2.6% in 2007. ECB staff projections for HICP inflation of early March 2006: 1.9% to 2.5% in 2006; 1.6% to 2.8% in 2007.

Chart 13

Euro Area Monetary Aggregates


Source: BIS, ECB.

Chart 14

Eurosystem Key Interest Rates


Source: ECB.

aggregate M3 has been driven mainly by its most liquid components. Against the backdrop of price dynamics in several national real estate markets, robust loan growth (in particular in the mortgage loan segment) also posed inflationary risks, as home loans account for the bulk of household borrowing. Monetary analysis thus pointed to a general rise in upward risks to price stability over the medium to longer term.

In response to information signaling risks to price stability, the Governing Council of the ECB adjusted its monetary policy stance toward the end of 2005. On December 1, 2005, the Governing Council decided to raise the Eurosystem's policy interest rates by 0.25 percentage points; this was the first interest rate increase since October 2000. In a second interest rate move, rates were raised by another 25 basis points on March 2, 2006. The minimum bid rate on the

Interest rates raised by 25 basis points in December 2005 and again in March 2006

main refinancing operations and the interest rates on the marginal lending facility and the deposit facility thus stand at 2.50%, 3.50% and 1.50%, respectively, at the time of writing. Before these interest rate moves, the key interest rates had remained at their lowest level since the establishment of the Eurosystem for two and a half years.

Euro Area Economy Recovering at a Modest Pace

Posting a growth rate of just under 5%, the global economy continued to

expand dynamically in 2005. This robust growth was attributable, in particular, to buoyant expansion of economic activity in the U.S.A., the Asian emerging economies – and here, above all, the dynamic growth of China and India – and the Central and Eastern European countries (CEECs). The only factor that had a dampening effect on global growth dynamics was the persistent rise in oil prices throughout the year.

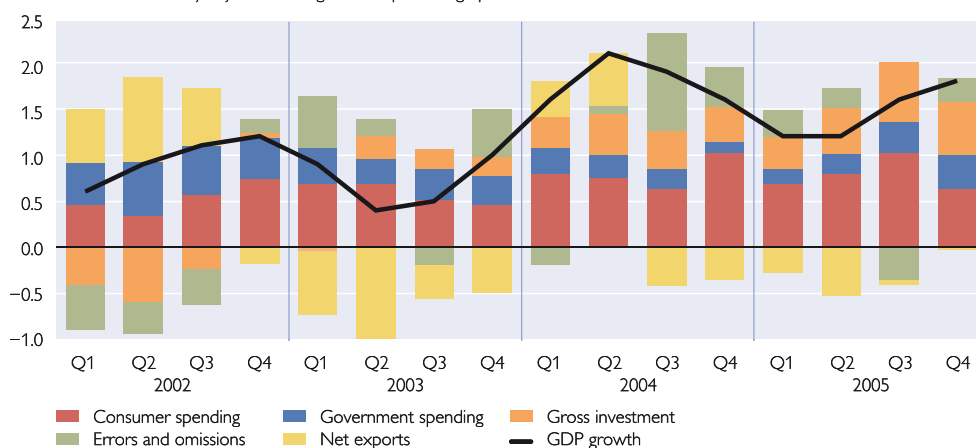
Following a period of moderate growth in the first half of 2005 (0.3% and 0.4% quarter-on-quarter growth

Chart 15

Contributions to Real GDP Growth

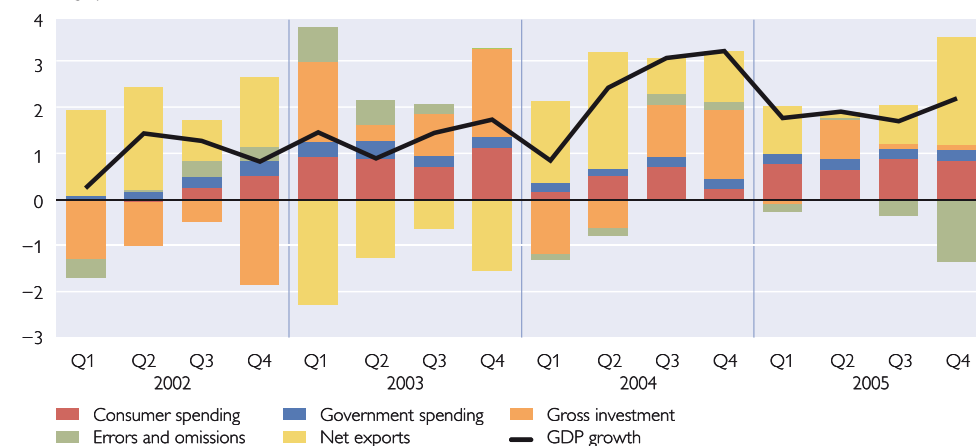
Euro area

Contribution to seasonally adjusted GDP growth in percentage points



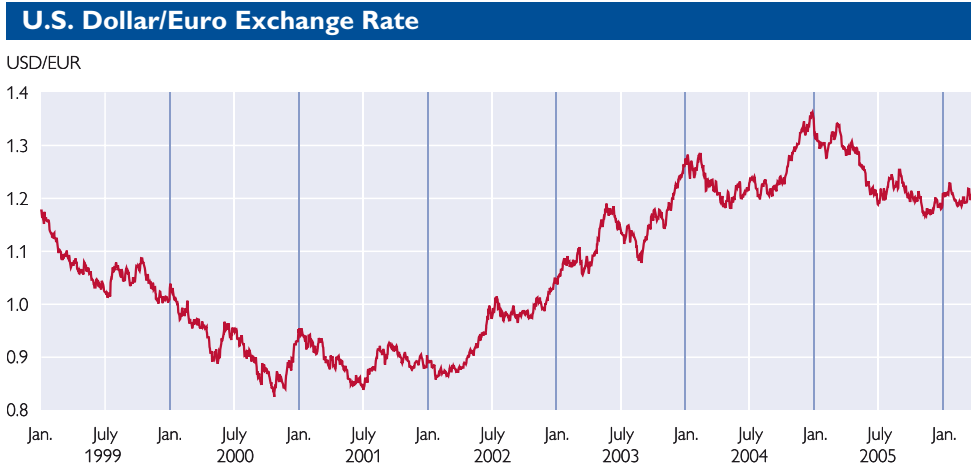
Austria

Percentage points



Source: Eurostat, WIFO, Statistics Austria, OeNB.

Chart 16



Source: Thomson Financial.

in the first and second quarters), real GDP in the euro area accelerated in the second half, coming to 0.7% in the third quarter. A major stimulus for economic growth came from exports, with a rise in investment also playing a key role, even though investment activity was rather modest during the first months of 2005 despite favorable corporate profits. Private consumption also augmented at a slightly faster rate, as did public spending. In the fourth quarter (+0.3%), growth dynamics slowed down a bit again so that overall economic growth in the EU-12 came to 1.3% (seasonally and working-day adjusted: 1.4%) for the entire year.

The external environment is favorable for future economic developments and provides support for euro area exports. Investment is expected to remain high and benefit from the prevailing excellent financing conditions, from balance sheet restructuring, profit growth and improvements in corporate efficiency. Consumption, by contrast, is expected to continue to grow at a moderate pace and accelerate only after a noticeable recovery of labor markets. According to the ECB staff projections of early

March 2006, economic growth in the euro area is expected to remain within a range of 1.7% to 2.5% in 2006 and 1.5% to 2.5% in 2007, which is a slight improvement on the projections of December 2005.

Downward risks to growth might inter alia stem from high oil prices, which affect real income and drive up costs for enterprises. The external value of the euro, which impacts above all the business of the export-oriented sectors, saw diverging developments in the last months of 2005: Following a steady decline from its record high of USD/EUR 1.34 in December 2004 to its lowest level at around USD/EUR 1.17 at the beginning of November 2005. Thereafter, the single currency strengthened, reaching a value of USD/EUR 1.24 on April 27, 2006. The nominal effective exchange rate of the euro has decreased by around 4.5% since January 2004, and at the beginning of 2006 was close to its average level for the period since 1993 (nominal and real effective exchange rates of the euro as calculated by the ECB using proxies). A correction of present global current account imbalances (the U.S. current account deficit

Economic growth in the euro area came to 1.3% in 2005

Cyclical conditions will stay favorable in the near future

came to 6.4% of GDP in 2005) and of house prices in some euro area countries might also have an influence on euro area growth prospects.

Austria's Economy Remains in Good Shape

Austria outperforms the euro area economy at almost 2% of GDP growth in 2005

The altogether more favorable global economic environment had positive effects on the Austrian economy as well. Real GDP growth accelerated throughout 2005: After posting 0.2% and 0.5% (seasonally and working-day adjusted, quarter on quarter) in the first and second quarters, respectively, GDP growth gained momentum in particular as of the third quarter (0.6%) and reached 0.7% in the fourth quarter of 2005. Economic growth in Austria thus came to 1.9% in the reporting year (2004: 2.4%), which means that it was around 0.6 percentage point higher than euro area output growth despite the very weak economic activity of Austria's

main trade partners Germany and Italy. This development was favored, on the one hand, by the moderate pace of unit labor costs over the last ten years and, on the other hand, by the reinforcement of export relations with Central, Eastern and Southeastern Europe. Economic policy measures such as the second part of the tax reform and three growth and employment packages also helped support growth in 2005.

Moreover, lively exports of goods and services, which climbed by 3.8% against 2004 in real terms and thus constituted a major pillar of domestic industrial production, continued to be key engines of growth in the reporting year. Private consumption, by contrast, remained subdued as a consequence of slightly higher inflation and increasing unemployment, but picked up toward year-end. Investments, which had stagnated in the first six months of 2005 as the special

Box 1

Oil Price Shock, Energy Prices and Inflation in Austria

Since the beginning of 2004, oil prices have more than doubled. In real terms (i.e. adjusted for inflation) the oil price in Austria recently reached the peak values of the first oil price shocks in early 1974; however, it still remains clearly below the price level observed after the second oil price shock of 1979–1980. The latest rise in oil prices is above all connected to a very dynamic international demand for oil. Over the next few years, crude oil prices cannot be expected to decline significantly. With its high share of hydropower in total power generation, Austria is in a comparatively favorable situation; however, Austria's dependence on oil and natural gas has been increasing continuously and substantially over the last few decades.

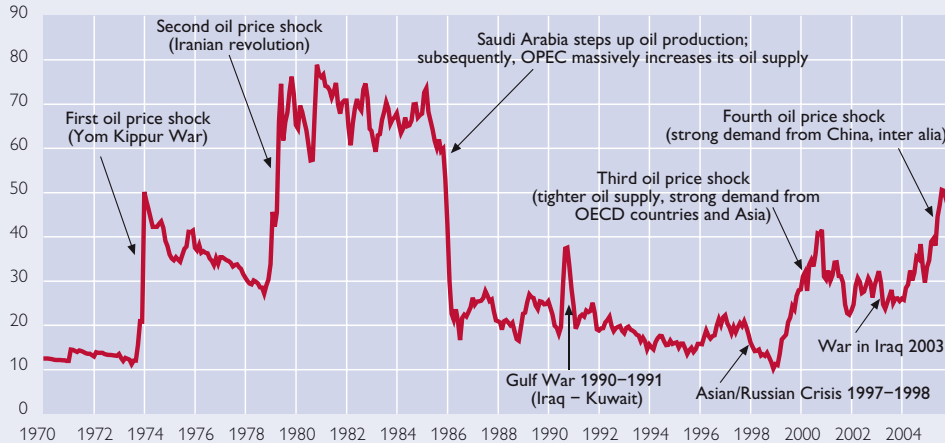
The rise in oil prices has also affected the prices of motor fuels, heating oil and other forms of energy. A related OeNB paper¹ shows that in an EU-wide comparison, Austrian fuel prices react to oil price fluctuations only to a limited degree and with a greater time lag. Austrian fuel prices adjust just as fast after a rise as after a fall in oil prices. The reaction of Austrian prices of district heating, electricity and solid fuels to oil price changes is only relatively weak. Over the last ten years, despite the doubling of oil prices, the price of natural gas in Austria has only risen slightly, and less pronouncedly than in the EU-15 on average. At the same time, the decline in electricity prices over the same period was stronger in Austria than in the EU-15. This favorable development probably reflects the timely liberalization of Austrian network industries, which preceded liberalization efforts in the rest of the EU.

¹ Arpa, M., J. Crespo-Cuaresma, E. Gnan and M. A. Silgoner. 2006. Oil Price Shock, Energy Prices and Inflation – A Comparison of Austria and the EU. In: Monetary Policy & the Economy Q1/06. Also available at www.oenb.at.

Real Crude Oil Prices in Austria

Real values based on the CPI for Austria (basis: December 2005)

EUR/barrel (before 1999: based on ATS)



Source: WIFO, Thomson Financial, OeNB.

Model simulations carried out by the OeNB show that the rise in oil prices from USD 29.74 per barrel in December 2003 to USD 57.16 per barrel in December 2005 dampened the level of real GDP in Austria by a total of around 0.9 percentage point, which drove up HICP prices by around 1.4 percentage points. The further decoupling of oil consumption from GDP growth, among other things, will determine how sensitively the inflation rate, growth and employment react to oil price shocks. Factors which can contribute to this process include the increasing share of services in the economy, technological advances and energy-saving measures. A country's energy mix can also be diversified by promoting alternative sources of energy. Energy policy thus not only has an influence on strategic and structural interrelations but also on macroeconomic development.

investment tax credit expired and capacity utilization slowed down, picked up considerably as of mid-2005. Winter tourism had a stimulating effect, and the financial services sector expanded vigorously as well.

Mid-term forecasts expect the economic upswing in Austria to continue: According to domestic and international forecasters, GDP growth rates for 2006 and 2007 are likely to be between 2% and 2.5%.

After HICP inflation had accelerated to up to 2.5% during 2004, it remained at a high level until September 2005. This development was attributable to several domestic and external factors. At the beginning of

2005, high cost pressures in the housing sector as well as individual government measures such as a rise in tobacco taxes kept the inflation rate at a rather high level. An additional factor was the oil price-induced surge in the price of energy products (see e.g. box 1). As of October 2005, inflation slowed down continuously to 1.3% in March 2006. In the reporting year, inflation in the food sector only reached half the level of overall HICP inflation (2.1%). This might have contributed to the fact that perceived inflation and the official inflation rate calculated by Statistics Austria have been converging again (see box 2). Price reductions in the tele-

HICP inflation at 2.1%

Perceived Inflation and Price Formation in Austria

Austrians perceived inflation during the euro cash changeover to be up to nearly 2 percentage points higher than the measured inflation rate, which was in fact low. In the course of 2005, however, this gap between perceived and measured inflation – which had been observed since 2002 – narrowed markedly. The rate of inflation as measured by the HICP came to 2.1% in 2005; perceived inflation – i.e. inflation as subjectively experienced by the general public – came to 2.8%. From the perspective of monetary policymakers, it is important to prevent unduly high perceived inflation from translating into persistently higher inflation expectations. High fuel and oil prices are the most likely explanation for the remaining gap between actual and perceived inflation. The divergence of these two indicators has several reasons. People's assessment of price developments is based above all on the goods they buy frequently. In the period between 2001 and 2005, the prices of these goods, which account for only around 20% of the basket of goods and services used to calculate the price index, climbed at a faster pace than the overall CPI. Moreover, as the most recent research on inflation perception indicates, people take greater note of price increases than of price reductions. Many people also compare the current euro prices with unadjusted schilling prices they remember from a few years back, which also reinforces their impression that inflation is higher than the actual figures. Furthermore, people have been especially sensitive to price increases because they were already convinced during the run-up to the euro cash changeover that prices would rise afterward. Finally, the temporary absence of signal prices (e.g. ATS 9.90) is thought to have boosted perceived inflation as well. The unconventional prices resulting from the exact conversion of schilling to euro prices and from dual pricing influenced people's understanding of prices immediately after the cash changeover. A great number of signal prices had been reintroduced by 2005, however.¹

Perceived inflation declines

Austrian enterprises adjust prices once a year

A study published by the OeNB² for the first time provides details on price-setting behavior in Austria. The study reports that on average, Austrian firms adjust consumer prices about once a year. The prices of energy products and unprocessed food (e.g. fruits and vegetables) are adjusted fairly often (every 5 to 8 months on average), whereas the prices of nonenergy industrial goods and of services are changed less frequently (about every 14 to 19 months), indicating that prices in that segment are fairly rigid. Additionally, the study shows that 55% of all price adjustments made between 1996 and 2003 were increases and 45% were reductions; on average the reductions were somewhat larger than the increases. Hence, like in most other euro area countries, price setting in the Austrian economy is neither particularly rigid nor particularly flexible.

¹ See also Fluch, M. and H. Stix. 2005. Perceived Inflation in Austria – Extents, Explanations, Effects. In: Monetary Policy & the Economy Q3/05. Also available at www.oenb.at.

² Kwapil, C. and F. Rumler. 2005. Price Setting in Austria – Results from the Eurosystem Inflation Persistence Network. In: Monetary Policy & the Economy Q4/05. Also available at www.oenb.at.

communications sector had a clearly dampening effect on inflation in 2005. In the reporting year, Austria posted the fifth-lowest inflation rate in the euro area (after Finland, the Netherlands, Germany and France). By March 2006, Austria had returned to the league of the three top-performing EU-25 countries in terms of price stability.

According to recent forecasts, HICP inflation is likely to again fall to below 2% on average in 2006 and 2007, that is, if oil prices do not increase further and the 2005 surge in oil prices does not trigger any second-round effects. High competitive pressure and the tight labor market situation imply that wage policies will continue to be moderate. In 2005,

negotiated wage increases were between 2.5% and 3%, depending on the respective sector.

Characteristic for the Austrian labor market in 2005 were strong employment growth and a rise in job vacancies. At the same time, however, unemployment went up. This apparently paradoxical situation can be explained by a pronounced rise in labor supply (particularly foreign labor). According to Eurostat, the unemployment rate in Austria came to 5.2% in 2005.

Robust employment growth – partly supported by the growth and employment packages launched in 2005 – is expected for 2006. Given the continued strong growth of labor supply, however, the labor market situation is not expected to ease sustainably and the jobless rate is likely to remain at just over 5%.

The government-funded growth and employment packages in combination with the effects of the second round of tax reforms caused the general government deficit in Austria to climb marginally to 1.5% of GDP in 2005 (2004: 1.1%). The Austrian government deficit is significantly lower than the comparable EU and euro area averages. The updated stability program of November 2005

expects the general government budget to flatten gradually over the next few years and to be fully balanced in 2008.

According to preliminary calculations, the Austrian current account closed with a surplus of EUR 3 billion in 2005, which corresponds to over 1% of GDP (2004: EUR 0.4 billion or 0.1% of GDP). This development continues the move into surplus that has been observed in the current account for a number of years. Higher receipts from exported goods and services (EUR 137.2 billion in 2005 against EUR 129.7 billion in 2004) more than compensated the rise in import spending to EUR 130.7 billion (2004: EUR 125.3 billion). Travel, which posted a surplus of EUR 3.5 billion (against EUR 2.7 billion in the comparable period of 2004), had a major share in this development, but other sectors also contributed to the positive overall picture (transport, transit trade, communications services).

Growing capital linkages with nonresidents are also reflected in the related income flows: At EUR 17.2 billion, domestic investors' investment income was now clearly higher than foreign currency travel receipts. The respective expenses for foreign

Unemployment rate remains just above 5%

Current account surplus

General government budget deficit comes to 1.5%

Table 1

Indicators for Austria

	1999	2000	2001	2002	2003	2004	2005
	Annual change in %						
Real GDP	3.3	3.4	0.8	1.0	1.4	2.4	1.9
HICP inflation rate	0.5	2.0	2.3	1.7	1.3	2.0	2.1
	%						
Unemployment rate (Eurostat definition)	3.9	3.7	3.6	4.2	4.3	4.8	5.2
	% of GDP						
Current account balance	-3.2	-2.5	-1.9	0.3	-0.2	0.1	1.2
Government surplus/deficit	-2.2	-1.5	0.1	-0.5	-1.5	-1.1	-1.5

Source: OeNB, Statistics Austria, WIFO, Eurostat, Federal Ministry of Finance.

capital in Austria came to EUR 19.1 billion. Taking the compensation of employees into account, these developments result in income outflows of EUR 1.4 billion, i.e. an improvement by EUR 0.4 billion.

Massive growth of private sector financial assets in 2005

In 2005 Austrian direct investors stepped up their net foreign investment by one-quarter to a new record high of EUR 7.5 billion (against EUR 6.0 billion in 2004). Accounting for 46% of new investment, Central, Eastern and Southeastern Europe remained the most important target region in 2005. Foreign direct investment in Austria was also markedly higher in the year under review, coming to EUR 7.2 billion (2004: EUR 3.0 billion).

For the first time, Austrian investors spent more than EUR 30 billion – namely EUR 34.3 billion net – on foreign securities, which corresponds to a rise by around 30% from the 2004 figure. Foreign shares were particularly popular with investors, increasing by around one-half against the previous year to EUR 4.7 billion. Money market instruments registered

net sales, resulting from the federal government's liquidity management transactions. Austria's capital imports from securities contracted slightly from EUR 25.8 billion in the previous year to EUR 23.1 billion net in the reporting year.

At EUR 18.3 billion in 2005 (2004: EUR 17.4 billion), financial investment of households recorded an annual growth rate of 5.5%, while financing needs went up by 6.6% to EUR 7.9 billion (2004: EUR 7.7 billion). Higher net lending is attributable above all to a rise in the saving rate. Investment in negotiable securities accounted for one-third of households' net acquisition of financial assets; demand was particularly strong for domestic fixed-income fund shares as well as for balanced funds with a capital guarantee. In their acquisition of domestic quoted stocks and housing bonds, households primarily focused on new issues. 30% of the rise in households' financial assets to EUR 356 billion in 2005 is traceable to the good performance of stocks and mutual fund shares resulting from stock

Box 3

**Favorable Assessment of Austria's Economic Situation
in IMF Article IV Consultations**

Every year the OeNB organizes and coordinates the Article IV Consultations for Austria, carried out by the International Monetary Fund (IMF) to examine the performance of Austrian economic policy. According to the IMF's assessment published in July 2005, the economic situation in Austria is good thanks to the country's sound and reform-oriented economic policy, its sustained focus on diversifying toward Eastern Europe and its moderate wage policies. The IMF supports the objective of reaching a balanced budget and reducing the tax burden. It also recommends simplifying the taxation system and increasing transparency. Structural policies should provide a framework for facilitating the integration of older workers, rendering services more flexible, harmonizing pensions further and handling access to invalidity pensions in a stricter manner. In the financial sector, the IMF identifies foreign currency loans as a risk factor. It recommends that the information campaign initiated by the supervisory bodies be implemented quickly. Measures to minimize risks might include strengthening the disclosure requirements made on banks and increasing capital requirements. The portfolio quality of Austrian banks' foreign subsidiaries should be made subject to close bilateral supervision, as their credit activities in Central, Eastern and Southeastern Europe are observed to be increasing fast.

price gains, which highlights the increasing impact of capital market developments on households' financial wealth. If they realize these valuation gains, households – and in particular higher-income investors – will be able to raise their financing potential by 5% of disposable income.

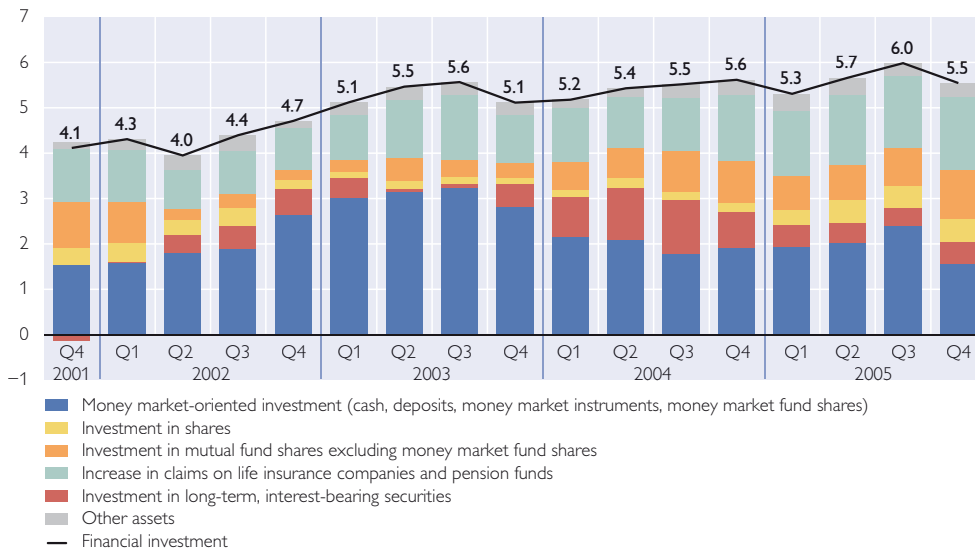
Despite lively exports, corporate investment only went up at a moderate pace in 2005. At the same time, favorable developments in corporate profits caused the internal financing ratio to climb to more than 85%. In

line with these developments, companies' net borrowing needs in the reporting year (EUR 5 billion) remained below the comparable figures of the last four years, even though financing conditions remained extremely favorable. As equity financing had increased over the past few years and the Austrian stock market continued its upward trend, companies' debt financing liabilities totaled less than 140% of the amount of corporate equity at market value at end-2005.

Chart 17

Structure of Households' Financial Investment¹

Annual growth rates in %, contributions in percentage points



Source: OeNB.

¹ Including nonprofit institutions serving households.



The OeNB Plays an Active Role in Enhancing European Integration and International Cooperation

Ambassador and Think Tank: How the OeNB Advances the Cause of European Integration

OeNB officials represented in more than 200 international forums and bodies

Close cooperation with neighboring central banks

The Oesterreichische Nationalbank (OeNB) is represented in numerous European and international forums, networks and organizations, above all in working groups and decision-making bodies of the Eurosystem/the European System of Central Banks (ESCB) and the European Union (EU). The bulk of this commitment concerns contributions to Eurosystem/ESCB committee and working group meetings and, most importantly, the input of the OeNB's Governor to monetary policy and other decision-making within the Governing Council of the ECB. The Governor also attends, among other things, the informal Council meetings of the EU finance ministers (Ecofin) and the bimonthly meetings of central bank governors at the Bank for International Settlements (BIS). Moreover, the OeNB is represented at the International Monetary Fund (IMF) and at the Organisation for Economic Cooperation and Development (OECD). All in all, OeNB officials participated in more than 200 different international forums, committees and working groups in 2005.

Apart from meeting statutory membership requirements, the OeNB seeks to maintain good relations with other central banks and international organizations, economic policymakers, academic circles as well as media representatives, with a view to foster-

ing the exchange of expert knowledge, promoting Austria's interests in national and international forums, and shaping monetary and economic policies in Austria and Europe.

The OeNB makes a special effort to further central bank cooperation and implement a "good neighbor" policy. Recent cases in point are a twinning project between the OeNB and Magyar Nemzeti Bank, Hungary's central bank, initiated by the European Commission and a project with Národná banka Slovenska, Slovakia's central bank, which is currently being developed.

The main channels of technical cooperation, which go far beyond the boundaries of Austria's immediate neighbors, are dedicated events providing guidance on specific issues and fact-finding visits at the expert level. In 2005, the OeNB hosted more than 120 visits by representatives from other central banks, and provided technical assistance to other central banks in 30 instances. In addition, OeNB officials shared their expertise in 14 seminars and workshops in Austria (primarily at the Joint Vienna Institute) and abroad. A highlight of the OeNB's technical cooperation activities was its contribution to the Tacis¹ program sponsored by the EU and coordinated by the ECB that provided training for about one-fourth of all Bank of Russia officials involved in banking supervision.

In 2005 OeNB staff members authored a total of 137 articles. The OeNB's flagship publications include

¹ Tacis: Technical assistance to the Commonwealth of Independent States.

the quarterly *Monetary Policy & the Economy*, the biannual *Financial Stability Report* and the biannual *Focus on European Economic Integration*. Further research is addressed to an academic audience in a *Working Paper* series. The OeNB moreover regularly hosts workshops on monetary and economic issues with experts and publishes the relevant contributions in the series *Workshops – Proceedings of OeNB Workshops*. A quarterly e-mail newsletter keeps interested parties up to date on recent and forthcoming publications of the OeNB's economic researchers.² Finally, the OeNB contributes to the international economic dialogue with two high-level conferences every year – its Economics Conference in spring and its Conference on European Economic Integration (CEEI) in fall.³ The Economics Conference of May 2005 marked the first presentation of the Klaus Liebscher Award, established on the occasion of Governor Liebscher's 65th birthday to honor his achievements in advancing European integration and Austria's participation in the third stage of Economic and Monetary Union (EMU).⁴ The prize, which is to be awarded annually, totals EUR 20,000.

Central, Eastern and Southeastern European States Gradually Integrate into the EU

Following the entry of Estonia, Lithuania and Slovenia to the exchange rate mechanism II (ERM II) in 2004,

Latvia followed suit in May 2005 (together with Cyprus and Malta), and Slovakia in November 2005. ERM II serves two purposes: First, it is designed to align the participating exchange rates within a range of $\pm 15\%$ vis-à-vis the euro. Second, successful ERM II participation for two years is one of the convergence criteria for accession to the euro area.

Upon joining the EU in 2004, the ten new Central and Eastern European Member States also committed themselves to avoiding excessive government deficits (i.e. deficits higher than 3% of GDP). However, Hungary (and Malta) reported a deficit exceeding 3% of GDP in 2005 (whereas in 2004, five out of the ten countries had breached this threshold).

Inflation remained moderate in most of the new EU Member States (NMS): Indeed, with the exception of Estonia, Latvia and Lithuania, average annual inflation was lower in 2005 than in 2004. Reflecting the surge in oil prices, inflation did, however, accelerate in the final months of 2005.

Following the established procedure used in 2004, the ECB and the European Commission are going to analyze the convergence progress of the NMS and Sweden and publish the results of their assessment in so-called convergence reports in the course of 2006. After a consultation of the European Parliament and discussions with the EU heads of state or government, the Ecofin Council will decide, based on a recommendation by the

Broad range of economic publications, workshops and conferences

Mixed convergence progress of the new EU Member States on the road to the euro

² All economic publications are also available at www.oenb.at.

³ See also the section entitled "The OeNB's External Communications – Conveying Stability and Security."

⁴ From among 21 excellent submissions the following two papers were selected: "Financial Differences and Business Cycle Movements in a Currency Area" by Ester Faia (Universitat Pompeu Fabra, Barcelona) and "The European Monetary Union as a Commitment Device for New EU Member States" by Federico Ravenna (University of California, Santa Cruz).

European Commission, which of the countries have already met the criteria for introducing the euro. Slovenia formally applied for euro area membership in early March, and Lithuania followed suit in mid-March 2006. Both countries aim to introduce the euro on January 1, 2007. Hence, the euro compatibility of Lithuania and Slovenia will be assessed by both the European Commission and the ECB already in May 2006, whereas the convergence reports on the other countries are to be produced in the fall of 2006.⁵ The EU heads of state or government will discuss the euro area accession of Lithuania and Slovenia in June 2006; the final decision by the Ecofin is expected for July 2006.

**Romania and Bulgaria
on the road to
EU membership**

In April 2005, the existing EU members signed the Accession Treaty with Bulgaria and Romania. In its monitoring reports of end-October 2005, the European Commission commended the two countries for their reform headway in many different areas. At the same time, the report listed a number of shortcomings that remain. Overall, Bulgaria and Romania were urged to swiftly increase the reform speed to indeed make the EU entry date envisaged for 2007. In May 2006 the European Commission is expected to submit monitoring updates, on the basis of which the entry date 2007 – or its postponement to 2008 – will be fixed.⁶

At the beginning of October 2005 the European Council furthermore decided to start negotiations for EU accession with Croatia and Turkey. The green light for negotiations with Croatia was given when the country was found to be cooperating satisfactorily with the International Criminal Court. The negotiations with Turkey are an *open-ended process*: the objective, accession to the EU, is clear but cannot be guaranteed beforehand. In this context, Turkey was for the first time officially classified as a functioning market economy by the EU.

The convergence of the countries of the Western Balkans with the EU is an ongoing process – and a dedicated goal of Austria's EU Council presidency. The Former Yugoslav Republic of Macedonia was granted the status of an EU candidate country at the end of 2005. Negotiations on a Stabilization and Association Agreement (SAA) started in October 2005 with Bosnia and Herzegovina as well as with Serbia and Montenegro⁷. The intention of SAAs is, among other things, to promote economic and trade relations and to pave the way, following a transition period, for free-trade rules compliant with the rules of the World Trade Organization (WTO). Albania's SAA negotiations with the EU already started on January 31, 2003. The final status of Kosovo remains open; negotiations to resolve this issue are on the agenda for 2006.

⁵ The convergence reports of the European Commission and the ECB on Slovenia and Lithuania were published on May 16, 2006, after the cutoff date for this report. The European Commission proposed to abrogate the derogation of Slovenia, but not that of Lithuania, with regard to euro area membership.

⁶ In its monitoring reports published on May 16, 2006, the European Commission concluded that Bulgaria and Romania should be prepared for EU membership on January 1, 2007, provided that they address a number of outstanding issues. The Commission will review further progress no later than early October 2006, on the basis of which it will offer a final recommendation regarding the EU entry date of Bulgaria and Romania.

⁷ Includes Kosovo under the interim UN administration for Kosovo according to Security Council Resolution 1244 of June 10, 1999.

Box 4

The Euro in Central, Eastern and Southeastern Europe¹

The euro already plays an important role in the new EU Member States and the EU acceding/candidate countries today. In most of these countries, the volume of exports and imports invoiced in euro markedly exceeds the volume of trade with the euro area. The euro is also a significant factor in the monetary and exchange rate policies of these countries: Most of the NMS are using the euro as an anchor and reserve currency.

Many Central, Eastern and Southeastern Europeans are already quite familiar with the euro. To learn more about foreign exchange holdings in selected countries in the area, the OeNB has been conducting surveys in the Czech Republic, Croatia, Hungary, Slovenia and Slovakia since 1997. The latest survey (May 2005) found 33% of the Czechs, 29% of the Croatians, 10% of the Hungarians, as many as 48% of the Slovenes and 27% of the Slovaks to be holding euro cash. The statistics show that demand for euro holdings for transaction purposes has been increasing in the NMS since 2002. Moreover, the findings imply that the euro is widely accepted as a means of payment in the countries reviewed.

The survey respondents were also asked to give their personal assessment of the stability of the euro and the U.S. dollar. The answers show that almost 90% of the respondents expected the euro to remain very stable or broadly stable within the next two years, compared with a ratio of 70% for the U.S. dollar.

¹ See also ECB. 2005. *Review of the International Role of the Euro, December 2005* (available at www.ecb.int).

Finally, the EU is also very active in advancing its European Neighbourhood Policy: In 2005, the EU recognized Ukraine as a market economy, and the 15th EU-Russia summit (May 2005) saw the conclusion of a framework agreement on closer political and economic cooperation between the EU Member States and Russia.

European Integration Faces New Challenges

The stability of the euro hinges, among other things, on the credibility of the underlying fiscal framework. The cornerstones of this framework are the provisions on safeguarding sound public finances laid down in the Treaty on European Union. To strengthen these provisions, the EU Member States adopted the so-called Stability and Growth Pact (SGP) in 1997. In March 2005, they agreed on a reform of the SGP, after a number of states had found it increasingly difficult to comply with the SGP rules for limiting public debt and deficit ratios.

While leaving the reference values for the general government deficit ratio (3% of GDP) and for the general government debt ratio (60% of GDP) unchanged, the reform altered a number of implementation details: Member States' medium-term budgetary objectives will now reflect their economic situation more strongly. Efforts to adjust fiscal positions will have to be higher in economically "good times," whereas in economically "bad times," Member States may put forward a larger number of relevant factors to be considered by the European Commission in its assessment of fiscal policies. In this context, special consideration will be given to pension system reforms or to outlays for fostering international solidarity and achieving European integration, if these have a detrimental effect on the growth and the fiscal burden of a Member State. Deficits in excess of the reference value shall be acceptable only temporarily, and only if the ratio remains close to 3%. Finally, the deadlines for correcting

Stability and Growth Pact reformed

Table 2

General Government Budget Balances								
% of GDP	1999	2000	2001	2002	2003	2004	2005	2006 ¹
Belgium	-0.4	0.2	0.6	0.0	0.1	0.0	0.1	-0.3
Germany	-1.5	1.3	-2.8	-3.7	-4.0	-3.7	-3.3	-3.1
Greece	-1.8	-4.1	-4.9	-4.9	-5.8	-6.9	-4.5	-3.0
Spain	-1.2	-0.9	-0.5	-0.3	0.0	-0.1	1.1	0.9
France	-1.8	-1.4	-1.5	-3.2	-4.2	-3.7	-2.9	-3.0
Ireland	2.4	4.4	0.8	-0.4	0.2	1.5	1.0	0.1
Italy	-1.7	-0.6	-3.1	-2.9	-3.4	-3.4	-4.1	-4.1
Luxembourg	3.7	6.0	5.9	2.0	0.2	-1.1	-1.9	-1.8
Netherlands	0.7	2.2	-0.2	-2.0	-3.1	-1.9	-0.3	-1.2
Austria	-2.2	-1.5	0.0	-0.5	-1.5	-1.1	-1.5	-1.9
Portugal	-2.8	-2.8	-4.3	-2.9	-2.9	-3.2	-6.0	-5.0
Finland	2.2	7.1	5.1	4.1	2.5	2.3	2.6	2.8
EU-12	-1.3	0.1	-1.8	-2.5	-3.0	-2.8	-2.4	-2.4
Denmark	2.4	1.7	2.6	1.2	1.0	2.7	4.9	3.9
Sweden	2.5	5.1	2.5	-0.2	0.1	1.8	2.9	2.2
United Kingdom	1.0	3.8	0.7	-1.6	-3.3	-3.3	-3.5	-3.0
EU-15	-0.7	1.0	-1.2	-2.2	-2.9	-2.6	-2.3	-2.2
Cyprus	-4.5	-2.4	-2.3	-4.5	-6.3	-4.1	-2.4	-2.1
Czech Republic	-3.6	-3.7	-5.9	-6.8	-6.6	-2.9	-2.6	-3.2
Estonia	-3.7	-0.6	0.3	1.0	2.4	1.5	1.6	1.4
Hungary	-5.6	-3.0	-3.5	-8.4	-6.4	-5.4	-6.1	-6.7
Latvia	-4.9	-2.8	-2.1	-2.3	-1.2	-0.9	0.2	-1.0
Lithuania	-5.6	-2.5	-2.0	-1.4	-1.2	-1.5	-0.5	-0.6
Malta	-7.6	-6.2	-6.4	-5.6	-10.2	-5.1	-3.3	-2.9
Poland	-1.4	-0.7	-3.7	-3.2	-4.7	-3.9	-2.5	-3.0
Slovakia	-6.4	-12.3	-6.5	-7.7	-3.7	-3.0	-2.9	-2.7
Slovenia	-2.1	-3.5	-4.3	-2.7	-2.8	-2.3	-1.8	-1.9
EU-25	-0.8	0.8	-1.3	-2.3	-3.0	-2.6	-2.3	-2.3

Source: Eurostat, European Commission.

¹ Spring economic forecast 2006 of the European Commission.

an excessive deficit were made extendable.

The Eurosystem central banks consider the SGP to be a very important tool. Given that its provisions have been softened with the reform package, a stringent and consistent implementation of the revised rules is now all the more important. After all, the average deficit ratio of the euro area stood at 3% in 2003 and dropped only slightly below that threshold in 2004 (-2.8%), but was reduced to 2.4% in 2005. Similar deficits are expected for both 2006 and 2007. In 2005, 4 of the 12 euro area countries (and 7 of the 25 EU Member States) posted deficits of 3% or more in 2005. Especially countries

running excessive deficits will have to make sure to use the incipient economic revival to consolidate their budgets and put them on a sustained basis.

When endorsing the reform of the SGP, the heads of state or government of the EU Member States also agreed to relaunch the so-called Lisbon agenda – the EU's policy and reform strategy for the first decade of the new millennium that the European Council of Lisbon had established in March 2000. In response to the poor implementation record of the strategy evidenced by the mid-term review of 2005, the priorities were refocused on growth and employment, with research, knowledge and

Lisbon agenda
relaunched

innovation identified as the engines of sustainable growth. Overall, the economic, social and environmental dimensions of the strategy were maintained. The mid-term reform was also used to streamline governance processes: Henceforth, the European Council will issue an integrated package of guidelines incorporating Broad Economic Policy Guidelines and Employment Guidelines. These are supposed to provide the EU countries with a basis for drawing up coherent (annual) national reform programs. Toward the end of 2005, all 25 EU countries submitted their initial reform programs, some containing broad-based and ambitious policies. In the years ahead, it will take a strong political commitment to follow through on those policies.

From a central banking perspective, the Lisbon strategy is an important pledge to support necessary reforms of economic structures. After all, sweeping structural reforms are required to increase Member States' ability to quickly adjust to new developments and allow them to reap the full benefits of the euro area. In other words, a commitment to structural reform is the crucial third economic policy pillar of the euro, next to the maintenance of monetary stability and sound, sustainable public finances.

To date, the Treaty establishing a Constitution for Europe has been ratified by 14 of the 25 EU Member States. The fact that the Constitution failed to achieve majority support in France and the Netherlands in May and June 2005 dealt the European integration process a bit of a blow. The EU heads of state or government con-

cluded at their meeting of June 16 and 17, 2005, that the EU Member States needed time to reflect and that the period of reflection should be used to enable a broad debate to take place in each of the EU countries.

OeNB Workshop proceedings on the potential implications of the Constitutional Treaty for the euro area and the euro⁸ imply that there is a broad consensus that the Constitutional Treaty, once in effect, would not entail any substantial material changes for EMU; adjustments in the realm of EMU would typically be of a technical nature.

The OeNB's Role in International Financial Organizations

The Governor of the OeNB attends the biannual meetings of the International Monetary and Financial Committee (IMFC), the primary steering committee of the IMF. The OeNB also represents the Republic of Austria at the IMF, and an OeNB official currently holds the post of the IMF Alternate Executive Director heading the constituency of member states to which Austria belongs.

As part of its surveillance activities in 2005, the IMF monitored the financial sectors and supervisory systems of its member states more closely. The publication of regular *Global Financial Stability Reports* and the merger of two previously independent departments involved in different aspects of financial sector work reflect the IMF's heightened commitment to surveillance issues.

Speaking in the context of the ongoing review of the IMF's medium-term strategy and organization, the

European integration process stalled following two negative referendums on the European constitution

⁸ OeNB. 2005. *A Constitutional Treaty for an Enlarged Europe: Institutional and Economic Implications for Economic and Monetary Union*. In: *Workshops – Proceedings of OeNB Workshops; No 4* (also available at www.oenb.at).

Managing Director of the IMF recommended expanding the analysis of exchange rate systems and balance of payments imbalances and paying greater attention to spillovers between economies in assessments. The discussion of the relevant proposals is in progress and will remain on the agenda of the IMF's decision-making bodies for quite some time.

Financing conditions for the IMF changed fundamentally in 2005. Given that the interest rate differential between funds provided by industrial countries and interest paid by crisis countries receiving IMF support is the latter's main source of funding, the IMF's income shrank dramatically in 2005 when Brazil and Argentina repaid 50% of their outstanding IMF loans. While the impact on the current budget is limited, the IMF does face the challenge of taking adequate steps to open up new sources of income and cut back spending in the financial years ahead. The OeNB contributes to the ongoing debate of these issues by the IMF and other international institutions.

In the field of development aid, the IMF backed a debt relief deal cancelling debt owed by the world's poorest countries. In December 2005, agreement was reached on a plan to forgive about USD 3.3 billion in debts of a group of 19 low-income countries. The OeNB supported this initiative in the relevant IMF forums.

EU Council Presidency Passed to Austria on January 1, 2006

Austria celebrated a number of anniversaries in 2005: Following the end of World War II, the Republic of Austria was reestablished in 1945

(60th anniversary). The Austrian State Treaty was signed in 1955 (50th anniversary). Finally, Austria joined the EU on January 1, 1995 (10th anniversary). The OeNB also marked the 60th anniversary of the resumption of independent operations in 1945. Since then, it has contributed to the catching-up of the economy by creating a climate of stability.

The OeNB reviewed the economic impact of ten years of EU membership in issue Q2/05 of its publication *Monetary Policy & the Economy*:⁹ the monetary policy effect of EU accession and participation in the third stage of EMU was the continuation of a stability policy. Austria's foreign trade volumes have been boosted strongly since 1995, especially by the opening up of new markets in Eastern Europe; the domestic export ratio (goods and services) has since risen to more than 50% of GDP. In terms of economic growth, Austria was one of



⁹ Available at www.oenb.at.

the top performers among the EU-15. Inflation rates continued to drop in an international environment of easing prices pressures, reflecting growing liberalization and keener competition. Unemployment ratios increased somewhat but remained comparatively low. Deficit ratios, finally, narrowed markedly.

In January 2006 Austria assumed the rotating presidency of the EU Council for the second time (first time: second half of 1998). Next to implementing the reformed Stability

and Growth Pact and finalizing the new Broad Economic Policy Guidelines, the policy priorities of the Austrian presidency include preparations for the enlargement of the euro area and initiatives to bring the countries of the Western Balkans closer to the EU. In this context the OeNB hosted an international conference in early May 2006 that provided insights for the new Member States into Austria's experiences with introducing the euro and preparing for its introduction.

Table 3

Selected Economic Indicators

% change p.a. from 1995 to 2005

	Austria	EU-15
Real GDP	2.2	2.2 ¹
HICP	1.6	2.0
Employment	0.6	1.3
Real unit labor cost	-0.9	-0.4
Real GDP per citizen	1.9	1.8 ¹
Real GDP per employed person	1.6	0.9 ¹
Unemployment rate (average)	4.2	8.5

Source: Eurostat, Ameco, OeNB.

¹ 1996 to 2005.

The OeNB Implements Monetary Policy Measures and Manages Reserve Assets

Changes in the Eurosystem's Monetary Policy Instruments

Tender operations effected in the course of open market operations are settled via a special system in Austria. The participating banks enter their bids in an electronic tender system based on Internet technology that collects and saves all bids. The tender bids are then forwarded to the European Central Bank (ECB), which carries out the allotment. The tenders conducted in the reporting year were exclusively *variable rate tenders*.

On May 30, 2005, the revised version of the "General documentation on Eurosystem monetary policy instruments and procedures," a comprehensive presentation of monetary policy operations, entered into force.¹ Since July 1, 2005, selected debt instruments issued by entities established in the G-10 countries that are not part of the European Economic Area (currently the United States, Canada, Japan and Switzerland) have been included in the list of eligible assets, which is available on the ECB's website (Monetary Policy/Implementation/Collateral Issues).

At its meeting of December 16, 2005, the Governing Council of the ECB decided to raise the allotment amount for each of the longer-term refinancing operations (LTROs) to be conducted in the year 2006 from EUR 30 billion to EUR 40 billion. This rise accounts for two important aspects: First, the liquidity needs of the euro area banking system are expected to go up further in the year 2006. Second, the Eurosystem has

decided to slightly increase the share of liquidity needs that are met by LTROs. The Eurosystem will, however, continue to provide the bulk of liquidity through its main refinancing operations. The Governing Council will review and may decide to adjust the allotment amount again at the beginning of 2007.

The collateral pool comprises eligible assets that are broken down into tier one and tier two assets. In 2005, counterparties pledged eligible assets averaging EUR 18.4 billion (in total) with the Oesterreichische Nationalbank (OeNB) as collateral for refinancing operations and intraday credit. In the past few years, foreign securities have increasingly been used as collateral. While in the first half of 2002 they had accounted for some 39% of the entire collateral pool, their share had risen to around 85% by the second half of 2005. In the reporting year, an average of approximately 75% of assets deposited as collateral by banks were frozen for refinancing operations and intraday credit.

Versatile Market Environment for OeNB Portfolio Management

Commodity markets, which have seen an uptrend for several years, experienced a major boom in 2005. The flourishing global economy, and in particular growth in emerging economies and industrial nations, has increasingly boosted demand for raw materials. China's consumption of raw materials, for instance, is already the second-largest in the world. As

Surge in commodity prices – focus on oil and gold prices

¹ The publication "The implementation of monetary policy in the euro area: General documentation on Eurosystem monetary policy instruments and procedures" is available at www.ecb.int.

supply capacities can only be expanded slowly in the course of several years, the ensuing imbalance between supply and demand inevitably leads to price increases. Rising oil prices reflect the enormous demand for raw materials particularly well; moreover, with refineries operating at full capacity, higher demand also causes logistical problems, as refinery capacities are fully utilized. In 2005 the price of Brent crude oil reached a new all-time high of USD 67.5 per barrel (early September 2005).

As of late summer 2005, gold price developments have been extremely dynamic: From September 2005 to February 2006, the price of one fine ounce of gold (London fixing) went up by around 30% in U.S. dollars and by approximately 34% in euro, reaching peaks of USD 572.15 and EUR 475.98, respectively. The reasons behind this uptrend are once again geopolitical tensions, such as the terrorist attacks in London in July or the crisis in Iran. Gold market-specific factors also provided a strong stimulus: As the level of prosperity in the emerging economies and oil-producing countries of the Middle East has been increasing, demand for gold as an investment instrument has been going up as well. Moreover, gold is being used more and more often as an investment instrument to hedge against exchange losses of internationally traded currencies (in particular the U.S. dollar). The gold price was also supported by the fact that in 2005 gold mining companies continued to refrain from hedging by selling their gold production forward or even reduced their hedge positions.

After three years of a continued downtrend, the U.S. dollar picked up in 2005, appreciating by 15% against both the euro and the Japanese yen.

This trend reversal may be mainly attributable to the fact that market participants shifted their focus and started to reassess market factors. In previous years, there were basically two driving forces behind market behavior: (1) concerns about the continuously growing external imbalance, more precisely, the twin deficit in the U.S.A. (current account and budget deficit) combined with the question whether foreign investors would continue to be willing to finance this imbalance, and (2) speculation that Asian central banks might shift their quickly expanding reserve assets from the U.S. dollar to other investment currencies (see box 5).

In summer 2004, a new factor came into play, causing the U.S. dollar to appreciate against other currencies. In a series of 15 moderate, but consistent moves of 25 basis points each, the Federal Reserve System raised its key interest rates from 1.00% to 4.75% at the time of writing, bringing short-term interest rates back to normal levels. Market participants understood that the Fed would respond to any sign of economic overheating by swiftly tightening the monetary stance. Subsequently, investment in U.S. dollars became more attractive for international investors, which resulted in a clear uptrend in net capital inflows to the United States.

Exceptional factors also played a role in strengthening the U.S. dollar. In the second quarter of 2005, market sentiment turned more and more against the euro after referendums on the Treaty establishing a Constitution for Europe had failed in France and the Netherlands. At end-2005, a temporary reduction in the tax rate on the repatriation of foreign profits entered into force in the United

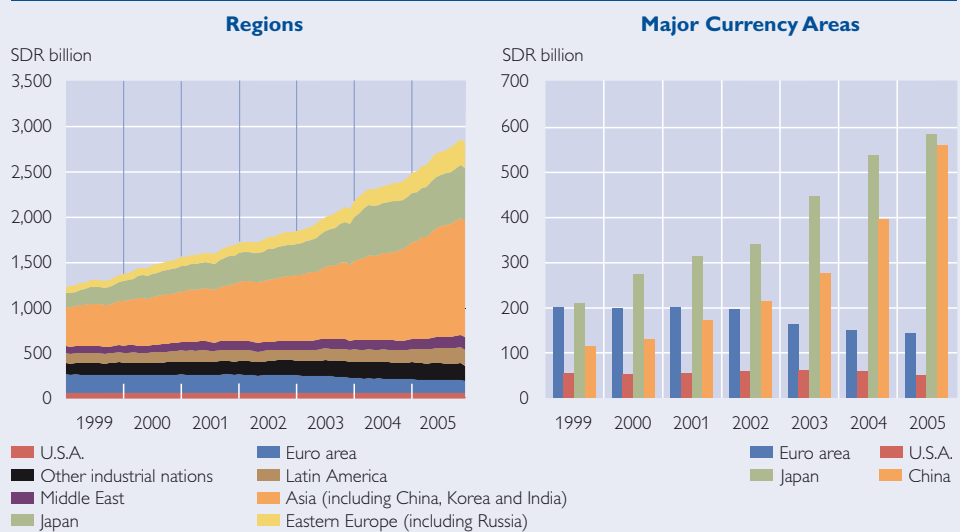
**U.S. dollar recovers
after years of
downward movement**

Regional Developments in Global Currency Reserves

Especially Asian countries (including Japan) have a growing potential to significantly influence exchange rates even by minor shifts in their currency portfolios. The chart “Total Reserve Assets – Regions” clearly shows the enormous expansion of foreign reserves¹ that can be observed in this region compared with western industrial economies (in particular the U.S.A. and the euro area, but also the countries of the Middle East). The rapid and sustained regional redistribution of reserves continued unabatedly in 2005. It should be noted that Eastern Europe and Russia are gaining importance in this context.

The changes in the level of official reserves in key economies also reflect the ongoing regional redistribution of reserve assets. The chart “Total Reserve Assets – Major Currency Areas” shows that euro area foreign reserves have been declining since 2003 and U.S. foreign reserves have been stagnating at a low level, while Japan’s and China’s reserve assets have been growing at a particularly dynamic pace. In 2005, China’s foreign reserves soared by 45.2% from SDR 396 billion to SDR 575 billion (or EUR 697 billion), while Japan’s foreign reserves remained at a record level of SDR 584 billion (or EUR 707 billion), but at a rate of 8.7% grew at a significantly slower pace than in 2004. In 2005, the Eurosystem’s reserve assets decreased by 4.9% to SDR 142 billion (or EUR 172 billion) against 2004.

Total Reserve Assets



Source: IMF International Financial Statistics, Bloomberg.

¹ Reserve assets include holdings of convertible foreign currencies, gold (valued at SDR 35 per fine ounce) and Special Drawing Rights (SDRs) of the International Monetary Fund (IMF). Foreign reserves are valued in SDRs, which constitute a unit of account based on a currency basket. This basket is made up of fixed amounts in world currencies (U.S. dollar, euro, Japanese yen and pound sterling) and is reevaluated on a daily basis. At end-2005, the value of SDR 1 was USD 1.429270 or EUR 1.211550, respectively.

States. As a consequence, American parent companies made extensive use of the possibility to bring home their foreign subsidiaries’ profits. The capital inflows thus generated apparently had a positive effect on both the U.S. current account and on the government deficit. The introduction of a

new exchange rate regime in China on June 21, 2005, combined with a slight appreciation of the Chinese renminbi-yuan against the U.S. dollar has had a relatively moderate impact on international currency markets so far.

International bond markets remained very stable in the reporting year. Despite robust economic activity, the yields on U.S. ten-year bonds tended to stay at low levels of between 4% and 4.6%. In the euro area, by comparison, long-term interest rates even dropped to a historical low, with ten-year German government bond yields falling to 3.0% in September 2005. The above-mentioned rise in U.S. key interest rates caused the U.S. yield curve to flatten significantly and, albeit to a lesser extent, also led to a flattening of the euro area yield curve. Demand was high not only for government bonds, but also for corporate bonds, whose yield spreads vis-à-vis government bonds narrowed markedly. Moreover, budding inflation concerns (due to commodity price hikes) drove up market participants' interest in inflation-indexed bonds. Bond market volatility, which had been decreasing since mid-2004, continued to be low in 2005.

The OeNB's Investment Portfolio is Well Diversified – Market Risk Is Perfectly Aligned to the OeNB's Risk-Bearing Capacity

The OeNB's Section Treasury manages an investment portfolio, comprising reserve assets and other assets, of around EUR 21.5 billion, along the OeNB's priorities: (1) security, (2) liquidity and (3) return. This investment portfolio can be broken down into various subportfolios that are subject to different objectives and rules; these subportfolios comprise gold investments, foreign currency and euro-denominated investments, the investment of own funds, of assets transferred to the ECB, of pension reserve assets and of reserve funds endowed for the National Foun-

ation for Research, Technology and Development (National Foundation).

For several years, the OeNB has been following an active portfolio management approach in investing a large amount of its gold reserves in a way that ensures that this part of its assets also contributes to overall profits. As gold interest rates in the short-term segment had dropped to almost zero in 2004 and have been at this level ever since, new investment in this area will currently not generate profits. It was possible, however, to lock in more attractive interest rates for the next few years by making timely investments in the long-term segment (maturities of up to ten years) against adequate collateral. Within the framework of the Second Central Bank Gold Agreement, which was signed for the period from September 2004 to September 2009, fairly small volumes of gold were sold in 2005. The OeNB is one of the signing parties of the Gold Agreement that established quotas for future gold sales.

For many years, maintaining a well-diversified foreign currency and euro-denominated investment portfolio – in particular with a view to currency selection (multicurrency portfolio) and investment instruments (asset classes) – has proved to be a successful approach. Broad-based diversification primarily aims at significantly reducing portfolio risk by spreading it across a number of sundry market segments. Moreover, it is also intended to help generate higher overall yields. The OeNB's exposure to credit risk, i.e. the risk of loss owing to default of a debtor, can altogether be regarded as very conservative. To earn higher revenues from more complex products at low risk, investment has increasingly concentrated on funds.

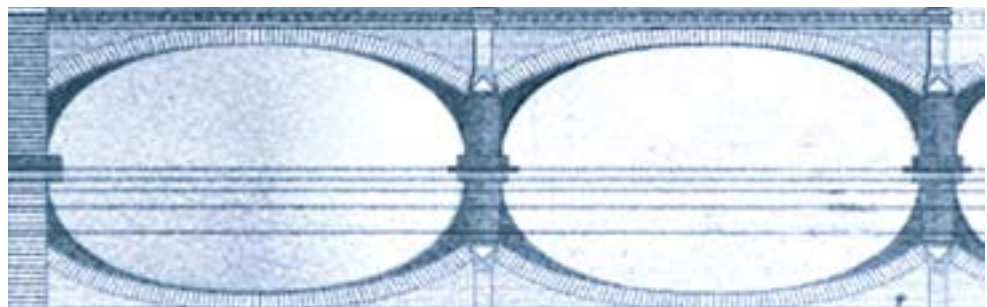
Long-term bond yields remain at very low levels

The portfolio's market risk is controlled by a so-called strategic benchmark, which provides guidance on the parameters² of currency distribution and maturity structure that are essential for effective portfolio investment. The strategic benchmark is specified by the OeNB's Treasury Section on the basis of fundamental market analyses and forecasts; the Governing Board of the OeNB then approves the benchmark. The value-at-risk (VaR) method³ is used for exact calculations to tune the risk content of the intended benchmark to the OeNB's specific requirements. This strategy focuses on the OeNB's risk-bearing capacity in view of its liability-side reserves.

Within the framework set by the strategic benchmark, an investment committee that meets in regular intervals defines the so-called *tactical benchmark*, which constitutes the actual reference measure for specific portfolio management decisions in the Front Office. Unlike the strategic benchmark, which focuses above all on defining the OeNB-relevant market environment and on longer-term market trends, the tactical bench-

mark reflects shorter-term market developments that require quick and flexible responses.

In line with a decentralized approach, the OeNB continues to manage its share in the foreign reserve assets transferred to the ECB on behalf and for the account of the ECB. These management activities are strictly separated from all other activities carried out by the OeNB's Treasury (Chinese walls). In 2005 the Governing Council of the ECB approved a major amendment to the framework for the management of the ECB's foreign reserves; the new framework provides for so-called currency specialization. Accordingly, since January 2006, most Eurosystem NCBs have specialized in either Japanese yen- or U.S. dollar-denominated investments instead of investing in both currencies. The OeNB, for its part, has concentrated exclusively on investments in Japanese yen in its management of reserves transferred to the ECB.⁴ This step is also in line with the OeNB's policy of shifting more attention to Asia in the future, as this region is quickly gaining importance.



² Target values (upper and lower limits) per currency are established both for currency distribution and interest rate risk.

³ The VaR concept serves to quantify market risks. Applying the VaR method yields a risk measure that indicates the estimated loss of market value over a given period of time and at a given level of probability. This measure makes it possible to accurately control market risk even in highly differentiated portfolios.

⁴ See also ECB. 2006. *Portfolio Management at the ECB. Monthly Bulletin* April. 75–86.

The OeNB Supports the Maintenance of Financial Stability

Financial Sector Stability in Austria Improved Further

Overall, 2005 was a good year for Austrian banks, with business going well both in the domestic and the Central and Eastern European markets. Total assets on an unconsolidated basis amounted to EUR 725 billion in 2005, growing by 11.1%, an increase last seen in 2000, when economic activity was strong. In particular, direct foreign business continued at a brisk pace: Foreign assets expanded by a hefty 22.7%, totaling EUR 246 billion, whereas domestic assets, amounting to EUR 479 billion, grew by a comparably modest 5.9%.

The profitability of the Austrian banking sector also strengthened in 2005. Unconsolidated operating profits came to EUR 5.6 billion in the year under review, up a strong 19.1% on 2004. Overall, unconsolidated operating income (EUR 15.7 billion) rose by 8% and thus much more markedly than operating expenses (totaling EUR 10.1 billion) at 4.1%. As a consequence, at 63.4%, Austrian banks' unconsolidated cost/income ratio hit a historic low in 2005. The main drivers behind this development were healthy fee-based income and strong equity investment income, whereas interest income, as in previous years, remained broadly unchanged. Austrian banks' claims on domestic customers picked up momentum in 2005, totaling EUR 265 billion and growing by 4.8% and thus more strongly than deposits (+4.7%; totaling EUR 221 billion), a movement which offset the further narrowing of the interest margin (2004: 1.21%, 2005: 1.1%). The profit for the year 2005 is expected to come to

EUR 3.9 billion, raising the unconsolidated return on assets to 0.54%, the highest value recorded over the past ten years. This development is supported by a further decrease in banks' risk provisioning requirements; in other words, banks benefited from the heightened quality of their loan portfolios.

Austrian banks' profits on a consolidated basis (i.e. including the results posted by their foreign subsidiaries) also continued to rise in 2005, mostly thanks to interest and fee-based income as well as – to a smaller extent – lower risk provisioning.

Austrian banks benefit particularly strongly from the growing markets in Central and Eastern Europe (CEE). The number of Austrian banks' subsidiaries in the region continued to rise in 2005, which in turn had a positive impact on parent banks' profitability. Accounting for approximately 15% of Austrian banks' total assets, the CEE subsidiaries contributed more than one-third to the parent banks' consolidated annual profits in the reporting year. In some CEECs, Austrian subsidiaries already hold a market share of up to 45%.

On average, domestic banks' total assets in CEE rose by an annual 22% over the past four years. However, the increasing market presence of Western banks in CEE leads to tighter competition and, as a consequence, to upward price pressure in privatization deals; in addition, margins can be expected to shrink in the future. The OeNB closely monitors these developments and publishes analyses on a regular basis, for instance in its bi-annual *Financial Stability Report*.

The increase in Austrian banks' profits went hand in hand with a

**Banks enjoyed
good earnings in 2005**

**CEE subsidiaries earn
more than one-third of
Austrian banks' profits**

further strengthening of their risk-bearing capacity. At 14.4% (most recent figure), the unconsolidated capital ratio was clearly higher than the minimum regulatory requirement. Furthermore, the results of regularly conducted market and credit risk stress tests show that Austrian banks are quite capable of coping with market and credit risk.

Like banks, other financial intermediaries also posted good results for the year under review. While mutual funds and pension funds gained from a favorable market environment, insurance companies enjoyed higher premium income and profited from better cost structures and, like banks, from their activities in CEE.

One of the most striking developments in lending to the private sector was that foreign currency loans to households and enterprises reached a new record high of EUR 53 billion (90% of which were denominated in Swiss francs) at the end of 2005. Households in particular continued in large numbers to opt for borrowing in foreign currency, with almost every third loan (31% as of December 2005, see chart 18) being foreign cur-

rency-denominated. As the interest margin between the euro and the Swiss franc has clearly been narrowing since 2002 – except for a slight widening recently – the risk exposure of households which have taken out foreign currency loans has increased: the exchange rate risk is rising while potential gains from lower interest rates are declining. This phenomenon contrasts with the trend witnessed in the corporate sector, where enterprises have been reducing the foreign currency-denominated share in their loan portfolios for quite some time. Against the background of these divergent trends the question arises as to whether households are sufficiently aware of the risks associated with foreign currency loans. Therefore, the OeNB, in cooperation with the Financial Market Authority (FMA), is planning to publish an information brochure in the first half of 2006 to help consumers get a clearer picture of the advantages and risks related to borrowing in foreign currency.

Apart from exchange rate risks, households have been increasingly exposed to the risk of interest rate fluctu-

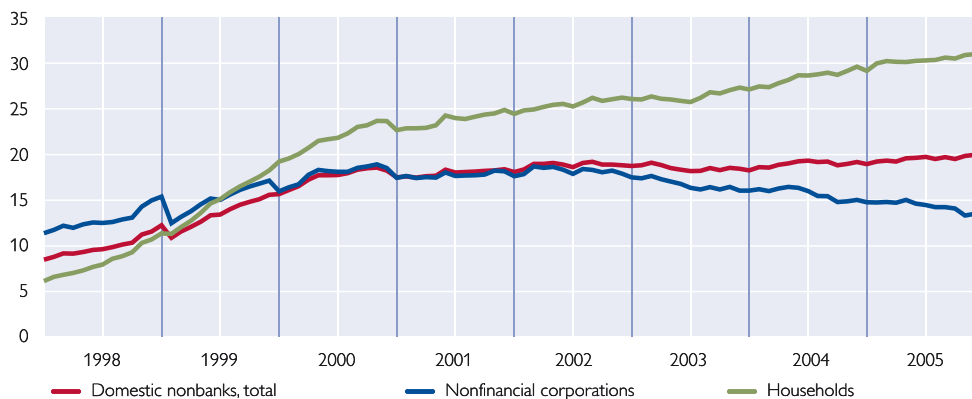
Mutual funds and insurance companies also fared well in 2005

Household borrowing in foreign currency continued at high levels in 2005

Chart 18

Share of Foreign Currency Loans in Austria

As a percentage of total loans



Source: OeNB.

tuations, since more than 75% of all loans to households are variable rate loans. All in all, households' market risk exposure has been rising, which in the long run may impact on the quality of Austrian banks' loan portfolios.

Implementation of Basel II Enters Final Stage

The acceptance of the Capital Requirements Directive proposal by the EU Council and the European Parliament in early fall 2005 marked the successful conclusion of the largest project to date pertaining to banking sector regulation at the European level. The wording of the directive is currently being finalized to meet all linguistic and legislative requirements and is planned to be formally adopted in the first half of 2006. According to the current schedule, the Basel II framework will be gradually implemented from January 1, 2007, onwards.

In view of the tight schedule, the preparations for transposing the new

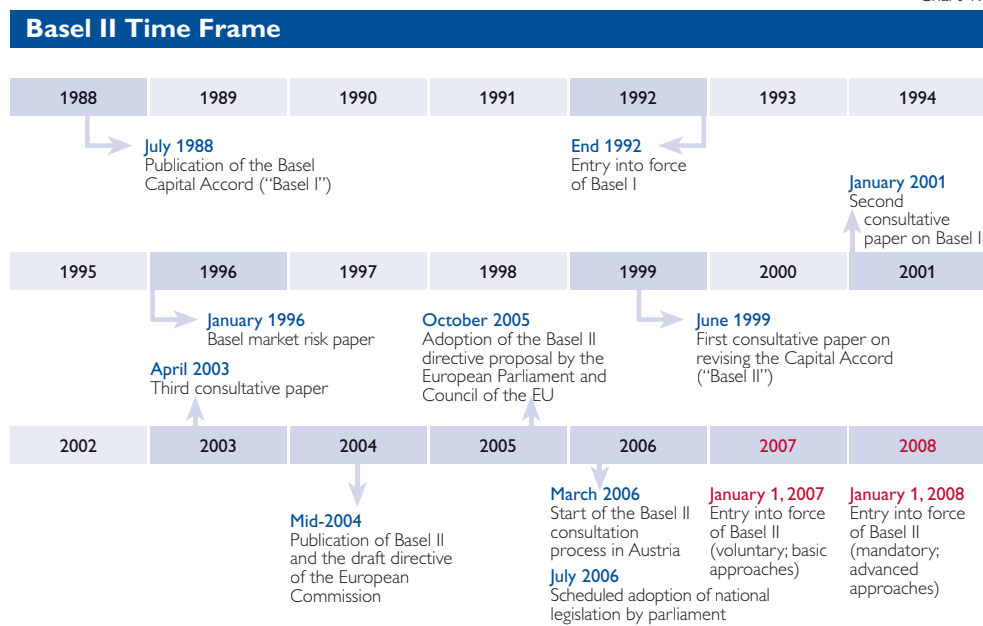
rules into Austrian national legislation have already been launched. The Federal Ministry of Finance, the FMA and the OeNB have continued their successful collaboration also in this area, setting up – next to the Basel II project secretariat, which had ensured the coordination of positions during the negotiation process – expert teams as well as a team of senior editors (made up of representatives of all three institutions) to deal with legislative work.

In the discussions on the new capital adequacy rules at the European level, the Austrian negotiators were successful in making sure that the provisions take account of a number of issues that are of particular relevance to the Austrian market; it is crucial that these favorable conditions are taken into consideration when Basel II is transposed into Austrian legislation.

- Small and medium-sized enterprises (SMEs) are put into a better position than large enterprises: the risk capital that banks are re-

New framework takes into account Austrian interests

Chart 19



quired to hold is lower for loans to SMEs than for loans to larger companies, even if their level of creditworthiness is the same. Conditions for SMEs were made even more favorable, as loans to SMEs below EUR 1 million are treated like retail loans. In addition, the new framework to a larger extent acknowledges collateral typical of SMEs (e.g. real estate).

- Consumers gain from the more favorable treatment of house purchase loans under Basel II. Loans for house purchase account for about two-thirds of total lending to private households in Austria.
- Savers and investors benefit from the new rules, as banks' improved risk management increases the safety of their deposits.
- Nonprofit organizations (such as religious communities or charities) are assigned to a favorable rating class.
- Banks will be treated according to the principle of proportionality; in other words, the requirements in connection with the im-

plementation of Basel II are less stringent for small banks than for large banks.

Banks wishing to apply the more complex calculation methods of the internal ratings-based approaches require the approval of the supervisory authorities as well as comprehensive preparations entailing an extensive use of resources. To facilitate these preparations, the OeNB together with the FMA entered into a focused consultation process with the banking industry in 2005. The consultation provided credit institutions with the opportunity to have their level of implementation of the new regulatory framework thoroughly assessed by the supervisory authorities, who also informed the respective banks of the results of their review. These prior consultations helped identify, at an early stage, those areas in which the regulatory provisions had already been fully implemented and those which required further efforts. On this basis it was possible to create a reliable setting for planning and investment for both the banking industry and the supervisory authorities.

Box 6

The Risk-Oriented Reporting System (ROM)

The implementation of Basel II warranted the adjustment of the provisions governing the supervisory reporting system in Austria. To this end, the OeNB and the FMA launched a joint project to set up the "Risk-Oriented Reporting System (ROM)," which covers both the data requirements of Basel II and those of the newly developed off-site analysis models. Following a series of intense and very constructive negotiations, in early November 2005, the OeNB and the FMA reached agreement with industry representatives on ROM, which has been designed to account for the new framework conditions in the domestic banking industry in particular. This implies that in future there will be a stronger focus on the compilation of data from bank groups and foreign subsidiaries as well as of detailed risk information. The first set of rules under the restructured supervisory reporting system will enter into force on January 1, 2007.

In addition, agreement was reached on substantial changes in banks' reports of major loans. The modified rules on risk-oriented reporting ensure that claims on borrowers are fully reflected and that the reported risk-related data meet the requirements of Basel II.

Close Cooperation with the FMA

The OeNB's broad involvement in supervisory tasks – as stipulated by the Austrian Banking Act – led to the further intensification and consolidation of cooperation between the OeNB and the FMA in the reporting year. The OeNB carries out electronic processing and plausibility checks of the data reported by the Austrian banking industry and draws up analyses on the basis of these data, which are made available to the FMA. Furthermore, the OeNB is strongly engaged in on-site inspections in accordance with its statutory mandate to carry out on-site inspections of credit institutions' market and credit risk exposure. The smooth collaboration between the FMA and the OeNB is highlighted by the fact that each of the two institutions has the right to participate in on-site inspections carried out by the other institution – an option the FMA has repeatedly made use of.

The working relations between the OeNB and the FMA are not limited to day-to-day business, but also involve regular meetings of heads of divisions and senior managers to exchange information and discuss issues of fundamental interest. Furthermore, a number of joint working groups have been established to deal with specific issues of financial supervision to ensure the effective pooling of expertise and, whenever necessary, timely and concerted action in the interest of the Austrian financial market.

Cooperation with the Federal Ministry of Finance has been successfully supported by the statutory Financial Market Committee, which also serves as a platform for an exchange of opinions and the coordination of legislative initiatives.

Lively exchange of opinions between institutions responsible for maintaining financial stability

Box 7

The EU Financial Services Action Plan – Better Regulation

After the completion of the Financial Services Action Plan (FSAP) and several years of consultation to which the OeNB had also contributed, in 2005 the European Commission published its financial services strategy for the next five years. The following five priorities have been identified to utilize the as yet untapped economic and employment growth potential of the EU financial services sector and thus promote the overall process of integration:

- Priority no. 1 is to dynamically consolidate progress and ensure the sound implementation and enforcement of existing rules.
- Priority no. 2 is to drive through the better regulation principles into all policy making.
- Priority no. 3 is to enhance supervisory convergence.
- Priority no. 4 is to create more competition between service providers, especially those active in retail markets.
- Priority no. 5 is to expand the EU's influence in globalizing capital markets.

The increased focus on consolidation and implementation is, inter alia, to answer to industry calls for a "regulatory pause." Moreover, the better regulation principle is to ensure that future regulatory measures are well targeted and based on impact studies and that they are made subject to ex-post reviews to assess their effectiveness.

The OeNB Takes Action to Enhance Financial Stability

Stepped-Up Supervisory Cooperation at the European Level

In 2005 the OeNB continued to closely cooperate with European NCBs and supervisory authorities, thereby providing a number of valuable stimuli. On the ESCB Banking Supervision Committee (BSC), a joint forum of representatives of EU central banks and supervisors, the OeNB contributed to analyses of developments in the European banking sector from a financial stability perspective and to discussions of specific regulatory and supervisory issues (for instance in connection with financial crisis management). Serving as the chair of the Working Group on Banking Developments, a BSC working group, the OeNB played a considerable role in shaping the deliberations of the BSC. Apart from its regular reports on the development of banking structures in the EU and on banking and financial sector stability, the BSC's 2005 agenda comprised issues such as the interaction between banks and hedge funds, banking structures in the new EU Member States, the increase in cross-border banking and the potential impact of the International Financial Reporting Standards (IFRS) on financial stability.

The OeNB participates in the Committee of European Banking Supervisors (CEBS), established in 2004, and, in addition, is represented in the CEBS Bureau, which proactively provides support and advice to the CEBS chair on key issues. CEBS' tasks are to advise the European Commission, especially on banking regulation issues, to ensure consistent implementation of EU directives in the banking sector and to foster the

convergence of supervisory practices and the overall cooperation among supervisors. In 2005 CEBS conducted a series of consultations, in particular on issues associated with Basel II (e.g. uniform reporting standards, supervisory review under pillar 2, recognition of external credit assessment institutions, validation of risk measurement and risk management systems, cooperation between home and host supervisors).

On the basis of the 2003 Memorandum of Understanding between EU supervisors and central banks, the EU Economic and Financial Committee (EFC) prepared another Memorandum of Understanding between banking supervisors, central banks and financial ministries on cooperation in financial crisis situations, which entered into force in July 2005. In April 2005, the Eurosystem's crisis management rules were successfully tested for their suitability to protect the financial system in case of crisis.

As regards financial crisis management in Austria, two major projects were completed in 2005: the Financial Market Committee set up a crisis management framework, and the OeNB drew up a crisis management manual. These two sets of rules complement the structural and organizational prerequisites for effective crisis management.

The OeNB's Analytical Tools: Comprehensive and Highly Professional

Given Austria's high bank density, on-site inspections of single banks cannot be conducted very frequently; therefore, off-site analyses play a particularly important role in the supervisory process. As a consequence, the OeNB, the FMA and the University of Vienna joined forces to enhance the analytical framework, creating a

OeNB contributes to improvement of financial crisis management

number of modern risk-based off-site analysis models.

Furthermore, the OeNB contributed to maintaining financial stability by promoting and participating in the linking of European loan registers. Since early October 2005, the OeNB has been legally entitled¹ to exchange data from its own loan register against data collected by the NCBs of Belgium, Germany, France, Italy, Portugal and Spain. This exchange of data provides Austrian banks and supervisors with more accurate information on Austrian borrowers' foreign debt and the opportunity to quickly and reliably retrieve information on the debt of borrowers from one of the participating countries if need be. This expansion of data collected in the Major Loans Register is not only an additional service to reporting banks, but also supplies supervisors with relevant information required for targeted and efficient off-site analysis.

The set of off-site analytical tools has been complemented by the *Systemic Risk Monitor*, a tool for analyzing banking sector stability at the aggregate level. The Systemic Risk Monitor model quantifies credit and market risks at the level of individual banks and places them into a systemic context by applying two innovative modeling approaches: on the one hand, it performs a joint statistical modeling of the risk factors determining credit and market risk, which allows an analysis of the concurrent influence of these factors on the banking system to be performed and on the other hand it explicitly takes into account the interlinkages between

banks in terms of interbank liabilities and mutual equity interests, which makes it possible to quantify the risk of contagion.

An innovative software tool has been introduced also for on-site inspection: BOSS (short for Bank On-Site Supervision) will contribute substantially to adding structure and uniformity to on-site supervisory processes. BOSS has been operational for real-time on-site inspections since October 2005; on the basis of an integrated analysis of strengths and weaknesses, the new tool provides, inter alia, a quick and graphically succinct evaluation of the key results of an on-site inspection exercise. In future, BOSS will support and document all on-site inspections.

In the year under review, the OeNB and the FMA added two guidelines to their joint series of publications on Basel II: The guideline on operational risk management deals with the risks caused by persons, infrastructure, IT, processes and external events and with the management of these risks, whereas the guideline on overall bank risk management explains the requirements of internal risk prevention, i.e. those risk management methods which banks apply regardless of regulatory requirements.²

Great Variety of Payment Systems Oversight Activities

In 2005 the OeNB was closely involved in the preparations of the new legal framework for payments in the Single Market, supporting the Federal Ministry of Finance in the respective working groups of the European Commission at the EU level

Systemic Risk Monitor analyzes contagion risk in banking

¹ Pursuant to Article 75 paragraph 5a of the Austrian Banking Act and the 299th regulation of the FMA on the international exchange of major loans data.

² Both guidelines are available at www.oenb.at.

The Tasks of Payment Systems Oversight

Pursuant to Article 44a of the Federal Act on the Oesterreichische Nationalbank 1984, the OeNB is entrusted with payment systems oversight. In accordance with this mandate, the OeNB monitors the systemic safety of multilateral payment systems operating in Austria as well as Austrian banks' secure participation in international payment systems. Oversight takes place by collecting payment systems statistics in the framework of the reporting system introduced in 2004 and by conducting reviews on the basis of the published guidelines. These reviews evaluate the measures taken to ensure legal, financial, organizational and technical system security. The Secure Information Technology Center – Austria (A-SIT) supports the OeNB in its activities by providing assistance on oversight issues in connection with organizational and technical system stability.

The numerous examinations the OeNB conducted in 2005 confirmed a high degree of systemic stability in Austria. The disturbances recorded were minor in scope and did not noticeably affect the Austrian financial system.

and, at the national level, conducting a survey to assess the potential implications of the introduction of a new license for payment institutions envisaged by the relevant directive on the Austrian financial market. Representatives of the European Commission, the ECB, Austrian public authorities and market participants discussed the results of this survey at an OeNB workshop in fall 2005.

Furthermore, in the year under review the OeNB's activities to advance and harmonize payment systems oversight in the Eurosystem included its contributions to developing a harmonized ESCB card payment oversight scheme – for which the OeNB's oversight principles and guidelines served as an essential basis for discussion – and to drawing up standards for securities settlement in the euro area.

In late January 2005, CCP.A³, a joint subsidiary of Oesterreichische Kontrollbank AG (OeKB) and Wiener Börse AG, opened business, as a

settlement agent and central counterparty for all trades concluded on the Vienna stock exchange (both spot and futures markets). The securities settlement system newly established and operated by CCP.A has been approved by the OeNB in accordance with the Settlement Finality Act and is now also subject to payment systems oversight.

In 2005 the OeNB examined the impact of systemic risk on the ARTIS⁴, applying a simulation software made available by Suomen Pankki – Finland's Bank, the Finnish central bank. The effects of operational problems on the liquidity situation of the system and its individual participants as well as on possible systemic risks were analyzed by simulating various risk scenarios. The results of the simulation showed that under the current security provisions, ARTIS has a high degree of operational reliability and – on this premise – functions smoothly also in a stress scenario.

³ CCP.A: CCP Austria Abwicklungsstelle für Börsengeschäfte GmbH.

⁴ ARTIS: Austrian Real Time Interbank Settlement.

Deepening of Financial Stability Analysis

Financial stability was also the central theme of the OeNB's 33rd Economics Conference in May 2005.⁵ Instability in the financial market makes it more difficult to predict the interaction between monetary policy and the real economy, which in turn adversely affects effective monetary policy implementation. Therefore, the ECB and the Eurosystem as a whole have always attached great importance to macroprudential financial market analysis. Such an analysis enables policymakers to take preventive measures or to counteract undesired developments at an early stage. Speakers at the conference highlighted the importance of preventive action against financial instability and the major role – due to the close relationship between price stability and financial stability – of macroprudential financial analysis conducted by central banks.

The OeNB regularly analyzes financial market developments in Austria to be able to identify potential risks to financial stability at an early stage. The results of these analyses are published, for instance, in the OeNB's biannual *Financial Stability Report* or presented at press conferences. In particular, in 2005 the OeNB continued to provide the public with information on the risk of foreign currency loans and conducted a survey among banks to examine the implications of banks' links to hedge funds for financial stability; the results of this survey, together with some regulatory considerations, were

published in a study⁶ in the Financial Stability Report 10. Furthermore, the OeNB conducted stress tests to calculate the potential losses Austrian banks might suffer from hedge fund investments.

The OeNB – A Center of Competence for Financial Statistics

At both the European (ESCB, Eurostat) and the national levels, the OeNB actively contributed to shaping the respective statistical frameworks in 2005. Also, the OeNB facilitated and expanded public access to its statistical data. This improvement in customer services is reflected in the number of visits (3.5 million in 2005) to the 1,800 pages of the OeNB website's "Statistics and Reporting" section and in the rising popularity of the statistics hotline, which recorded 2,200 inquiries by phone and e-mail (a 22% increase compared with 2004). In addition, the OeNB is continuously improving the usability of its online statistical services. The range of data available was increased also thanks to a joint initiative of the Eurosystem central banks: Since December 2005, the OeNB and the other euro area NCBs have provided comparative tables of selected data covering all euro area countries. The OeNB is currently working to broaden the scope of this service.

The consolidated analysis of bank data, i.e. the integrated examination of individual bank and group data, is increasing in importance, as reflected by the numerous data requests submitted by international organizations

Public makes extensive use of the OeNB's statistical services

Studies on foreign currency loans and hedge funds complement stability analysis

⁵ See also the conference proceedings of the OeNB's 33rd Economics Conference, available at www.oenb.at.

⁶ Endlich E., M. S. Schwaiger and G. Stöffler. 2005. *The Exposure of Austrian Banks to Hedge Funds: Survey Results and Regulatory Aspects*. In: *Financial Stability Report 10*. 74–82. Available at www.oenb.at.

What Central Banks Require from and Expect of Official Statistics

Selected Quotes from Governor Klaus Liebscher's Speech on the Official Statistics Day on September 20, 2005¹

- *“Responsible policies must be built on reliable information. Such information not only supports decision-making, but also contributes to understanding policy decisions and to making their effects transparent. Therefore, we need scientifically sound concepts and high-quality data based thereupon.”*
- *“Central banks have to be able to rely on the high quality of official data they use for policy decisions.”*
- *“However, central banks' statistical requirements and expectations are not limited to central bank-specific tasks.”*
- *“A dynamic economy needs dynamic statistical offices. At the same time, it is vital that in a continuously changing environment the quality of data be sustained at all times.”*
- *“As the role of statistics in policymaking – for instance in the excessive deficit procedure or in the convergence process – has been growing, those responsible for compiling data may be increasingly exposed to political pressure. For this reason, ensuring the official statistical offices' independence in terms of methods, staff and funding is a key priority. Structuring the European statistical system on the ESCB model may be one possible approach.”*
- *“It should be borne in mind that even data that meet the highest scientific criteria ‘do not speak for themselves’; they must be communicated and interpreted to be clear and credible to the public, which is a key aspect of the responsibility of statistical offices and other providers of statistics.”*
- *“Policymakers at the European and the national levels owe it to citizens to provide the necessary resources for delivering reliable statistics.”*

¹ The full German text of this speech was published in the OeNB's “Statistiken – Daten & Analysen” series (Q4/05) and is available at www.oenb.at.

(including the ECB and the IMF). In response to this development, in 2005 the OeNB implemented a widely automated process to calculate consolidated data on the profitability, business structures and own funds of banks. These data are reported to the ECB within the consolidated banking data framework.

Moreover, the OeNB compiles data for the IMF's Financial Soundness Indicators (FSI). The IMF has

launched this initiative in response to the financial crises of the late 1990s. The FSIs are to help increase transparency, improve the regular analysis and evaluation of financial systems and assess their strengths and vulnerabilities. At present, more than 60 countries (including all EU Member States) participate in this initiative.

New Foreign Trade Data Reporting System

The Quality of Statistics Hinges on Reliable Information

A small economy in the common European market, Austria has achieved a high degree of openness. The ratios of exports and imports to GDP are each higher than 50%, and the amount of capital Austrians invested in international markets came to some EUR 65 billion in 2005. In other words, Austria's prosperity depends to an ever larger extent on its international economic ties. Therefore, reliable balance of payments data are crucial for an accurate picture of the economic situation in Austria.

The OeNB has a statutory obligation to compile Austria's foreign trade statistics (including balances of payments and international investment positions) and must thus meet the challenge of adequately depicting Austria's current and financial transactions with other countries, while keeping the reporting burden for enterprises low. Against this background, the OeNB introduced a new reporting system in early 2006. The system is based on qualified concentration samples among importers and exporters and uses, to the largest extent possible, existing administrative data.

In the interest of both reporting agents and users of macroeconomic statistics, the OeNB is keen to use existing data bases. For instance, in preparing the balance of payments as part of the financial accounts, the OeNB uses ECB monetary statistics (which serve as the basis for calculating the euro area monetary aggregates). The OeNB and Statistics Austria cooperate closely on balance of payments statistics, each focusing on its field of specialization (Statistics Austria on the real economy, the OeNB on the financial sector), thus making best use of synergies and producing high-quality statistics while keeping the reporting burden low.

First experience gained from applying the new reporting system confirms that the cooperation between the OeNB and reporting agents is working well. Thanks to the OeNB's and Statistics Austria's well-established direct links to respondents, any remaining uncertainties as to reportable items and technical matters can be eliminated as they arise.

The OeNB Helps Ensure Safe Payments and a Smooth Cash Supply

New legal framework introduces common standards for domestic and cross-border payments in the EU

EU Aims at Increasing Payment System Efficiency by Creating a Pan-European Infrastructure

On December 1, 2005, the European Commission published the final proposal for a directive on a new legal framework for payments. The proposed directive would establish a modern legal framework for a single payments area in the EU and remove existing legal obstacles. It aims at making cross-border electronic payments as simple, cheap and safe as domestic payments, irrespective of how transactions are carried out (through payment cards, credit transfers or direct debits). The new directive is designed to provide market participants with fair and unimpeded access to payment markets, increase the transparency of payment services and ensure uniform consumer protection standards within the EU.

The directive will apply to payment transactions in all EU Member States and in the currencies of all Member States, while at the same time creating the necessary legal basis for the Single Euro Payments Area (SEPA), which is to be established by 2010 at the latest. From then on, there will be no discernible differences between domestic and cross-border payment systems.

The Oesterreichische Nationalbank (OeNB) supports the European Commission's initiative to create a new legal framework for payment services within the EU. It closely cooperates with the competent EU institutions and is represented in the relevant working groups at the EU level.

Milestones on the road toward SEPA

At the Lisbon European Council in 2000, the heads of state or govern-

ment of the EU Member States adopted the objective of making the EU the world's most competitive economy by 2010 (Lisbon strategy).

One essential element of this objective is the creation of a single payments area. The smooth euro change-over was an important step in achieving this goal; the next step addresses the harmonization of payment systems. The SEPA goal will be achieved when euro area citizens can use a single set of payment instruments to make payments throughout the euro area from a single bank account as easily and safely as they can in a national context today. In other words, in which euro area country or with which euro area bank customers hold an account will no longer play a role. In June 2002, European banks and banking associations founded the European Payments Council (EPC) as a governance structure for guiding and implementing the SEPA project. One of the EPC's key tasks in this context is drafting a framework for card payment processing and defining uniform process guidelines for credit transfers and direct debit payments in euro. The SEPA Cards Framework was published in August 2005, and the SEPA Scheme Rulebooks for Credit Transfer and Direct Debit were published in September 2005. These documents specify the general and operational requirements for uniform payment processing in euro and serve as a basis for the implementation of SEPA standards at the national level. The payment systems used in Austria today have to be adapted accordingly, as only SEPA-compliant systems are to be used in the long run. The NCBs – and thus also the OeNB – are required to support the

banks in the transition to such systems. Integrating the Austrian financial market in the evolving SEPA environment requires a coordinated approach and consultations of all market participants. This is why the OeNB initiated the establishment of the Austrian Payments Council (APC) within the Austrian Society for Payment System Research and Cooperation (STUZZA) in early 2005. The APC is Austria's central coordinating body for the implementation of SEPA. Its working group structure was modeled after that of the EPC.

The vision for SEPA is that all payments effected in the euro area are treated like domestic payments and that they are at least as secure and efficient as payments made through the best-performing national payment systems today.

Standardizing Payment Systems to Accelerate Settlement

The OeNB provides market participants with open and neutral access to the pan-European retail clearing infrastructure STEP2, which is in line with the ESCB's policy statement on "Central banks' provision of retail payment services in euro to credit institutions" published on August 4, 2005. In this statement, the ESCB underscores the NCBs' obligation to promote the smooth operation of payment systems and highlights the significance of NCBs providing processing facilities for retail payments in euro.

The number of Austrian transactions routed through STEP2 by the OeNB is increasing thanks to the OeNB's successful cooperation with domestic and foreign banks. The daily number of basic credit transfers processed by the OeNB in 2005 in-

creased by 6.97% compared with 2004, which confirms the rising demand in the Austrian market for STEP2 access for all market participants. The OeNB and its STEP2 participants accounted for about 7% of the total European STEP2 volume on average in 2005, thus significantly furthering the market penetration of standardized and cost-efficient settlement systems in European retail transactions. Ultimately, the entire market benefits from this development, not just banks alone but businesses and consumers as well. The OeNB's STEP2 access is used by Austrian credit institutions as well as banks from the Czech Republic, Germany, Hungary, Malta and Slovakia (including Národná banka Slovenska). The OeNB has thus become one of the largest STEP2 participants within a short period of time. All in all, 157 banks, i.e. more than 10% of all indirect participants in Europe, are using the OeNB's STEP2 access point.

The success of STEP2 in Austria shows that joining forces and pooling transactions can help optimize interbank payments. This is why the OeNB decided in 2005 to introduce a clearing service also for domestic payments. The new system, which will be operational from mid-2007 onward, will be neutral, open to all domestic banks irrespective of their size, and based on the principle of cost recovery. With this step, Austria will close the gap on the 23 EU Member States that have clearing systems in place. The NCBs play an active role in the creation of the clearing houses.

The OeNB will expand its access point to the pan-European STEP2 system by mid-2007 to include a clearing facility for domestic interbank transactions. This service, called

ESCB's policy statement confirms OeNB's approach to retail payments

STEPAT – OeNB creates a hub for interbank payments in Austria

TARGET2 – uniform standards for large-value payments in the EU from 2007 onward

STEP.AT, is the logical next step to increase the efficiency and security of payment systems in Austria. It will substantially reduce the adjustments costs associated with SEPA that Austrian banks will have to bear over the next years.

The OeNB's expanded STEP2 access platform will help avoid parallel structures and will further the standardization of payment systems, thus cutting the cost of necessary future investments in the payment systems infrastructure.

Compared with the current correspondent banking system (which is based on bilateral relations), a harmonized clearing system for domestic interbank retail payments will simplify day-to-day operations. STEP.AT is a milestone in making the Austrian system comply with SEPA standards; it will adopt the uniform SEPA formats for direct debit and credit transfer across Europe as soon as possible.

The OeNB ensures smooth functioning of ARTIS/TARGET

The OeNB operates one of the 16 real-time gross settlement (RTGS) systems in the EU, which form together with the ECB payment mechanism the TARGET¹ platform, one of the world's largest wholesale payment systems. In 2005, TARGET processed some 296,306 domestic and cross-border transactions with a value of around EUR 1,900 billion on average a day. TARGET contributes significantly to reducing systemic risk, as it is a real-time gross settlement system in which payments are settled with immediate finality. The Austrian RTGS system, ARTIS², was used to settle 2,387,806 domestic and 543,615 cross-border payment orders in 2005, which corresponds to a rise

by 12.7% and 4.4%, respectively, against 2004.

The existing TARGET system will be replaced by a Single Shared Platform (SSP) for TARGET2, which is scheduled to become operational in November 2007. In addition to providing a higher and standardized level of service across Europe, TARGET2 will also offer a uniform price structure for all participants.

The ESCB's decision to process all TARGET transactions with the SSP (instead of the 16 RTGS systems) requires all participating EU Member States to migrate their systems to this platform. This migration will be split into four waves over a period of six months, with the last wave being reserved for extraordinary connections to the SSP only. The OeNB and the Austrian banking community are part of the first migration group.

The envisaged pricing scheme in TARGET2 will allow participants to choose between (1) a small monthly fee plus a flat rate per transaction and (2) a higher monthly fee plus a volume-based degressive fee per transaction. The prices for TARGET2 services, which will replace the existing TARGET fees as from May 2008, will be fixed by the Governing Council of the ECB based on the results of the relevant market consultation in early 2006.

The OeNB has taken all necessary steps to connect its system to the SSP. Furthermore, it keeps the Austrian banks up to date on the latest developments of TARGET2 at meetings of the national migration teams, at technical workshops and at STUZZA meetings.

¹ TARGET: Trans-European Automated Real-time Gross settlement Express Transfer.

² ARTIS: Austrian Real Time Interbank Settlement.

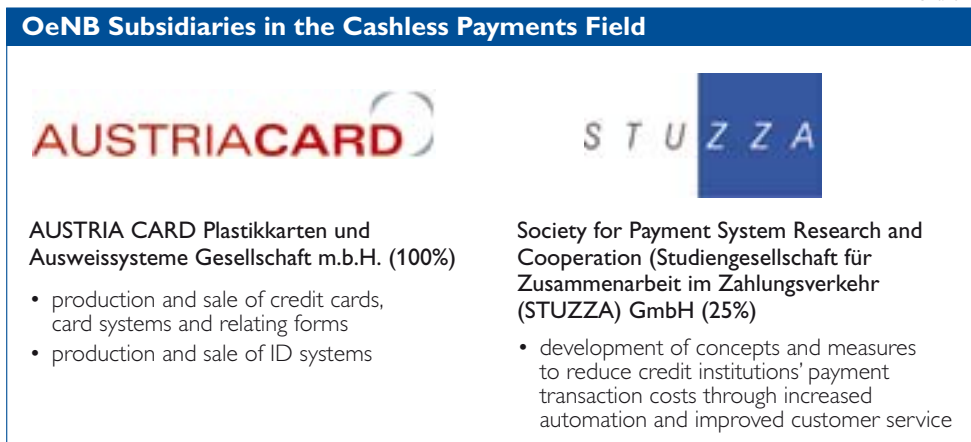
Strategic Review of OeNB Subsidiaries that Provide Cashless Services

In 2005, the OeNB's role in the field of cashless payments was marked by a process of strategic change. The OeNB sold its 38% share in Austrian Payment Systems Services (APSS) GmbH and prepared the sale of its 9.1% share in A-trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH in 2006. Both enterprises, which provide important payment infrastructure solutions for the Austrian financial market, will, of course, continue to offer their high service quality to market participants. Moreover, AUSTRIA CARD Plastikkarten und Ausweissystemgesellschaft m.b.H., a 100% subsidiary of the OeNB, continued to produce highly secure chip cards for the domestic and international markets in 2005. The Austrian Society for Payment System Research and Cooperation (STUZZA), in which the OeNB holds 25%, was assigned a major new task with the establishment of the APC in 2005.

APSS is a provider of cashless payment solutions with a track record of 25 years and a reputation for top quality and maximum security. The company processes around 393 million payment transactions a year, develops highly specialized software applications for card-based payment systems and runs Austria's ATM and POS³ terminal network.

Until recently fully owned by Austrian banks (62%) and the OeNB (38%), APSS was successfully established as an independent payment processor for (credit) card organizations and credit institutions. The OeNB had acquired its stake in APSS in 1995 with the aim of improving the security standards in Austrian payment systems. Along with its co-owners, the OeNB readily supported any measures necessary to ensure the continued high service quality of APSS. Looking ahead, however, new strategies are in order to support the company's expansion to new markets and business segments. Hence, the owners decided in 2005 to sell APSS to a strategic partner. After intense

Chart 20



³ POS: Point of Sale.

First Data International (FDI) acquires APSS

negotiations with several multinational corporations, APSS was sold to First Data International (FDI), which is the best solution for APSS.

Formally a strategically important competitor of APSS, FDI will now support APSS' expansion to the fast-growing markets of Eastern and Southeastern Europe. Taking over the well-positioned APSS was a perfect strategic move by FDI to complement its core business: being a global market leader in the field of payment processing, FDI will thus expand its presence in Central and Eastern Europe.

APSS, which now operates under the name of First Data Austria, will continue to offer the major services provided to Austrian clients in the past for a minimum of five years. Moreover, the enterprise will serve as a competence center within the FDI group, holding a strategically important position in the further development of SEPA-compliant card payment systems.

Promoting safe and efficient payment systems is one of the OeNB's tasks under the Federal Act on the Oesterreichische Nationalbank 1984 (Nationalbank Act) as well as according to the ESCB Statute. The Nationalbank Act, moreover, put the responsibility for payment systems oversight into the hands of the OeNB; in this capacity it continues to secure a safe environment for payment card transactions in Austria. In other words, consumers will not feel the change of ownership at the leading Austrian infrastructure provider for card-based payments: ATMs and POS terminals will still be available for payment with around 7 million debit and credit cards 24 hours a day.

Using digital signatures raises security standards for electronic com-

munications, notably for transactions over the Internet. Digital signatures are thus a very useful tool for satisfying the security requirements with regard to electronic payments (e.g. e-banking), for any kind of e-business and for e-government applications.

Improving the security of electronic payment transactions is a matter of particular concern to the OeNB.

A-Trust Gesellschaft für Sicherheitssysteme im elektronischen Datenverkehr GmbH was founded in early 2000 with the aim of supporting the evolving market for a safe electronic signature from the very beginning and providing the Austrian financial market with a safe infrastructure in accordance with the Austrian Signature Act. For this reason, the OeNB chose to help establish A-Trust.

Today, A-Trust is providing the market with a highly sophisticated infrastructure that complies with all legal requirements.

In February 2006, the OeNB sold its minority stake in the enterprise after having contributed to its strategic development for five years. In the interest of the Austrian financial marketplace, the OeNB will continue to promote the use of digital signatures in domestic and international payment transactions. The products offered by A-Trust still form an essential part of the OeNB's security concept.

The *Society for Payment System Research and Cooperation (STUZZA)* was founded in fall 1991 as a joint undertaking of Austrian credit institutions and the OeNB. After running numerous projects to raise the degree of automation in payment systems, STUZZA served as an indispensable communications hub in the context of the euro changeover. Now, STUZZA

Having helped establish a safe digital signature scheme, the OeNB sells its A-Trust shares

STUZZA – defining methods and standards for payment transactions

is committed to assisting the consolidation of cashless payment systems in Europe and actively supporting the establishment of the Single Euro Payments Area by 2010. The relevant working groups were set up at STUZZA in early 2005.

OeNB Cash Service Subsidiaries

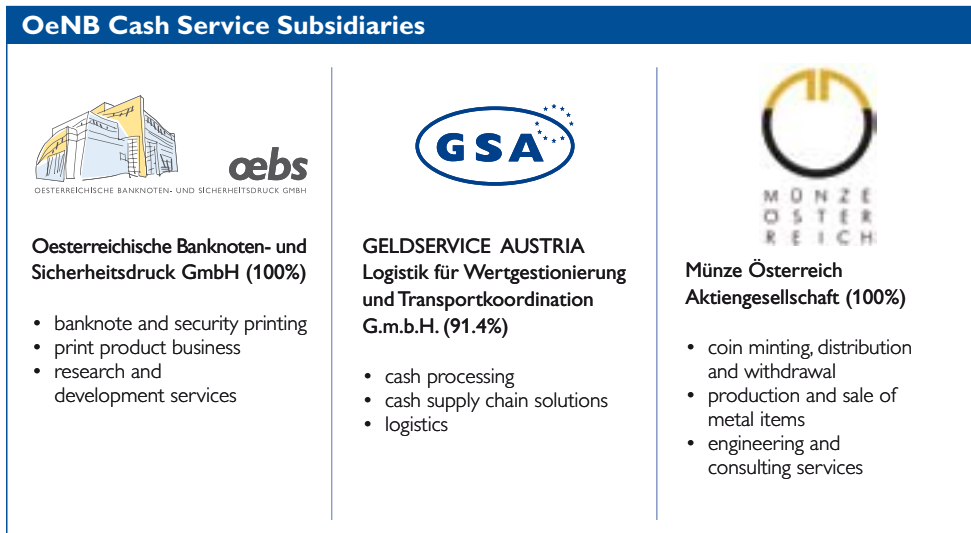
The core purpose of *Münze Österreich Aktiengesellschaft* (the Austrian mint, a 100% OeNB subsidiary) is the minting, distribution and withdrawal of divisional and negotiable coins as well as the production and sale of items made of precious and other metals. The national and international success of the Austrian mint is primarily attributable to the products' high coinage quality and attractive design, but also to excellent intermediate products: it is a global supplier of e.g. top-quality precious metal blanks. *Münze Österreich Aktiengesellschaft* can perform its main task – producing coins – in a cost- and quality-efficient manner owing to the broad range of customer-oriented products (e.g. collectors' coins and commemo-

rative coins, Wiener Philharmoniker bullion coin).

The tasks of *Oesterreichische Banknoten- und Sicherheitsdruck GmbH* (OeBS) include banknote and security printing, print product business as well as research and development services. The OeBS is committed to the highest quality and security standards and applies a strict quality management system to ensure the optimal use of resources and the maximum benefit for its customers (which, apart from the OeNB, include the ECB and other Eurosystem NCBs). The company strategy as well as its R&D and business activities aim at retaining a market leader position in the field of security standards and at achieving a top position above all for the production of the second series of euro banknotes.

GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H. (GSA) is Austria's leading cash services company; it offers cash processing services and solutions for the entire cash supply chain, buys and sells foreign currency and handles cash transports. GSA's well-

Chart 21



**Currency in circulation
in the euro area
and in Austria**

established cash management system conforms to the highest security standards. The company is intent on optimizing the cost efficiency of its cash processing and logistics services with a focus on top quality and short turn-around times. GSA's overall importance lies in its pivotal role as a service provider in the field of payment systems; it is committed to keeping the cost of cash logistics low, while at the same time contributing to technical enhancements in the field of cash processing.

The OeNB and its associates have been able to create synergies by optimizing their business portfolio and by bundling procedures. This strategy has produced very good results, especially in the sales sector of the OeNB's cash-producing subsidiaries Münze Österreich Aktiengesellschaft and OeBS, by integrating formerly separate functions and by coordinating activities. The joint use of human and material resources makes it possible to continually increase cost efficiency.

Through its associated companies, the OeNB can pursue its security aims and take confidence-building measures in the field of cash services. The network of associates supports

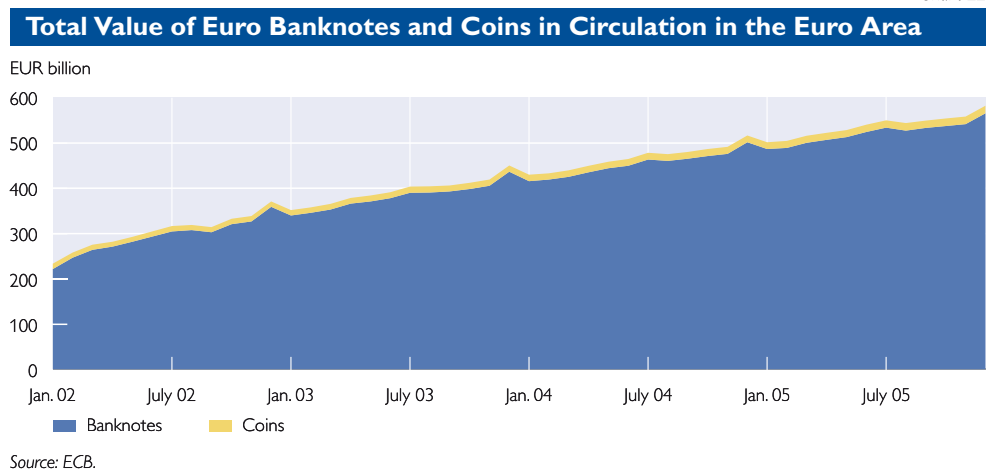
the OeNB in fulfilling its responsibility to maintain the stability of the Austrian financial system by creating a positive climate for doing business and investing in Austria.

**Demand for Cash
Remains High**

At year-end 2005, the number of euro banknotes in circulation in the euro area stood at 10.4 billion (equivalent to EUR 565.2 billion, +13% against 2004 in value terms), while the volume of euro coins came to 63 billion (equivalent to EUR 16.6 billion, +8% against 2004 in value terms).

The euro cash developments observed in Austria in 2005 broadly mirror those of recent years. The balance of euro banknotes issued by and returned to the OeNB continued to decrease steadily, given the free flow of euro cash across borders and the higher number of banknotes returned. At year-end, the number of euro banknotes deposited with the OeNB in 2005 exceeded withdrawals by 174 million, while coin deposits fell 2.6 billion short of withdrawals. Based on transaction data, the OeNB estimates that 330 million to 350 million euro banknotes were actually in

Chart 22



circulation in Austria at end-2005. Coin circulation in Austria broadly corresponded to the volume of coin withdrawals minus deposits.

The persistently high demand for euro banknotes is attributable to the popularity of euro cash as means of payment in the euro area on the one hand, and on the other hand to the fact that payments in euro are increasingly accepted in countries outside the euro area (in particular in EU candidate and accession countries as well as new EU Member States).

The number of counterfeit banknotes recovered from circulation in Austria in 2005 dropped by 46.8% to 7,127 against 2004, even though the number of banknotes issued by the OeNB that year increased by 18.7% to 950 million against 2004. At the EU level, the number of recovered counterfeit banknotes also declined slightly to 579,000.

In 2005, more than half of all counterfeits were EUR 50 banknotes, which represents a shift from higher to lower denominations. This trend is confirmed by the fact that the damage caused by counterfeits in 2005 was EUR 853,735 lower than in 2004 (–57%). In Austria, most incidences of counterfeit banknotes (53% in 2005) continued to be recorded in the greater Vienna area.

All links in the security chain that includes the OeNB, credit institutions, law enforcers and retailers have vital tasks in effectively protecting the population against counterfeits. The OeNB's main focus is on producing high-quality banknotes and coins, constantly checking the authenticity of banknotes and coins in circulation and keeping the Austrian population informed.

A top priority in the production of euro banknotes is the integration

of security features anyone can check without special equipment. This strategy has proved effective – all euro counterfeits can still be spotted by applying the FEEL – LOOK – TILT test (see box 11).

Introducing the second series of euro banknotes in a few years' time will be the largest cash logistics challenge since the euro changeover. As banknotes are highly sophisticated products that need to be produced in large quantities, preparatory work on the next banknote series already started in 2004. In this context, the OeNB considers it vital to

- integrate the security features of the new banknote series even better with the banknote design, and
- to retain the catchy, simple slogan FEEL – LOOK – TILT in educating the general public.

The banknotes of the new series will be issued at intervals, denomination by denomination, starting toward the end of this decade. The EUR 50 banknote will probably be the first denomination of the second series to be put into circulation.

When establishing the authenticity of banknotes, their quality (“fitness”) is a key factor. The better the quality, the easier it is to check the security features, especially the paper and the raised ink features. To guarantee the fitness of the euro banknotes circulating in Austria, the OeNB and GSA processed more than 1 billion banknotes in 2005. In other words, every banknote circulating in Austria is checked three to four times on average by OeNB or GSA experts and is removed from circulation when found unfit. This is an essential contribution to banknote security.

However, banknote security requires more than state-of-the-art

Number of counterfeits declines markedly

Protecting the population against counterfeits

banknotes and the fitness of circulating banknotes – cash users must also be familiar with the security features of banknotes. This is why educating the general public and above all professional cash handlers about the distinctive features of euro banknotes is of utmost priority. Professional cash handlers are cashiers at banks and retailers as well as the police; they are the forefront of protecting the public against counterfeits. In 2005, the OeNB reached out to approximately 64,000 people via 132 workshops, the euro bus touring the country as well as representations at trade fairs and events. The OeNB's branch office network, which was reorganized in 2004, has also played an important part.

The Austrian police, who are increasingly relying on international cooperation as a key to success in combating counterfeiting, posted very good results in 2005. Several counterfeit printing plants were shut down in Europe thanks to the cooperation with Europol and Interpol. The number of counterfeit EUR 100 banknotes, for instance, declined substantially after a printing plant was closed in Lithuania. The breakup of several distribution networks also contributed to the positive results. Over the last few years, the Austrian police seized 4,771 counterfeit banknotes with a face value of EUR 1,148,640 before they were put into circulation.

Box 11

Security Features FEEL – LOOK – TILT

How to Identify Genuine Euro Banknotes

FEEL

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



LOOK

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



TILT

Tilt the banknote to see the moving image on the hologram stripe or patch applied to the front of the banknote: The hologram image will change between the value and the € symbol (EUR 5, EUR 10, EUR 20) or between the value and a window or doorway (EUR 50, EUR 100, EUR 200, EUR 500).



On the reverse side, if you tilt the banknote, you can see a glossy gold-colored stripe (EUR 5, EUR 10, EUR 20) or a color-shifting ink feature, i.e. the value numeral in the right-hand corner shifting color from purple to olive green or brown (EUR 50, EUR 100, EUR 200, EUR 500).

Called-In Banknotes and Dates at which Exchange Periods End



Denomination: ATS 100 (5th motif)
Portrait (front): **Angelika Kauffmann**
Date of issue: October 19, 1970
Exchange deadline: **November 28, 2006**



Denomination: ATS 500 (2nd motif)
Portrait (front): **Josef Ressel**
Date of issue: October 24, 1966
Exchange deadline: **August 31, 2007**



Denomination: ATS 50 (3rd motif)
Portrait (front): **Ferdinand Raimund**
Date of issue: February 15, 1972
Exchange deadline: **August 31, 2008**



Denomination: ATS 20 (4th motif)
Portrait (front): **Carl Ritter von Ghega**
Date of issue: November 4, 1968
Exchange deadline: **September 30, 2009**



Denomination: ATS 500 (3rd motif)
Portrait (front): **Otto Wagner**
Date of issue: October 20, 1986
Exchange deadline: **April 20, 2018**



Denomination: ATS 1,000 (4th motif)
Portrait (front): **Erwin Schrödinger**
Date of issue: November 14, 1983
Exchange deadline: **April 20, 2018**

Following a project to identify possible uses of cash recyclers, the OeNB established a Test Center for checking counterfeit detectors, banknote counting and sorting machines, cash recyclers and coin counting machines. After the technical infrastructure for testing had been implemented in 2005, the OeNB's Test Center checked 60 machines free of charge. The test results are available to the public – and especially to interested businesses – via the OeNB's website. The OeNB thus assumes a pioneering role in the ESCB in this field. So far, 21 manufacturers and trading companies have had their machines checked

at the OeNB's new Test Center. Several manufacturers use this service also for endurance and stress testing.

The euro bus toured Austria for the fourth time in 2005, providing Austrians with the opportunity to exchange their remaining schillings for euro free of charge and to obtain information on the euro and its security features.

Between May 13 and August 30, 2005, the euro bus made 89 stops in 85 towns and municipalities, servicing 104,000 customers, who exchanged a total of ATS 73.4 million for euro. At each stop, ATS 824,674 were exchanged for euro on average,

Test Center established and expanded

The OeNB reaches out to its customers with the euro bus

which represents a 36% increase compared with the (already very successful) euro bus tour in 2004.

In addition to using the cost-free currency exchange service, Austrians were also highly interested in obtaining information on the euro. The euro bus tour allowed the OeNB to deliver several important services – such as providing background information on the FEEL – LOOK – TILT test and the security features – directly at the customers’ doorsteps all over Austria. The euro bus will continue touring the country in 2006.

**Exchange deadline for
“Bertha von Suttner”
banknotes expires**

August 30, 2005, marked the end of the redemption period for the ATS 1,000 banknote featuring a portrait of Bertha von Suttner. The banknote had ceased to be legal tender in 1985. Since this was the first time that an exchange deadline expired for a schilling banknote after the cash change-over, the OeNB placed special emphasis on informing the Austrian citizens in time about this fact. Many customers came to the OeNB’s head

office, branch offices and the euro bus to exchange their “Bertha von Suttner” banknotes for euro. Still, a total of 457,403 banknotes were not returned to the OeNB. The euro equivalent of the outstanding banknotes (EUR 33,240,772.37) was credited to the Austrian Federal Ministry of Finance’s giro account at the OeNB on August 31, 2005.

While the exchange deadlines for schilling banknotes of series which had been called in before the euro was launched continue to apply, there is no deadline for converting the schilling banknotes and coins of the last series into euro at the OeNB free of charge.

The next exchange deadline expires on November 28, 2006; it applies to the ATS 100 banknote featuring a portrait of Angelika Kauffmann. 2,904,324 of these banknotes with a value of EUR 21,106,546 were still outstanding as of December 31, 2005.

The OeNB's External Communications – Conveying Stability and Security

Information Campaigns and Media Presence in 2005

Money is not just an economic, but also an emotional issue. That is why, next to providing economic analyses, the Oesterreichische Nationalbank (OeNB) strives to keep Austrians well informed on all matters concerning their money – the euro. These information activities in turn foster public trust in the single currency as a stable and secure means of payment.

In 2005, the OeNB continued its widely publicized information campaign revolving around a (German) slogan which roughly translates as “I work hard for my money. Good that each euro is worth it.” Moreover, the OeNB placed ads in daily and weekly newspapers, launched a series of TV spots and used its media cooperation network to disseminate information on various euro-related topics (such as the euro's stability, the security of

euro banknotes and coins as well as the OeNB's tasks within the Euro-system).

In its campaign the OeNB showed situations of everyday working life to illustrate how hard many people have to work for their money and how important it is, therefore, for the euro to keep its value and remain a secure means of payment. Within the framework of the single monetary policy, the OeNB acts as a guardian of the euro's stability.

Following up on the motifs used in the previous year (shoe store, circus, driving school), the OeNB introduced two new motifs in its campaign in 2005 (hairdresser, mover) as well as a TV spot showing the difficult recovery of a lost cat. These measures helped communicate complex issues such as price stability and cash security in a humorous and understandable way. As in 2004, the bottom line

The OeNB's
information campaign:
“Stability and Security.”





Fall 2005
information campaign

OeNB Hotline
in high demand

More than 160 press
releases and almost
1,500 media reports

of the campaign remained, “I work hard for my money. Good that each euro is worth it.”

In fall 2005, the OeNB launched an information campaign on the tasks it fulfills on behalf of the Austrian public, the business community and the Austrian economy as a whole. The campaign rested on advertorials published in Austria’s most influential media and addressed topics in the following four categories: (1) monetary policy, (2) analysis/data/dialogue, (3) secure money, and (4) financial stability/banking supervision. The OeNB also placed teaser ads designed to explain specific terms and concepts (e.g. purchasing power, banking supervision).

At the same time, the OeNB intensified its efforts to disseminate information on the New Basel Capital Accord (Basel II), inter alia by stepping up its cooperation with media suited to targeting the audience affected by Basel II and by organizing

road shows for small and medium-sized enterprises together with the Austrian Federal Economic Chamber.

The OeNB Hotline (+43-1-404 20-6666), which is publicized in the OeNB’s ads, continued to be in high demand in 2005. The number of requests directed to the OeNB Hotline team remained more or less unchanged against the previous year (slightly above 31,000). However, there was a marked shift in the composition of queries: While the share of e-mail requests increased from 22% (2004) to almost 31% in 2005, the percentage of telephone inquiries dropped from 78% to 69%.

In 2005, the OeNB also concentrated its public relations efforts on reinforcing its cooperation with economic journalists: In addition to its already well-established module-based seminars for journalists, the OeNB introduced special seminars for young journalists (up to the age of 35) in the

reporting year. The OeNB's seminar series is very popular with its participants and is considered extremely useful.

In the reporting year, the OeNB published a total of 162 press releases, which, together with journalists' queries and the OeNB's press contacts, provided the basis for 1,500 reports in various print media.

ECB and OeNB Provide Schools with New Teaching Materials

Following three years of joint efforts on the part of the European Central Bank (ECB) and the euro area NCBs, 2005 saw the completion of an information kit for teachers and students aged 14 to 16. The compilation of this information kit, which explores the topic "Price stability: why is it important for you?", was initiated by the ECB and carried out within the framework of the Eurosystem's coordinated communication activities. This new educational tool¹ consists of a comprehensive teachers' booklet, leaflets for students and an eight-minute animated film, which explains the concept of price stability in an entertaining and easily understandable manner. In determining the design and characters used for the film, the ECB and the NCBs relied on the input of partner schools all across the EU and, for the dubbing of the film in the various EU languages, the ECB hired renowned actors and actresses. In Austria, more than 1,000 information kits have been distributed so far.

In fulfilling its mandate to keep the Austrian public well informed, the OeNB places special emphasis on educational activities in the school

sector. For many years now, the OeNB's school information kit on money and currency ("Geld und Wahrung") has played a pivotal role in familiarizing teachers with economic topics and helping them prepare relevant teaching material for their classes. The information kit, which previously had only been available in print format, was also published in a CD-ROM version in 2005. Governor Klaus Liebscher and Elisabeth Gehrler, Austria's Federal Minister for Education, Science and Culture, presented this CD-ROM to the public in December 2005. So far it has been distributed among more than 4,500 secondary schools across Austria.

As an additional service, the OeNB also expanded and relaunched its online information package for teachers and students in December 2005 (see www.oenb.at, "Schule und Jugend"). The OeNB's website now provides access to brochures on money, the Austrian financial system and the OeNB's role in the European System of Central Banks (ESCB), as well as a broad range of teaching materials (in German only). The school information CD-ROM contains some suggestions on how to use these materials in the classroom. (As these suggestions are intended for teachers only, they are not published on the Internet.)

The OeNB decided to add more new features to its communicative repertoire in 2005 and initiated a thorough review of its educational activities. To maximize the benefit of the addressed target groups, the OeNB conducted a systematic needs assessment before going ahead with

**The ECB's school
information kit**

**The OeNB's school
information kit**

¹ The information kit is available on the ECB's website in all 20 official languages of the EU (see www.ecb.int).

**T€MPO – the
OeNB's interactive quiz
for students**

the reorientation of its educational activities.

The online quiz T€MPO is yet another new feature of the OeNB's educational program. Designed to complement the school CD-ROM, the quiz allows students to check and deepen their understanding of topics they have discussed in the classroom. Students are guided through the quiz by a comic character which was specifically designed for the educational section of the OeNB's website. Students (grades 5 to 13) who achieve good results in the quiz can enter a competition and win various non-cash prizes, which provides an additional incentive. The first winners were announced in late March 2006.

Tours for school classes

As in previous years, many school classes made use of the possibility of visiting the OeNB. The OeNB's visitor service, which is available all year round, includes an informative presentation (one hour) and a tour of the OeNB's Money Museum. 111 school classes visited the OeNB's Vienna-based head office in 2005. In addition, the OeNB organized a traveling exhibition for secondary academic schools all over Austria, which was accompanied by presentations on economic processes and monetary policy issues. With these services, the OeNB reached about 7,700 Austrian students and their teachers in 2005.

**Successful event
management**

The OeNB continued to support training activities for teachers, i.e. seminars on economic and monetary policy, which attracted around 300 participants.

**The OeNB's Growing
Importance as a Hub for
International Dialogue**

**The OeNB supports EU
twinning projects**

The OeNB not only promotes the exchange of information and views with other central banks, but also actively

participates in EU twinning projects. These projects, which involve the euro area countries and the new EU Member States, were initiated by the European Commission to support new EU members in preparing the introduction of the euro, in particular in the area of public relations. The OeNB, for instance, is the twinning partner of Magyar Nemzeti Bank, the Hungarian central bank. Within the framework of this cooperation, various meetings were organized in Budapest and Vienna to discuss different aspects of introducing the euro. The areas covered included the coordination of national measures and requirements, the language and terminology of the Eurosystem, detailed target group and media analyses, the creation of an ideal communication mix, the role of national partners and platforms, as well as the production and distribution of brochures and products among different target groups.

As an important partner in national and international dialogue, the OeNB hosted events on a total of 279 days during the reporting year, welcoming around 11,600 participants. These figures roughly equal the high level already reached in previous years and show that the OeNB's event management is a driving force in its overall communication strategy.

Among the multitude of conferences and workshops hosted in 2005, two events stood out: the OeNB's 33rd Economics Conference in May and the Conference on European Economic Integration (CEEI) in November, which was organized in cooperation with the ECB and the Frankfurt-based Center for Financial Studies (CFS). The central themes of the Economics Conference (overall topic: "Monetary Policy and Financial

Stability”) were discussed in sessions entitled “Macroeconomic Policies and Financial Stability,” “Institutional and Regulatory Issues,” and “Micro-Challenges for Financial Institutions.” The CEEI focused on financial integration, an issue which has been given a new geographic dimension and greater scope by the EU enlargement round of May 2004 and the new European Neighbourhood Policy. As financial market development and integration may significantly contribute to the economic catching-up process of Central, Eastern and Southeastern European countries, the conference attracted many renowned economic policymakers, financial market players and researchers.

The Economics Conference and the CEEI once more underlined the OeNB’s importance as a hub for international dialogue and debate.

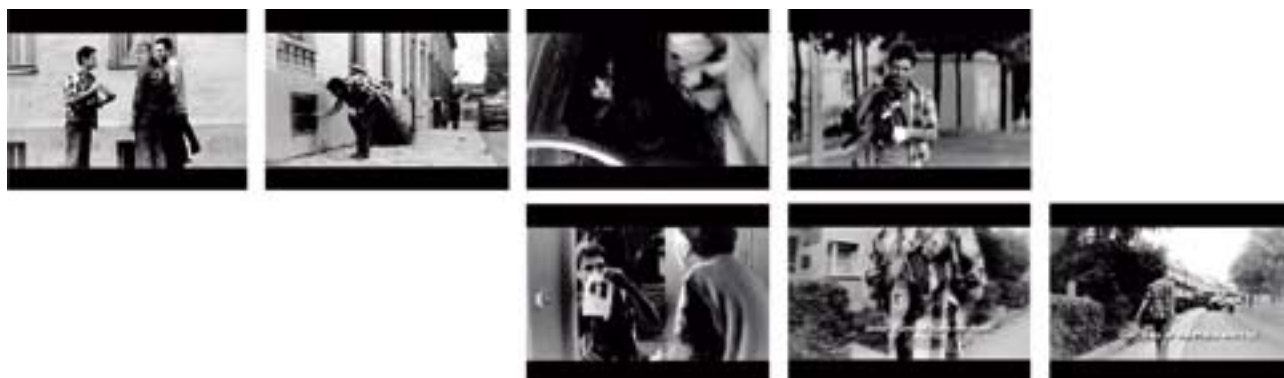
The OeNB’s Money Museum

In the reporting year, the OeNB’s Money Museum attracted around 11,200 visitors, which represents a 6% increase vis-à-vis 2004. The number of guided tours even rose by 25%. In addition to its day-to-day business, the Money Museum opened its doors during the Austrian Broadcasting Corporation’s annual Museum Night, contributed to the activity program the City of Vienna organizes for chil-

dren every summer and, for the first time, participated in the children’s summer university program offered by the University of Vienna.

Moreover, the Money Museum hosted several special exhibitions in 2005:

- “Der Euro im Entwurf”: the successful euro banknote design exhibition was extended throughout the first half of 2005.
- “Kupferstecher der OeNB in den letzten 40 Jahren”: In early 2005, the Money Museum and the OeBS organized a special exhibition featuring the work of three OeNB copperplate engravers from the past 40 years.
- “Der Blick hinter die Fassaden”: In mid-September the Money Museum launched an exhibition on central bank architecture in the 25 EU Member States, which presented central bank buildings as a manifestation of architectural epochs. The exhibition was rounded off by the presentation of the design competition for the future ECB premises.
- “Geld in Österreich – Von der Antike bis zur Gegenwart”: This exhibition on Austria’s monetary history from antiquity to modern times, which was adapted in spring 2005, is part of the standard tour for school classes.



As in previous years, the OeNB's Money Museum took part in numerous joint exhibition projects in 2005. As many as 760,000 visitors attended exhibitions in which the Money Museum was involved as a cooperation

partner and/or for which it provided loan objects from its collection. Thus, the Money Museum makes an important contribution to the OeNB's overall visibility.

**Jeder Euro ist hart verdient.
Darum muss der Wert des Geldes
jederzeit gesichert sein.**

Der Wert unseres Geldes soll stabil sein und bleiben, denn eine stabile Wahrung starkt unsere Wirtschaft und kommt jedem Einzelnen zugute. Die Oesterreichische Nationalbank sorgt dafur.

Der Wert des Geldes bildet die Basis fur Wachstum, Investitionen und Beschaftigung. Ist zu viel Geld im Umlauf, steigen die Preise und die Kaufkraft sinkt. Bewegt sich der Preisanstieg mittelfristig unter, aber nahe bei 1% gemessen am Harmonisierten Verbraucherpreisindex (HVPI), sprechen wir von

Preisstabilitat. Diese ist das vorrangige Ziel des Eurosystems.

Die Oesterreichische Nationalbank setzt diese Geldpolitik in Oesterreich um. Sie versorgt die oesterreichischen Banken – und damit Bevolkerung und Wirtschaft – mit genug Geld und steuert die Geldversorgung im Sinne eines stabilen Geldwertes. Mit der verantwortungsvollen Veranlagung der Wahrungsrerven tragt die Oesterreichische Nationalbank dazu bei, allfallige Wahrungskrisen und Spekulationen abzuwenden. Gewinne aus der Veranlagung der Reserven

kommen allen Oesterreichern und Oesterreichern wieder zugute.

Gut zu wissen:
Das sich die Oesterreichische Nationalbank fur einen stabilen Geldwert einsetzt. Aber wissen Sie auch, dass die OeNB dafur immer fur sicheres Bargeld und sichere Zahlungsmittel sorgt, zur Stabilitat der Finanzmarkte und des Bankwesens beitragt, analysiert, untersucht und steuert? Mehr dazu finden Sie auf www.oenb.at.



OeNB
OESTERREICHISCHE NATIONALBANK
Stabilitat und Sicherheit.

The OeNB – A Performance-Oriented, Efficient Enterprise

As an integral part of the Eurosystem, the Oesterreichische Nationalbank (OeNB) has manifold tasks to fulfill. Its activities are marked by continuous efficiency improvements, pronounced cost consciousness and a high level of customer orientation, goals that the OeNB strives to reach by providing and promoting continuing staff training, by regularly implementing state-of-the-art innovations to optimize its services and by reliably ensuring the smooth operation of its technical infrastructure. This commitment enhances the OeNB's broad range of services to the best advantage of its customers.

The OeNB's 2005 *Intellectual Capital Report* (published separately) provides key figures depicting the development of corporate structures and information about innovations made, the network of relationships and human capital. This chapter of the Annual Report represents a synopsis of these corporate developments.

The year 2005 was marked by the successful completion of many projects. Some 15.4% of staff (measured in full-time equivalents) was on project teams, i.e. engaged in improving the OeNB's services and operations.

Staying the course of lean and modern central banking, the OeNB made steady headway with organizational development in the review year. To this end, the OeNB applied internal organizational analyses and business process analyses in the following areas:

- Optimization of transport and storage logistics as well as standardization of cash packaging, in particular for international deliveries, substantially improved the

efficiency and reduced the costs of cash supply. In addition, the OeNB adapted its cash services in line with its customers' needs, e.g. by introducing new counter opening hours.

- The OeNB restructured and enhanced its public relations and external communications processes and services. As a case in point, the opening hours of the OeNB's Money Museum were adjusted to take account of visitors' preferences.
- Process analysis was used to optimize the activities of the Economic Analysis and Research Section.
- The use of electronic media for documentation management and communications services was increased to reorganize mail processing and distribution, streamline the processes involved and further reduce the OeNB's paper consumption as well as the workload involved in handling printed matter.
- Procurement and technical services responsibilities were updated to meet market requirements. Moreover, the central assignment of purchasing responsibilities within the group yielded considerable cost savings.
- A special initiative of the employee suggestion scheme calling for proposals centered on operating efficiency and efficient work organization was highly successful in activating staff innovation potential.

The *operational risk management system* ORION established at the OeNB is continually monitored to ensure regular evaluation and updates. These

Numerous innovative projects implemented

Operational risk management at the OeNB expanded

monitoring exercises make certain that ORION reduces operational risk in ongoing business activities and that the OeNB is highly crisis resistant.

The OeNB has extended the principles underlying ORION to the Austrian financial market to draw up a crisis management manual specifying the organizational framework for concerted action during financial crises. Recent events induced the OeNB to upgrade ORION to include a pandemic preparedness plan, enabling the OeNB to react swiftly and effectively to any threat of a global epidemic.

In 2005, the OeNB's corporate governance was subjected to a management system analysis. The OeNB contracted an external consultant to help analyze the utility and effectiveness of the OeNB's business management tools. The analysis focused particularly on determining whether strategic plans had been effectively and consistently transposed into concrete measures and operational activities.

Improvements in cost accounting addressed a key optimization concern during the review year. In particular, an approval in principle by the Governing Council of the ECB of a uniform cost accounting method represented a major step forward in introducing a harmonized cost accounting system for the Eurosystem. The explicit aim of the Eurosystem is to apply a standardized procedure to calculate the costs of products and services with the intention of optimizing procedures and raising efficiency.

In addition, cost accounting within the OeNB was further improved, in particular to better capture intracompany cost allocation. The general intention behind user-pays cost accounting is to clearly identify who is responsible for which costs

and in a next step to streamline cost management.

As a contracting authority, the OeNB is subject to the Federal Procurement Act, which prescribes a call for tenders for procurements exceeding a certain threshold amount. 25 calls for tender were handled in 2005, and the OeNB succeeded in cutting costs significantly for the contracts awarded. Moreover, the OeNB uses its procurement platform to achieve synergy effects in procurement across the OeNB group.

Above and beyond implementing internal optimization measures, the OeNB remains committed to the principle of customer orientation. The product management system introduced several years ago has meanwhile become firmly established. Customers are closely involved in product improvement and benefit enhancement efforts, and product managers' participation in strategic as well as operational planning is being stepped up.

In 2005, IT security efforts centered on the definition and implementation of better security standards for the key platforms used at the OeNB. In more detail, the work included the elaboration of new security standards for IT applications developed in-house and by outside specialists, the creation of a special application to facilitate the review of authorization consistency in the OeNB and the implementation of a concept for the secure administration of network components.

As part of the planned further development of the OeNB's information technology services, platform consolidation made further headway in 2005.

The OeNB's personnel development activities concentrated on cre-

Establishing structures to guarantee efficient delivery and customer orientation of services

Improving Security Standards for IT Infrastructure

ating incentives and means to enhance staff mobility. A new electronic platform was established to upgrade information about job rotations available for specific periods at the OeNB, the ECB, NCBs and other institutions. In the review year, 63 employees participated in the job rotation scheme; 25 of the job rotation positions were international. Offering part-time positions, teleworking and sabbaticals, the OeNB promotes flexible working arrangements, which a rising number of employees is making use of.¹

The importance of mobility and flexibility is on the rise also at the international level. A basic training program for managers and new staff members that is standardized across the ESCB is targeted at fostering and enhancing the common understanding of the ESCB/Eurosystem. Cooperation on the conception and organization of seminars on a broad range of fields within the ESCB/Eurosystem support the integrative education and training approach.

In 2005, the OeNB launched a highly successful pilot project aimed at introducing a special program to quickly identify and optimally promote high-potential employees. This program was based on the development of a job specification for future managers and senior experts.

Within the framework of its participation in the European Recovery Program (ERP), the OeNB continued to give financial support to numerous small and medium-sized enterprises in 2005. Providing a total of EUR 280 million – 54% of the entire amount disbursed by the ERP fund

for 2005 – the OeNB sponsored internationalization, innovation and structural improvement efforts. The promotion of replacement investment in Austria's westernmost provinces after the extensive flood damage in the region in the summer of 2005 represented a further focus of the OeNB's financial support activities.

The OeNB has traditionally been closely involved in Austria's export promotion and financing activities. Taking into account the overall economic situation in Austria and in the countries to which exports with a federal guarantee are delivered, the OeNB contributes to the optimal handling of such exports. The joint deliberation of the OeNB and the other institutions involved in export promotion helps support Austrian exporters.

As the OeNB takes a strong interest in securing the future of Austrian science and research, it has provided Austrian researchers with considerable funding for almost 40 years. In 1966, the OeNB set up the Anniversary Fund for the Promotion of Scientific Research and Teaching (Jubiläumfonds – Anniversary Fund) to mark the 150th anniversary of the OeNB's establishment. Since then, the Anniversary Fund has provided financial support to the tune of approximately EUR 668 million for close to 8,500 projects of basic and applied research, making it an indispensable pillar of Austrian research promotion. Therefore, this promotion instrument for outstanding basic research, which provides direct support for Austrian researchers, will be preserved side by side with the

The OeNB promotes job flexibility and mobility

The OeNB is committed to research, science, culture and environmental protection

The OeNB fosters business development

¹ For more details, see the OeNB's 2005 Intellectual Capital Report.

National Foundation for Research, Technology and Development (National Foundation), which was established several years ago.

In 2005, the OeNB made direct grants amounting to roughly EUR 9.4 million for 161 research projects in economics, medicine (clinical research), social sciences and the humanities, with an emphasis on reinforcing the promotion of economic science projects.

In addition, the OeNB Anniversary Fund provides a forum in which cutting-edge economics and human medicine project results are periodically presented to an expert audience.

The National Foundation provides a sound and reliable basis for the sustainable, strategic long-term financing of Austrian research initiatives independently of public finances. Its efforts are targeted particularly at supporting interdisciplinary research projects which generate long-term benefits. The provision of sustainable financing for such initiatives contributes to visibly positioning and internationalizing Austrian excellence in research. In the review year, the OeNB provided a total of EUR 75 million of support to the National Foundation.

In addition, the OeNB provided EUR 3.6 million of basic funding to three economic research institutes – the Institute for Advanced Studies (IHS), the Austrian Institute of Economic Research (WIFO) and The Vienna Institute for International Economic Studies (wiiw) – and

EUR 1.0 million to help finance the fourth research year of the Austrian Academy of Sciences' Institute of Molecular Biotechnology (IMBA).

The OeNB also attaches great importance to the promotion of cultural activities. Its collection of valuable old string instruments, which today ranks among the most outstanding of its kind in Europe, currently comprises 34 instruments, which are on loan to rising Austrian violin stars and Austrian chamber music ensembles and orchestras. The OeNB feels an obligation to make this collection accessible also to a broader public. In late 2005, 28 of these exquisite string instruments were shown at a special exhibition at the Kunsthistorisches Museum in Vienna.

In 2005, the OeNB published an art book about its collection of Austrian paintings of the interwar years, with detailed descriptions and presentations of works by Oskar Kokoschka, Albin Egger-Lienz, Max Oppenheimer, Alfons Walde, Wilhelm Thöny, Josef Floch, Carl Moll, Anton Kolig, Greta Freist and Franz Sedlacek.

By introducing an integrated environmental management system with certification according to EMAS² for all its offices across Austria and fulfilling EMAS standards, the OeNB has further strengthened its pronounced commitment to protecting the environment for future generations beyond the legal requirements. The OeNB's energy conservation measures and the nearly complete switch from virgin to recycled paper

² EMAS is short for "eco-management and audit scheme" (environmental audit). The objective of EMAS is for companies to improve environmental performance on a continuous basis. EMAS can help companies to eliminate environmental and economic shortcomings and to save material and energy, and hence costs. Thus, EMAS is an efficient instrument for implementing preventive environmental protection.

use stand out among its efforts to protect natural resources.

Environmental performance is measured on the basis of ecological indicators for businesses, which rely on input and output data. These indicators make it possible to regularly assess efforts to enhance environmen-

tal performance, facilitate comparisons with other companies in the industry and thus help identify potential for long-term improvement. Table 4 provides a brief overview of the OeNB's ecological indicator values and a benchmark of other financial service providers.³

Table 4

Overview of the OeNB's Ecological Indicator Values

Energy	Location	2005	2004	2003	2002	2001	Unit ¹	Benchmark ²		
								+	~	-
Electricity consumption	Vienna	8.3	8.4	8.4	8.7	9.2	MWh/emp	< 4.5	6	> 8
Heat consumption	Vienna	66	73	80	135	119	kWh/m ²	< 110	130	> 150
Water										
Water consumption	Vienna	114	121	114	128	131	l/emp/day	< 60	100	> 120
Consumption of material and products										
Total paper consumption	All sites	159	212	186	254	467	kg/emp	< 100	200	> 500
Consumption of writing/photocopying paper	All sites	11,830	12,330	20,958	25,377	27,797	sheets/emp	< 8,000	10,000	> 12,000
Share of recycled paper	All sites	90	90	65	34	34	%	> 30	20	< 10
Consumption of cleaning agents	Vienna	22	31	105	105	105	g/m ²	not available		
CO₂ emissions (total)										
CO ₂ emissions ³	All sites	2.9	3.0	4.1	4.3	4.9	t/emp	< 2.8	4	> 4.5

Source: OeNB.

¹ emp = employee.

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

³ Operation and business trips.

³ For a more detailed account, please see the Environmental Statement of the OeNB, published every three years in German and updated annually.



Financial Statements
of the Oesterreichische Nationalbank
for the Year 2005

Balance Sheet as at December 31, 2005

	December 31, 2005		December 31, 2004	
	EUR		EUR	
1 Gold and gold receivables		4,229,152,318.69		3,179,012,958.74
2 Claims on non-euro area residents denominated in foreign currency		5,786,985,589.54		5,589,745,328.36
2.1 Receivables from the IMF	512,056,414.91		722,997,433.49	
2.2 Balances with banks and security investments, external loans and other external assets	5,274,929,174.63		4,866,747,894.87	
3 Claims on euro area residents denominated in foreign currency		1,132,332,872.37		746,608,748.13
4 Claims on non-euro area residents denominated in euro		434,254,091.19		617,603,102.40
4.1 Balances with banks, security investments and loans	434,254,091.19		617,603,102.40	
4.2 Claims arising from the credit facility under ERM II		–		–
5 Lending to euro area credit institutions related to monetary policy operations denominated in euro		12,511,816,494.00		8,853,559,167.00
5.1 Main refinancing operations	9,307,000,000.00		8,029,000,000.00	
5.2 Longer-term refinancing operations	3,204,816,494.00		824,559,167.00	
5.3 Fine-tuning reverse operations		–		–
5.4 Structural reverse operations		–		–
5.5 Marginal lending facility		–		–
5.6 Credits related to margin calls		–		–
6 Other claims on euro area credit institutions denominated in euro		104,558.34		136,214.40
7 Securities or euro area residents denominated in euro		3,181,050,094.26		3,085,653,396.16
8 General government debt denominated in euro		419,956,629.70		362,922,577.16
9 Intra-Eurosystem claims		9,980,534,553.24		4,148,728,298.24
9.1 Participating interest in the ECB	116,475,959.82		116,475,959.82	
9.2 Claims equivalent to the transfer of foreign reserves	1,157,451,203.42		1,157,451,203.42	
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates ¹		×		×
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	8,706,607,390.00		2,874,801,135.00	
9.5 Other claims within the Eurosystem (net)		–		–
10 Items in course of settlement		93,593,378.76		90,938,617.90
11 Other assets		8,620,004,487.34		8,908,155,713.87
11.1 Coins of euro area	162,808,807.41		210,722,512.58	
11.2 Tangible and intangible fixed assets	156,223,313.73		163,644,100.60	
11.3 Other financial assets	6,866,730,342.43		7,176,598,738.76	
11.4 Off-balance sheet instruments' revaluation differences	7,015,432.92		6,792,217.76	
11.5 Accruals and prepaid expenses	385,321,338.14		294,596,508.26	
11.6 Sundry	1,041,905,252.71		1,055,801,635.91	
		46,389,785,067.43		35,583,064,122.36

¹ Only an ECB balance sheet item.

Liabilities

	December 31, 2005	December 31, 2004
	EUR	EUR
1 Banknotes in circulation	15,128,006,240.00	13,416,143,605.00
2 Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4,975,937,306.98	4,000,043,265.50
2.1 Current accounts (covering the minimum reserve system)	4,969,837,306.98	3,993,473,265.50
2.2 Deposit facility	6,100,000.00	6,570,000.00
2.3 Fixed-term deposits	–	–
2.4 Fine-tuning reverse operations	–	–
2.5 Deposits related to margin calls	–	–
3 Other liabilities to euro area credit institutions denominated in euro	–	–
4 Debt certificates issued¹	×	×
5 Liabilities to other euro area residents denominated in euro	7,785,714.85	7,626,156.01
5.1 General government	3,878,973.09	6,903,198.34
5.2 Other liabilities	3,906,741.76	722,957.67
6 Liabilities to non-euro area residents denominated in euro	8,133,374.73	6,292,924.74
7 Liabilities to euro area residents denominated in foreign currency	47,603.90	47,360.94
8 Liabilities to non-euro area residents denominated in foreign currency	501,654.30	156,255.63
8.1 Deposits, balances and other liabilities	501,654.30	156,255.63
8.2 Liabilities arising from the credit facility under ERM II	–	–
9 Counterpart of Special Drawing Rights allocated by the IMF	216,626,545.50	204,039,682.00
10 Intra-Eurosystem liabilities	15,712,996,024.99	9,000,500,379.24
10.1 Liabilities equivalent to the transfer of foreign reserves ¹	×	×
10.2 Liabilities related to promissory notes backing the issuance of ECB debt certificates	–	–
10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem	–	–
10.4 Other liabilities within the Eurosystem (net)	15,712,996,024.99	9,000,500,379.24
11 Items in course of settlement	–	–
12 Other liabilities	651,428,588.97	597,408,380.49
12.1 Off-balance sheet instruments' revaluation differences	2,831,748.60	907,327.70
12.2 Accruals and income collected in advance	43,874,231.84	20,271,797.34
12.3 Sundry	604,722,608.53	576,229,255.45
13 Provisions	2,227,186,837.52	2,280,637,317.78
14 Revaluation accounts	3,307,525,203.79	1,935,987,262.97
15 Capital and reserves	4,117,008,962.34	4,104,427,565.58
15.1 Capital	12,000,000.00	12,000,000.00
15.2 Reserves	4,105,008,962.34	4,092,427,565.58
16 Profit for the year	36,601,009.56	29,753,966.48
	46,389,785,067.43	35,583,064,122.36

¹ Only an ECB balance sheet item.

Profit and Loss Account for the Year 2005

	Financial year 2005 EUR	Financial year 2004 EUR
1.1 Interest income	908,835,336.59	691,121,580.37
1.2 Interest expense	-457,404,954.92	-242,510,370.53
1 Net interest income	451,430,381.67	448,611,209.84
2.1 Realized gains/losses arising from financial operations	218,151,499.02	264,521,726.71
2.2 Writedowns on financial assets and positions	-44,291,261.03	-263,543,394.87
2.3 Transfer to/from provisions for foreign exchange and price risks	8,097,746.79	214,178,897.52
2 Net result of financial operations, writedowns and risk provisions	181,957,984.78	215,157,229.36
3.1 Fees and commissions income	3,707,251.01	3,304,450.43
3.2 Fees and commissions expense	-2,927,529.40	-2,316,197.10
3 Net income from fees and commissions	779,721.61	988,253.33
4 Income from equity shares and participating interests	68,424,721.58	21,096,009.05
5 Net result of pooling of monetary income	7,053,357.45	-30,871,847.36
6 Other income	21,157,284.59	7,506,145.76
Total net income	730,803,451.68	662,486,999.98
7 Staff costs	-104,910,021.29	-98,034,796.58
8 Administrative expenses	-85,322,038.76	-89,901,715.55
9 Depreciation of tangible and intangible fixed assets	-15,236,889.89	-16,181,905.35
10 Banknote production services	-16,184,763.09	-7,157,705.06
11 Other expenses	-21,136,277.78	-393,203.54
Total expenses	-242,789,990.81	-211,669,326.08
12 Corporate income tax	-122,003,365.22	-153,278,009.13
	366,010,095.65	297,539,664.77
13 Central government's share of profit	-329,409,086.09	-267,785,698.29
14 Profit for the year	36,601,009.56	29,753,966.48

Notes to the Financial Statements 2005

General Notes to the Financial Statements

Accounting Fundamentals and Legal Framework

The Oesterreichische Nationalbank (OeNB) is committed (pursuant to Article 67 paragraph 2 of the Federal Act on the Oesterreichische Nationalbank 1984 as amended and as promulgated in Federal Law Gazette I No. 161/2004 – Nationalbank Act) to prepare its balance sheet and its profit and loss account in conformity with the provisions established by the Governing Council of the ECB under Article 26.4 of the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB). These rules are laid down in an accounting guideline the Governing Council of the ECB adopted on December 5, 2002 (ECB/2002/10). The OeNB's financial statements for the year 2005 were prepared fully in line with the provisions set forth in the accounting guideline. In cases not covered by this guideline, the generally accepted accounting principles referred to in Article 67 paragraph 2 second sentence Nationalbank Act were applied. The Nationalbank Act provisions that govern the OeNB's financial statements (Articles 67 and 69 as well as Article 72 paragraph 1 Nationalbank Act) have remained unchanged from the previous year. The provisions of the 2004 Financial Reporting Amendment Act (ReLÄG, Federal Law Gazette I No. 161/2004) provided a legal basis in amending paragraph 3 of Article 68 Nationalbank Act for the exemption of the OeNB from the applicability of Article 243 paragraph 2 last sentence as well as paragraph 3 items 2 and 5 of the Commercial Code.

In accordance with Article 67 paragraph 3 Nationalbank Act, the OeNB has continued to be exempt in 2005 from preparing consolidated financial statements as required under Article 244 et seq. of the Commercial Code.

The financial statements for the year 2005 were prepared in the format laid down by the Governing Council of the ECB.

The ECB and the 12 participating national central banks (NCBs), which together form the Eurosystem, have issued euro banknotes as from January 1, 2002. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key.¹ The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% have been allocated to the Eurosystem NCBs. The share of banknotes allocated to each NCB is disclosed under liability item 1 *Banknotes in circulation*.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. In the OeNB's financial statements for 2005, these balances are recognized as a single net asset under 9.4 *Net claims related to the allocation of euro banknotes within the Eurosystem*.

¹ The banknote allocation key designates the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in this total.

From 2002 to 2007 the intrasystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in NCBs' relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the period from July 1999 to June 2001 and the average value of the banknotes that would have been allocated to them during that period under the ECB's subscribed capital key. The adjustments will be reduced in annual stages until the end of 2007; from 2008 onward, income on banknotes will be allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital. The interest income and expense on these balances is cleared through the accounts of the ECB and disclosed under item 1 *Net interest income* of the profit and loss account.

The Governing Council of the ECB has decided not to distribute the ECB's seignorage income, which arises from the 8% share of euro banknotes allocated to the ECB, to the NCBs in 2005 but to transfer it instead to the provision established for foreign exchange rate, interest rate and gold price risks.

Accounting Policies

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

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

On the basis of the Guideline of the European Central Bank of 5 December 2002 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2002/10), transactions may be recorded on the settlement date (cash or settlement approach) or on the transaction date (economic approach). From January 1, 2007, only the economic approach may be used.

On May 27, 2005, the OeNB switched from the cash (or settlement) to the economic approach for recording gold and foreign exchange transactions as well as accruals. At the end of the first quarter of 2005, the economic approach replaced the cash (or settlement) approach for the recording of transactions with futures contracts.

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

At year-end, both financial assets and liabilities are revalued at current market prices/rates. This applies equally to on-balance sheet and off-balance sheet transactions. The revaluation of forward rate agreements takes place on the basis of the London Interbank Offered Rate (LIBOR) curve of the respec-

tive currency. The arbitrage pricing principle is used to value gold interest rate swaps and forward interest rate swaps. To this end, the products are split into the components at which these products are traded on international exchanges (LIBOR curve, gold swap rates and gold forward rates).

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

Gains and losses realized in the course of transactions are taken to the profit and loss account. The average cost method is used on a daily basis for gold, foreign currency instruments and securities, to compute the acquisition cost of items sold, having regard to the effect of exchange rate and/or price movements. As a rule, the realized gain or loss is calculated by juxtaposing the sales price of each transaction with the average acquisition cost of all purchases made during the day.

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

Unrealized revaluation gains are not taken to the profit and loss account, but transferred to a revaluation account on the liabilities side of the balance sheet. Unrealized losses are recognized in the profit and loss account when they exceed previous revaluation gains registered in the corresponding revaluation account; they may not be reversed against new unrealized gains in subsequent years. Furthermore, based on current legislation, the OeNB's management² determined that unrealized foreign currency losses that must be expensed were to be covered by the release of an offsetting amount from the *reserve fund for exchange rate risks* accumulated in the run-up to 1999. Unrealized losses in any one security or currency are not netted with unrealized gains in other securities or currencies, since netting is prohibited under the ECB's Accounting Guideline.

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

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

² Decision of the Governing Board of November 10, 1999, and of the General Council of November 25, 1999.

As a result of the harmonized accounting rules which have to be observed since January 1, 1999, future market developments, especially (volatile) interest and exchange rate movements, may entail considerable fluctuations of the income accruing to the OeNB, the other Eurosystem NCBs and the ECB.

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

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

Tangible and intangible fixed assets are valued at cost less depreciation. Depreciation is calculated on a straight-line basis from the quarter after acquisition throughout the expected economic lifetime of the assets as follows:

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

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

Realized Gains and Losses and Revaluation Differences and Their Treatment in the Financial Statements of December 31, 2005

Table 1

	Realized gains profit and loss account item 2.1	Realized losses profit and loss account item 2.1	Unrealized losses profit and loss account item 2.2	Change in revaluation accounts
	(posted to the profit and loss account)			
	EUR million	EUR million	EUR million	EUR million
Gold	45.331	–	–	+1,089.743
Foreign currency				
holdings for own account	100.992	7.314	13.109 ¹	+356.040
own funds	0.022	0.278	2.989 ¹	–1.836
Securities				
holdings for own account	78.197	62.658	19.579	–38.893
own funds	20.133	1.896	8.327	–14.787
IMF euro holdings	51.894	–	–	–
Participating interests	–	–	0.186	+11.059
Off-balance sheet instruments				
holdings for own account	16.875	21.670	0.101	+0.223
own funds	1.357	2.834	–	–
Total	314.801	96.650	44.291	+1,401.549

¹ This amount did not have an impact on profit because the loss was offset against the reserve fund for exchange rate risks.

Risk Management

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

Financial Risk

Financial risk covers a range of collateral-related risks, basically market, credit and liquidity risk. Reserve asset and risk management principles are laid down in a rule book adopted by the OeNB's Governing Board. The investment of reserve assets is governed by a benchmarking system and is subject to defined limits and durations. Moreover, the OeNB holds separately managed investment portfolios for different asset types and currencies. Regular reports are made to an investment committee and to the Governing Board of the OeNB. The Governing Board must authorize diversification options to include new types of investment.

Market Risk

Market risk is the risk of exposure arising from movements in markets, in particular exchange rate and interest rate changes, as determined by generally recognized value-at-risk (VaR) calculation models. Exchange rate risk is controlled through a dual benchmarking system (strategic and tactical benchmarks). The strategic benchmarks, which the Governing Board of the OeNB adopts, as a rule, for one-year periods, also define the upper exposure limits. The strategic measures are complemented by tactical benchmarks, which are defined for shorter periods at the regular meetings of the responsible investment committee to reflect e.g. short-term market developments. Interest rate risk is managed on the basis of duration targets or limits.

Credit Risk

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

Liquidity Risk

Liquidity risk is the risk arising from a counterparty's inability to meet its financial obligations in time or in full or the risk that the OeNB may not dispose of sufficient funds to meet its obligations. To avoid this risk, the OeNB selects counterparties with the highest credit standing and strictly applies the established limits, with a particular emphasis on security and liquidity. These principles take precedence over profitability considerations.

Operational Risk

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

losses. It is an ongoing process, and reports are submitted to the management every half year.

Table 2 shows financial risk and financial provisions as on December 31, 2005.

Table 2

Risk	Risk assessment	Financial provisions		
		EUR million	EUR million	
Gold risk	VaR	618	618 ¹	revaluation account
Exchange rate risk	VaR	1,778	492 394 844 48	reserve fund for exchange rate risks revaluation accounts reserve for nondomestic and price risks provisions for exchange rate risks
		1,778	1,778	
Risk of interest rate changes and pro rata Eurosystem risk	VaR	1,129	1,129	reserve for nondomestic and price risks
Total		3,525	3,525	

¹ Holdings on the revaluation accounts come to EUR 1,833 million.

Capital Movements

Table 3

Movements in Capital Accounts in 2005	December 31, 2004	Increase	Decrease	December 31, 2005
	EUR million	EUR million	EUR million	EUR million
Capital	12.000	–	–	12.000
Reserves				
Reserve for nondomestic and price risks	1,973.263	–	–	1,973.263
Reserve for retained earnings	2.226	–	–	2.226
Earmarked capital funded with net interest income from ERP loans	585.439	12.581	–	598.020
OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching				
Initial OeNB Anniversary Fund	31.500	–	–	31.500
OeNB Anniversary Fund National Foundation endowment	1,500.000	–	–	1,500.000
	4,092.428	12.581	–	4,105.009
Profit for the year	29.754	6.847	–	36.601
Total	4,134.182	19.428	–	4,153.610
Revaluation accounts				
Reserve fund for exchange rate risks	537.349	–	45.491	491.858
Initial valuation reserve	281.151	–	0.874	280.277
Revaluation accounts	1,117.487	1,476.407	58.504	2,535.390
Total	1,935.987	1,476.407	104.869	3,307.525

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

Development of the OeNB's Currency Positions in the Financial Year 2005

Table 4

Net currency position (including gold)	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Gold and gold receivables	4,229.152	3,179.013	+1,050.139	+33.0
Claims on non-euro area residents denominated in foreign currency ¹	7,664.347	7,129.312	+535.035	+7.5
Claims on euro area residents denominated in foreign currency	1,132.333	746.609	+385.724	+51.7
Other assets	185.019	22.932	+162.087	+706.8
<i>less:</i>				
Liabilities to euro area residents denominated in foreign currency	0.047	0.047	–	–
Liabilities to non-euro area residents denominated in foreign currency	0.502	0.156	+0.346	+221.8
Counterpart of Special Drawing Rights allocated by the IMF	216.627	204.040	+12.587	+6.2
Off-balance sheet instruments' revaluation differences	0.409	0.712	–0.303	–42.6
Other liabilities	4.382	–	+4.382	–
Revaluation accounts ²	23.431	59.326	–35.895	–60.5
	12,965.453	10,813.585	+2,151.868	+19.9
<i>less:</i>				
Off-balance sheet assets/liabilities (net)	759.223	–	+759.223	
Total	12,206.230	10,813.585	+1,392.645	+12.9

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

² Resulting from the change in net unrealized exchange rate gains on foreign currency-denominated securities as on December 31, 2004, and December 31, 2005, respectively.

Notes to the Balance Sheet

Assets

1 Gold and Gold Receivables

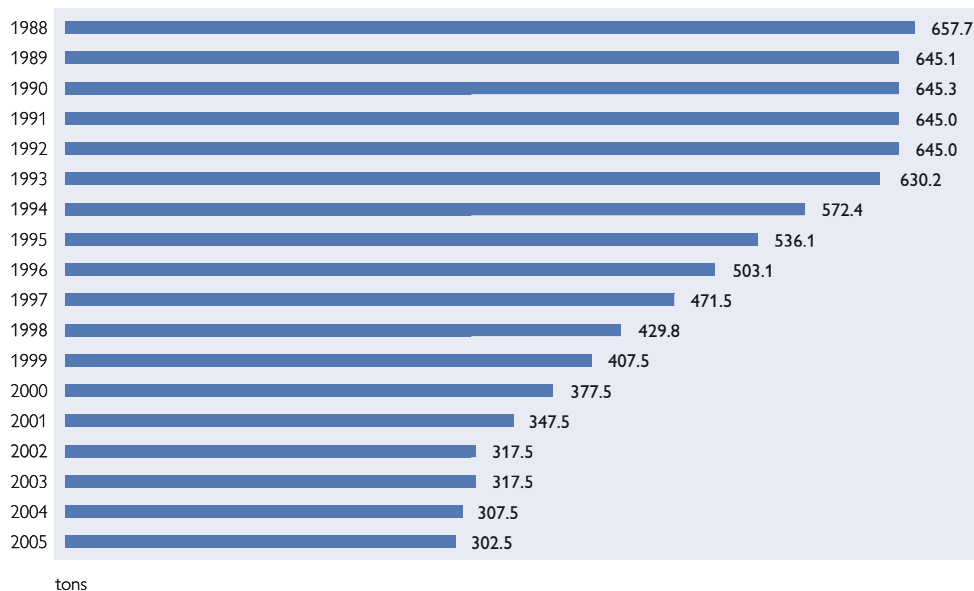
Closing balance	EUR million
December 31, 2005	4,229.152
December 31, 2004	3,179.013
Change	+1,050.139 (+33.0%)

This item comprises the OeNB's holdings of physical and nonphysical gold, which amounted to 302 tons on December 31, 2005. At a market value of EUR 434.856 per fine ounce (i.e. EUR 13,980.94 per kg of fine gold), the OeNB's gold holdings were worth EUR 4,229.152 million at the balance sheet date.

The valuation on December 31, 2005, resulted in unrealized valuation gains of EUR 1,089.743 million.

In 2005, 5 tons of gold were sold for EUR 56.782 million (2004: 10 tons for EUR 107.454 million). The sales were effected within the framework of the Joint Statement on Gold concluded by 14 central banks (including the OeNB) and the ECB in March 2004. The price gains of EUR 45.331 million realized on these sales (2004: EUR 84.551 million) were disclosed under item 2.1 *Realized gains/losses arising from financial operations* of the profit and loss account.

The OeNB's Gold Holdings



Source: OeNB.

Note: Includes the gold holdings transferred via swaps to the EMI and the ECB in 1995 (101.3 tons), 1996 (89.2 tons) and 1997 (71.1 tons).

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

2 Claims on Non-Euro Area Residents Denominated in Foreign Currency

Closing balance	EUR million
December 31, 2005	5,786.985
December 31, 2004	5,589.745
Change	+197.240 (+3.5%)

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

Table 5 shows the development of *receivables from the IMF*.

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Total claims (Austrian quota) equivalent to SDR 1,872.3 million ¹	2,265.296	2,133.673	+131.623	+6.2
less:				
Balances at the disposal of the IMF	1,877.361	1,539.566	+337.795	+21.9
Receivables from the IMF	387.935	594.107	-206.172	-34.7
Holdings of Special Drawing Rights	124.121	117.494	+6.627	+5.6
Other claims against the IMF	-	11.396	-11.396	-100.0
Total	512.056	722.997	-210.941	-29.2

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

Drawings of Special Drawing Rights (SDRs) on behalf of IMF members, the revaluation, by the IMF, of euro holdings under *balances at the disposal of the IMF* as well as transfers by the IMF boosted *receivables from the IMF* by a total of EUR 73.298 million. Conversely, repayments by members reduced these receivables by EUR 411.093 million. Revaluation gains (+EUR 130.968 million) increased these claims, as did realized exchange rate gains and book value reconciliation (+EUR 0.655 million).

The IMF remunerates participations in the Fund at a rate of remuneration that is updated weekly. In 2005, this rate hovered between 2.22% and 3.03% per annum, mirroring the prevailing SDR rate.

The *holdings of Special Drawing Rights*³ were recognized in the balance sheet at EUR 124.121 million on December 31, 2005, which is equivalent to SDR 103 million. The net increase of holdings by EUR 6.627 million in 2005 resulted from interest credited, above all remunerations of the participation in the IMF (+EUR 13.034 million), net sales of SDRs (–EUR 11.406 million) and revaluation differences.

No purchases arising from designations by the IMF were effected in 2005. Principally, the OeNB continues to be obliged under the IMF's statutes to provide currency on demand in exchange for SDRs up the point at which its SDR holdings are three times its cumulative allocation. The OeNB's net cumulative allocation amounted to SDR 179.045 million on December 31, 2005.

Other claims against the IMF comprise the OeNB's other contributions to loans under special borrowing arrangements, most recently claims arising from contributions to the Poverty Reduction and Growth Facility (PRGF). The PRGF is a special initiative designed to support the IMF's objectives by granting the poorest countries credits at highly concessional terms in order to finance economic programs targeted at fostering economic growth and ensuring a strong, sustainable recovery of the balance of payments. The most recent repayments under this item were made as planned in August 2005.

Table 6 shows the development of *balances with banks and security investments, external loans and other external assets*.

Table 6

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Balances with banks	1,260.593	861.379	+399.214	+46.3
Securities	4,008.794	4,000.386	+8.408	+0.2
Other external assets	5.542	4.983	+559	+11.2
Total	5,274.929	4,866.748	+408.181	+8.4

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

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

3 Claims on Euro Area Residents Denominated in Foreign Currency

Table 7 shows the *development of claims on euro area residents denominated in foreign currency*.

Table 7

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Balances with banks	440.100	286.195	+153.905	+53.8
Securities	692.233	460.414	+231.819	+50.4
Total	1,132.333	746.609	+385.724	+51.7

4 Claims on Non-Euro Area Residents Denominated in Euro

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

Table 8 shows the *development of claims on non-euro area residents denominated in euro*.

Table 8

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Securities	426.008	373.613	+52.395	+14.0
Other investments	8.246	243.990	-235.744	-96.6
Total	434.254	617.603	-183.349	-29.7

5 Lending to Euro Area Credit Institutions Related to Monetary Policy Operations Denominated in Euro

Table 9 shows the *development of the liquidity-providing transactions executed by the OeNB*.

Table 9

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
5.1 Main refinancing operations	9,307.000	8,029.000	+1,278.000	+15.9
5.2 Longer-term refinancing operations	3,204.816	824.559	+2,380.257	+288.7
5.3 Fine-tuning reverse operations	—	—	—	—
5.4 Structural reverse operations	—	—	—	—
5.5 Marginal lending facility	—	—	—	—
5.6 Credits related to margin calls	—	—	—	—
Total	12,511.816	8,853.559	+3,658.257	+41.3

5.1 Main Refinancing Operations

Main refinancing operations are regular liquidity-providing reverse transactions. In 2005, the NCBs carried out such operations with a weekly frequency and a maturity of two weeks in the form of standard (variable rate) tender operations. Since March 8, 2004, the maturity of the standard tender has been one week. All counterparties that fulfill the general eligibility criteria may submit bids within a timeframe of 24 hours from the tender announcement.

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

On December 1, 2005, the Governing Council of the ECB decided to increase the minimum bid rate on the main refinancing operations of the Eurosystem by 0.25 percentage point to 2.25%, starting from the operation that was to be settled on December 6, 2005.

5.2 Longer-Term Refinancing Operations

Longer-term refinancing operations are regular liquidity-providing reverse transactions with a monthly frequency and a maturity of three months. They are aimed at providing counterparties with additional longer-term refinancing and are executed through standard tenders by the NCBs. All *longer-term refinancing operations* conducted in 2005 were carried out in the form of variable rate tenders.

5.3 Fine-Tuning Reverse Operations

Fine-tuning reverse operations are executed on an ad hoc basis with a view to managing the liquidity situation in the market and steering interest rates, in particular to smooth the effects on interest rates caused by unexpected liquidity fluctuations in the market. The choice of fine-tuning instruments and procedures depends on the type of transactions and their underlying objectives. Fine-tuning operations are normally executed by the NCBs through quick tenders or through bilateral procedures. It is up to the Governing Council of the ECB to empower the ECB to conduct fine-tuning operations itself under exceptional circumstances.

In 2005, two such operations with a total volume of EUR 890 million were conducted with a counterparty.

5.5 Marginal Lending Facility

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

The *marginal lending facility* was accessed repeatedly in 2005.

On December 1, 2005, the Governing Council of the ECB decided to increase the interest rate on the marginal lending facility by 0.25 percentage point to 3.25%, with effect from December 6, 2005.

6 Other Claims on Euro Area Credit Institutions Denominated in Euro

Closing balance	EUR million	
December 31, 2005	0.104	
December 31, 2004	0.136	
Change	-0.032	(-23.2%)

This item comprises claims not related to monetary policy operations.

7 Securities of Euro Area Residents Denominated in Euro

Closing balance	EUR million	
December 31, 2005	3,181.050	
December 31, 2004	3,085.653	
Change	+95.397	(+3.1%)

This item covers all marketable securities that are not used in monetary policy operations and that are not part of investment portfolios earmarked for specific purposes.

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

8 General Government Debt Denominated in Euro

Closing balance	EUR million	
December 31, 2005	419.957	
December 31, 2004	362.923	
Change	+57.034	(+15.7%)

This balance sheet item exclusively subsumes the claim on the Austrian Federal Treasury from silver commemorative coins issued before 1989,

based on the 1988 Coinage Act as promulgated in Federal Law Gazette No. 425/1996.

In theory, the maximum federal liability is the sum total of all silver commemorative coins issued before 1989, minus any coins returned to and paid for by the central government, minus any coins directly withdrawn by Münze Österreich Aktiengesellschaft and minus repayments, which are effected by annual installments of EUR 5.814 million out of the *central government's share* in the OeNB's profit. The proceeds from silver recovery, including the interest on the investment of these proceeds by Münze Österreich Aktiengesellschaft, are designated for repayment by the contractual deadline (every year on December 15). Any amount outstanding on December 31, 2040, will have to be repaid in the five following years (2041 to 2045) in five equal installments. The maximum federal liability came to EUR 1,219.881 million on December 31, 2005.

The net increase in this claim resulted from returns of silver commemorative coins to the central government with a total face value of EUR 66.753 million less redemptions made out of the *central government's share* in the OeNB's profit for the year 2004 plus the proceeds from silver recovery, which together totaled EUR 9.719 million.

9 Intra-Eurosystem Claims

Closing balance	EUR million	
December 31, 2005	9,980.534	
December 31, 2004	4,148.728	
Change	+5,831.806	(+140.6%)

This balance sheet item consists of the claims arising from the OeNB's share in the ECB's capital and the claims equivalent to the transfer of

foreign reserves to the ECB. Furthermore, this item shows net claims related to the allocation of euro banknotes within the Eurosystem.

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

Table 10 shows *intra-Eurosystem claims* as on December 31, 2004, and December 31, 2005.

Table 10

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
9.1 Participating interest in the ECB	116.476	116.476	–	–
9.2 Claims equivalent to the transfer of foreign reserves	1,157.451	1,157.451	–	–
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates	x	x	x	x
9.4 Net claims related to the allocation of euro banknotes within the Eurosystem	8,706.607	2,874.801	+5,831.806	+202.9
9.5 Other claims within the Eurosystem (net)	–	–	–	–
Total	9,980.534	4,148.728	+5,831.806	+140.6

9.1 Participating Interest in the ECB

This subitem shows the share that the OeNB holds in the capital of the ECB. Pursuant to Article 28 of the ESCB Statute, the ESCB national central banks are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29(3) of the ESCB Statute and which must be adjusted every five years. The first such adjustment following the establishment of the ECB took effect on January 1, 2004. On May 1, 2004, a second adjustment of the ECB's capital key followed to accommodate the accession of ten new Member States to the EU. At 2.0800%, the OeNB's share in the ECB's subscribed capital has remained unchanged since May 1, 2004, as has its share of the participating NCBs' fully paid up shares of the ECB's capital (2.9095%).

Council Regulation (EC) No 1009/2000 of 8 May 2000 concerning capital increases of the European Central Bank empowers the Governing Council of the ECB to increase the capital of the ECB by an additional amount of up to EUR 5 billion beyond the amount specified in Article 28(1) of the ESCB Statute (about EUR 5.6 billion).

9.2 Claims Equivalent to the Transfer of Foreign Reserves

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

The claim shown in the financial statements for 2005 has remained unchanged since May 1, 2004.

9.4 Net Claims Related to the Allocation of Euro Banknotes within the Eurosystem

Intra-Eurosystem balances on euro banknotes in circulation balance the OeNB's liabilities resulting from the share of euro banknotes put into circulation allocated to the balance sheet of the ECB (8%) with the OeNB's claim resulting from the allocation of euro banknotes in circulation within the Eurosystem. On December 31, 2005, these balances resulted in a net

claim of EUR 8,706.607 million stemming from the adjustments of euro banknotes in circulation (see the section “Accounting Fundamentals and Legal Framework”).

9.5 Other Claims within the Eurosystem (Net)

This item shows net claims arising from balances of TARGET accounts and other (net) claims within the Eurosystem, provided that these items closed the reporting year with net claims. As the balance recorded on December 31, 2005, was a net liability, it is represented under liability item 10.4 *Other liabilities within the Eurosystem (net)*.

10 Items in Course of Settlement

This claim results from 2005 net float items settled at the beginning of January 2006.

11 Other Assets

Table 11 shows the development of *other assets*.

Table 11

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
11.1 Coins of euro area	162.809	210.723	-47.914	-22.7
11.2 Tangible and intangible fixed assets	156.223	163.644	-7.421	-4.5
11.3 Other financial assets	6,866.730	7,176.599	-309.869	-4.3
11.4 Off-balance sheet instruments' revaluation differences	7.016	6.792	+0.224	+3.3
11.5 Accruals and prepaid expenses	385.321	294.596	+90.725	+30.8
11.6 Sundry	1,041.905	1,055.802	-13.897	-1.3
Total	8,620.004	8,908.156	-288.152	-3.2

11.1 Coins of Euro Area

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

11.2 Tangible and Intangible Fixed Assets

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

Table 12 shows the development of *premises*.

Table 12

	EUR million
Cost incurred until December 31, 2004 ¹	124.766
Purchases in 2005	0.562
Sales (cost incurred) in 2005 ²	7.470
Accumulated depreciation	22.468
Book value on December 31, 2005	95.390
Book value on December 31, 2004	100.700
Annual depreciation in 2005	4.481

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

² The balance between the book value of sales and the underlying historical costs less accumulated depreciation is EUR 1.391 million.

Additions in 2005 mainly relate to capitalized costs of work. The sales (book value of EUR 1.391 million) relate to OeNB real estate in 2005; income on these sales comes to EUR 11.921 million net.

Table 13 shows the development of *equipment*.

EUR million	
Cost incurred until December 31, 2004	83.636
Purchases in 2005	8.692
Sales (cost incurred) in 2005 ¹	6.820
Accumulated depreciation	61.402
Book value on December 31, 2005	24.106
Book value on December 31, 2004	26.205
Annual depreciation in 2005	10.741

¹ The balance between the book value of sales and the underlying historical costs is EUR 0.050 million.

Tangible real assets amounted to EUR 36.100 million and represent the OeNB's collection of antique string instruments (EUR 35.615 million) and coins of the OeNB's Money Museum, for which purchases have come to EUR 0.485 million since 2004. On December 31, 2005, the OeNB's collection of valuable string instruments encompassed 26 violins, 5 violoncellos and 3 violas, unchanged from December 31, 2004.

Table 14 shows the development of *intangible fixed assets* (right of use).

EUR million	
Cost incurred until December 31, 2004	0.720
Purchases in 2005	–
Sales in 2005	–
Accumulated depreciation	0.093
Book value on December 31, 2005	0.627
Book value on December 31, 2004	0.643
Annual depreciation in 2005	0.016

11.3 Other Financial Assets

Table 15 shows the development of *other financial assets*.

	December 31,	December 31,	Change	
	2005	2004	EUR million	%
	EUR million	EUR million	EUR million	
Securities	5,739.070	6,020.453	–281.383	–4.7
Participating interests	835.091	814.355	+20.736	+2.5
Other investments	292.569	341.791	–49.222	–14.4
Total	6,866.730	7,176.599	–309.869	–4.3

Of the OeNB's securities portfolio, EUR 1,657.795 million represent investments of pension reserve assets, another EUR 1,549.053 million reflect investments of the *OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching* (of which EUR 1,516.705 million were earmarked as an endowment for the National Foundation for Research, Technology and Development, also referred to in brief as the National Foundation). Moreover, the securities portfolio related to capital and reserves, i.e. the OeNB's own funds management, came to EUR 2,532.222 million.⁴ Revaluations of the portfolios resulted in unrealized valuation gains of EUR 84.302 million and unrealized price losses totaling EUR 8.369 million as well as unrealized foreign currency losses of EUR 2.989 million.

Of *participating interests*, EUR 523.025 million formed part of the OeNB's own funds portfolio and EUR 312.066 million part of the portfolio relating to investments of the pension reserve.

Table 16 shows the development of *participating interests*.

	EUR million
Net asset value on December 31, 2004	814.355
Purchases in 2005	8.930
Sales in 2005 (at book value)	8.528
Annual depreciation in 2005	0.186
Revaluation in 2005	20.520
Net asset value on December 31, 2005	835.091

Other investments include investments of the pension reserve (EUR 32.933 million), investments to promote the National Foundation (EUR 1.617 million), investments of the initial OeNB Anniversary Fund (i.e. exclusive of the National Foundation endowment; EUR 23.408 million) and the own funds portfolio (EUR 234.611 million) and consisted mainly of overnight and short-term funds.

11.6 Sundry

Table 17 shows the development of sundry assets.

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Claims arising from ERP loans to companies	828.865	649.991	+178.874	+27.5
Money market investment for ERP lending	111.110	277.216	-166.106	-59.9
ERP loan portfolio managed by the OeNB	939.975	927.207	+12.768	+1.4
Schilling coins	23.064	88.566	-65.502	-74.0
Shareholder loans	5.824	6.720	-0.896	-13.3
Advances on salaries	7.141	6.734	+0.407	+6.0
Claims arising from prepayments of corporate income tax in 2005	37.406	-	+37.406	x
Claims arising from real estate sales	6.667	-	+6.667	x
Other claims	21.828	26.575	-4.747	-17.9
Total	1,041.905	1,055.802	-13.897	-1.3

⁴ The OeNB's own funds shown under liabilities include its capital, the reserve for nondomestic and price risks, earmarked ERP capital, the reserve fund for exchange rate risks and the provisions for exchange rate risks.

Pursuant to Article 3 paragraph 2 of the ERP Fund Act, the maximum total of the OeNB's financing commitment corresponds to the sum by which the federal debt was written down initially (EUR 341.955 million) plus interest accrued (EUR 598.020 million as on December 31, 2005). The ERP loan portfolio managed by the OeNB thus totaled EUR 939.975 million on December 31, 2005. The provisions governing the extension of loans from this portfolio are laid down in Article 83 Nationalbank Act.

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

Other claims came to EUR 21.828 million on December 31, 2005, and mainly comprised advances, accounts receivable and claims arising from day-to-day business.

Liabilities

1 Banknotes in Circulation

Closing balance	EUR million	
December 31, 2005	15,128.006	
December 31, 2004	13,416.143	
Change	+1,711.863	(+12.8%)

This item consists of the OeNB's share of the euro banknotes in circulation in the entire Eurosystem as calculated by applying the banknote allocation key⁵. Table 18 shows the development of banknotes in circulation.

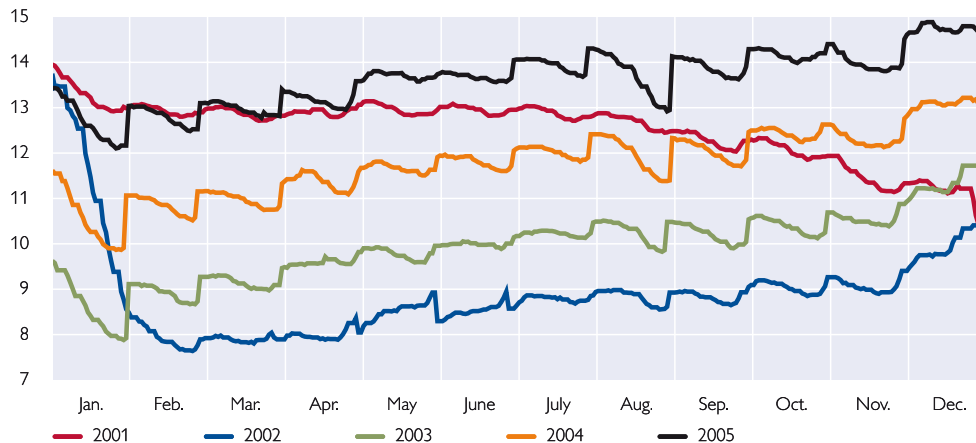
Table 18

	December 31, 2005	December 31, 2004	Change
	EUR million	EUR million	EUR million
Total value of euro banknotes in circulation	6,421.399	10,541.342	-4,119.943
less:			
Liability resulting from the share of euro banknotes in circulation allocated to the balance sheet of the ECB (8%)	-1,315.581	-1,166.712	-148.869
Liability or claim resulting from the allocation of euro banknotes within the Eurosystem	+10,022.188	+4,041.513	+5,980.675
Value of euro banknotes in circulation	15,128.006	13,416.143	+1,711.863

⁵ The banknote allocation key for the OeNB has been 2.6765% since May 1, 2004. It is calculated on the basis of the OeNB's share of 92% of the paid-up capital of the ECB.

The OeNB's Banknotes in Circulation over the Past Five Years

Calendar-day volumes, EUR billion



Source: OeNB.

Note: In the business year 2002, the OeNB's banknotes in circulation included two components:

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

Table 19 shows the annual averages of banknotes in circulation during the past five years.

Table 19

	Banknotes in circulation, annual average ¹		Change	
	EUR million	EUR million	EUR million	%
2001	12,519	-332	-2.6	
2002	8,887	-3,632	-29.0	
2003	9,913	+1,026	+11.5	
2004	11,751	+1,838	+18.5	
2005	13,618	+1,867	+15.9	

¹ The value for 2001 represents schilling banknotes in circulation. In 2002, the figures cover both euro and schilling banknotes in circulation. From 2003, they refer exclusively to euro banknotes in circulation.

2 Liabilities to Euro Area Credit Institutions Related to Monetary Policy Operations Denominated in Euro

Table 20 shows the development of *liabilities to euro area credit institutions related to monetary policy operations denominated in euro*.

Table 20

	December 31, 2005	December 31, 2005	Change	
	EUR million	EUR million	EUR million	%
2.1 Current accounts (including reserve holdings)	4,969.837	3,993.473	+976.364	+24.4
2.2 Deposit facility	6.100	6.570	-0.470	-7.2
2.3 Fixed-term deposits	-	-	-	-
2.4 Fine-tuning reverse operations	-	-	-	-
2.5 Deposits related to margin calls	-	-	-	-
Total	4,975.937	4,000.043	+975.894	+24.4

2.1 Current Accounts (Covering the Minimum Reserve System)

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

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

The maintenance period starts on the settlement day of the main refinancing operation following the meeting of the Governing Council at which the monthly assessment of the monetary stance is prescheduled. The reserve maintenance periods came to between 20 and 43 days in 2005.

2.2 Deposit Facility

The *deposit facility* refers to overnight deposits placed with the OeNB by Austrian banks that access the Eurosystem's standing facility at the prespecified rate. In 2005, the volume of such transactions averaged EUR 9.007 million.

On December 1, 2005, the Governing Council of the ECB decided to increase the interest rate on the deposit facility by 0.25 percentage point to 1.25%, with effect from December 6, 2005.

5 Liabilities to Other Euro Area Residents Denominated in Euro

Closing balance	EUR million	
December 31, 2005	7.786	
December 31, 2004	7.626	
Change	+0.160	(+2.1%)

This item comprises general government deposits of EUR 3.879 million and current account deposits of credit institutions that are not subject to minimum reserve requirements and of nonbanks.

6 Liabilities to Non-Euro Area Residents Denominated in Euro

Closing balance	EUR million	
December 31, 2005	8.133	
December 31, 2004	6.293	
Change	+1.840	(+29.2%)

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

9 Counterpart of Special Drawing Rights Allocated by the IMF

Closing balance	EUR million	
December 31, 2005	216.627	
December 31, 2004	204.040	
Change	+12.587	(+6.2%)

This item represents the counterpart in euro of the SDR 179 million the IMF allocated gratuitously to the OeNB, measured at current market values on the balance sheet date. The OeNB was allocated SDRs in six installments from 1970 to 1972 and from 1979 to 1981, always on January 1.

10 Intra-Eurosystem Liabilities

Closing balance	EUR million	
December 31, 2005	15,712.996	
December 31, 2004	9,000.500	
Change	+6,712.496	(+74.6%)

This item shows the OeNB's net liabilities arising from transactions with the 11 other Eurosystem central banks as well as the remaining three ESCB central banks (the Bank of England, Sveriges Riksbank and Danmarks Nationalbank) and with the ECB (in particular balances arising in connection

with the TARGET payment system). Moreover, this item covers net claims arising at year-end from the difference between monetary income to be pooled and distributed and the balances arising from any redistribution of ECB seignorage income as well as from correspondent accounts⁶ of individual NCBs.

The individual bilateral end-of-day balances of the OeNB with the other NCBs are netted by novating them to the respective bilateral account with the ECB. The ECB remunerates the net balance at the prevailing marginal interest rate for the Eurosystem's main refinancing operations.

12 Other Liabilities

Table 21 shows the development of *other liabilities*.

Table 21

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
12.1 Off-balance sheet instruments' revaluation differences	2.832	0.907	+1.925	+212.2
12.2 Accruals and income collected in advance	43.874	20.272	+23.602	+116.4
12.3 Sundry	604.723	576.229	+28.494	+4.9
Total	651.429	597.408	+54.021	+9.0

12.1 Off-Balance Sheet Instruments' Revaluation Differences

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

12.3 Sundry

Table 22 shows the development of *sundry liabilities*.

Table 22

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Central government's share of profit (without dividends)	329.409	267.786	+61.623	+23.0
Liability from schilling banknotes in circulation with an exchange deadline	192.233	232.028	-39.795	-17.2
Earmarked funds of the OeNB Anniversary Fund				
Initial OeNB Anniversary Fund	22.879	22.915	-0.036	-0.2
OeNB Anniversary Fund National Foundation endowment	45.123	43.614	+1.509	+3.5
Other	15.079	9.886	+5.193	+52.5
Total	604.723	576.229	+28.494	+4.9

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

According to the General Meeting's decision, EUR 12.579 million of the profit for the year 2004 were apportioned to the OeNB's Anniversary Fund for the Promotion of Scientific Research and Teaching. Adjusted for the return

⁶ These correspondent accounts may be used for a limited amount of transactions, e.g. in case of temporary disruptions of TARGET.

on investment for 2005 and repayments made, the initial OeNB Anniversary Fund thus received funds of EUR 38.383 million. Of these funds, EUR 15.504 million were paid out in 2005; EUR 19.441 million of the remaining undisbursed funds of EUR 22.879 million have been pledged. In 2005, the General Council decided to allocate an additional EUR 10.345 million to fund 162 projects and EUR 3.579 million to fund 3 institutes. This means that since funds were first pledged as financial assistance in 1966, a total EUR 667.755 million have been paid out.

The EUR 45.123 million the OeNB Anniversary Fund provided for the National Foundation are earmarked pro rata income for 2005; payment to the National Foundation is made the day after the General Meeting.

13 Provisions

Table 23

	December 31, 2004	Transfer from	Transfer to	December 31, 2005
	EUR million	EUR million	EUR million	EUR million
Pension reserve	1,879.000	-93.593	+107.709	1,893.116
Personnel provisions				
Severance payments	43.817	-2.351	+4.724	46.190
Anniversary bonuses	10.050	-1.046	+1.628	10.632
Residual leave entitlements	9.492	-0.004	+0.303	9.791
Sabbaticals	0.038	-0.018	-	0.020
Statutory or contractual social charges	0.074	-0.074	+0.084	0.084
Salary cost revisions in 2005	0.405	-0.405	+0.448	0.448
Provisions for				
Schilling banknotes without an exchange deadline	234.231	-19.389	-	214.842
Exchange rate risks	40.000	-	+8.000	48.000
Retained monetary income	39.569	-39.569	-	-
Corporate income tax	10.278	-10.278	-	-
Conclusion of the renovation work on the OeNB's main building and northern office building	5.088	-3.460	-	1.628
Accounts payable	1.313	-1.313	+0.923	0.923
Premises management	1.438	-1.438	-	-
Accounts payable to subsidiaries	5.195	-5.195	+0.848	0.848
Other	0.649	-0.416	+0.432	0.665
Total	2,280.637	-178.549	+125.099	2,227.187

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

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

Pension benefits as covered by the pension reserve augmented by EUR 2.655 million or 2.9% to EUR 93.593 million in 2005. This includes the remuneration

of 15 retired board members or their dependents (totaling EUR 4.139 million; 2004: EUR 4.043 million).

The income on investment relating to the pension reserve was transferred to the pension reserve when the financial statements for 2005 were prepared. The pension reserve is shown at its actuarial present value. The pension reserve on December 31, 2005, was calculated according to actuarial principles; the discount rate of 3.50% per annum is the same as that applied in 2004.

Provisions for severance payments and anniversary bonuses are calculated according to actuarial principles; again, the discount rate of 3.50% per annum is the same as that applied in 2004.

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

14 Revaluation Accounts

Table 24 shows the development of *revaluation accounts*.

	December 31, 2005	December 31, 2004	Change
	EUR million	EUR million	EUR million
Table 24			
Revaluation accounts			
Gold	1,833.123	743.380	+1,089.743
Foreign currency	393.793	39.588	+354.205
Securities	105.140	151.928	-46.788
Participating interests	196.319	175.799	+20.520
Off-balance sheet instruments	7.015	6.792	+0.223
Subtotal	2,535.390	1,117.487	+1,417.903
Unrealized valuation gains from January 1, 1999 (initial valuation)			
Securities	1.423	1.423	0
Participating interests	278.854	279.728	-0.874
Subtotal	280.277	281.151	-0.874
Reserve fund for exchange rate risks (funded up to the end of 1998)			
	491.858	537.349	-45.491
Total	3,307.525	1,935.987	+1,371.538

The amounts on the *revaluation accounts* reflect the valuation gains established in the valuation of assets as on December 31, 2005. Those gains can be realized in the context of future transactions in the respective category or may be used to reverse revaluation losses that may arise in future years. The revaluation gains in each currency cover the risk associated with nondomestic assets (as established with the VaR method).

In line with requirements, the initial valuation gains recorded in the opening balance sheet of January 1, 1999, were partly realized during 2005 in the course of sales of underlying assets.

Article 69 paragraph 1 Nationalbank Act obliges the OeNB to maintain a *reserve fund for exchange rate risks* which may arise on nondomestic assets. The *reserve fund for exchange rate risks* posted in the financial statements for 2005 contains exchange rate gains accrued before Stage Three of EMU totaling EUR 491.858 million. On the one hand, the annual change reflects the realization of exchange rate gains resulting from the sale of underlying assets (gold and foreign currency). On the other hand, the fund is used to cover unrealized exchange rate losses that must be expensed, as well as any exchange rate risks

(as calculated with the VaR method) that are not offset by the balances on the *revaluation accounts*. As from January 1, 1999, no further allocations to this special reserve have been permitted.

15 Capital and Reserves

Table 25 shows the development of *capital and reserves*.

Table 25

	December 31, 2005	December 31, 2004	Change	
	EUR million	EUR million	EUR million	%
Reserve for nondomestic and price risks	1,973.263	1,973.263	–	–
Reserve for retained earnings	2.226	2.226	–	–
Earmarked capital funded with net interest income from ERP loans	598.020	585.439	+12.581	+2.1
OeNB Anniversary Fund for the Promotion of Scientific Research and Teaching	1,531.500	1,531.500	–	–
Total	4,105.009	4,092.428	+12.581	+0.3

The *reserve for nondomestic and price risks* serves to cover the risks associated with foreign currency and security prices as calculated with the VaR method. The section “Risk Management” above contains more information on the OeNB’s risk management principles.

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

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

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

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

Other Financial Liabilities (Off-Balance Sheet Positions)

Apart from the items recognized in the balance sheet, the following financial liabilities and financial derivatives were stated off the balance sheet on December 31, 2005:

- forward purchases (EUR 1,251.584 million) and sales (EUR 1,254.007 million) consisting of swaps and euro- as well as foreign currency-denominated forward transactions;
- contingent liabilities to the IMF under the New Arrangements to Borrow totaling EUR 493.639 million;
- obligation under the IMF’s statutes to provide currency on demand in exchange for SDRs up to the point at which the OeNB’s holdings of SDRs are three times as high as its gratuitous net cumulative allocation of EUR 525.758 million;

- contingent liabilities to the IMF under the emergency assistance for member countries afflicted by natural disasters totaling EUR 8.469 million;
- obligation to make a supplementary contribution of EUR 38.856 million (equivalent to SDR 32.115 million) to the OeNB's stake in the capital of the Bank for International Settlements (BIS) in Basel consisting of 8,564 shares of SDR 5,000 each;
- liabilities totaling EUR 15.744 million from foreign currency investments effected in the OeNB's name for third account;
- repayment obligations to the amount of EUR 16.896 million arising from pension contributions paid by OeNB staff members payable on termination of employment contracts;
- contingent liability equivalent to the OeNB's share of EUR 1,040.000 million of the maximum of EUR 50 billion of additional foreign reserve assets of the euro area NCBs on which the ECB is entitled to call;
- contingent liability equivalent to the OeNB's share of EUR 104.000 million of the EUR 5 billion by which the ECB may increase its paid-up capital;
- contingent liabilities of EUR 20.520 million arising from guarantees given in connection with the sale of the OeNB's shares of Austrian Payment Systems Services (APSS) GmbH; and
- contingent liabilities of EUR 111.001 million arising from bank guarantees given and contingent assets of EUR 2.278 million arising from bank guarantees received.

At the current juncture, no substantiated figures about the possible material impact on the OeNB of lawsuits pending against the Republic of Austria in a bankruptcy case can be provided.

Table 26 shows *holdings of derivatives* on December 31, 2005.

Table 26

	Underlying value <i>EUR million</i>	Market value gains <i>EUR million</i>	Market value losses <i>EUR million</i>
Interest rate swaps			
Sales	237.199	6.707	0.101

The market values represent the valuation of December 31, 2005, with gains of EUR 7.015 million less a depreciation effected in previous years of EUR 0.308 million entered in the *revaluation accounts* (liability item 14) and losses entered in the profit and loss account as *writedowns on financial assets and positions* (item 2.2).

Moreover, foreign currency and security options were traded in 2005, all of which matured prior to December 31, 2005. The result of these transactions was taken to item 1 *Net interest income* of the profit and loss account.

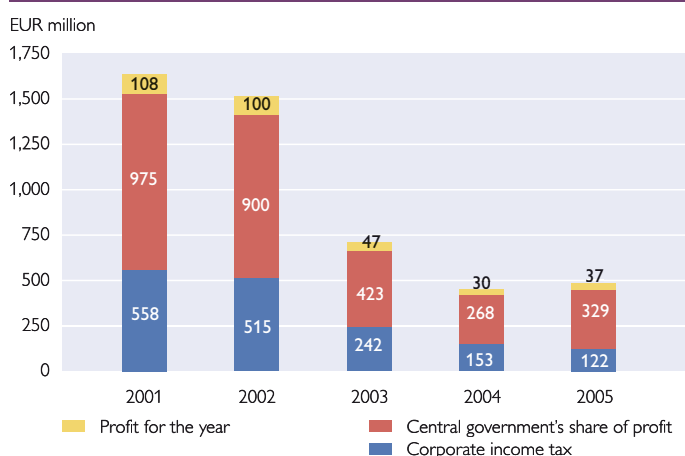
Notes to the Profit and Loss Account

Table 27

	2005	2004	Change ¹	
	EUR million	EUR million	EUR million	%
1 Net interest income	451.430	448.611	+2.819	+0.6
2 Net result of financial operations, writedowns and risk provisions	181.958	215.157	-33.199	-15.4
3 Net income from fees and commissions	0.780	0.989	-0.209	-21.1
4 Income from equity shares and participating interests	68.425	21.096	+47.329	+224.3
5 Net result of pooling of monetary income	7.053	-30.872	+37.925	+122.8
6 Other income	21.157	7.506	+13.651	+181.9
Total net income	730.803	662.487	+68.316	+10.3
7 Staff costs	-104.910	-98.035	+6.875	+7.0
8 Administrative expenses	-85.322	-89.902	-4.580	-5.1
9 Depreciation of tangible and intangible fixed assets	-15.237	-16.182	-0.945	-5.8
10 Banknote production services	-16.185	-7.157	+9.028	+126.1
11 Other expenses	-21.136	-0.393	+20.743	
Total expenses	-242.790	-211.669	+31.121	+14.7
Operating profit	488.013	450.818	+37.195	+8.3
12 Corporate income tax	-122.003	-153.278	-31.275	-20.4
	366.010	297.540	+68.470	+23.0
13 Central government's share of profit	-329.409	-267.786	+61.623	+23.0
14 Profit for the year	36.601	29.754	+6.847	+23.0

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

Operating Profit over the Past Five Years



1 Net Interest Income

Net interest income represents the balance of interest income and interest expense.

Net interest income from assets and liabilities denominated in foreign currency totaled EUR 257.273 million (+EUR 0.654 million), that from euro-denominated assets and liabilities came to EUR 115.126 million (-EUR 8.050 million). Monetary policy refinancing operations yielded EUR 224.803 million (+EUR 109.330 million), and the ECB remunerated the transfer of foreign reserves with EUR 20.662 million (+EUR 0.541 million). Income on intra-Eurosystem balances arising from the allocation of euro banknotes within

the Eurosystem came to EUR 146.017 million (+EUR 113.805 million). Conversely, EUR 96.579 million (+EUR 8.283 million) were required to remunerate minimum reserves. Interest expenses of EUR 268.865 million (+EUR 183.228 million) resulted from TARGET liabilities.

2 Net Result of Financial Operations, Writedowns and Risk Provisions

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

Net realized gains contracted by EUR 46.370 million (17.5%) to EUR 218.151 million, which basically stems from gold and foreign currency transactions (EUR 190.647 million, +EUR 22.444 million from 2004) and securities transactions (EUR 33.776 million, –EUR 61.443 million from 2004).

Writedowns on financial assets and positions largely reflect the decline in market prices of balance sheet items as on December 31, 2005, below the average cost of the respective currencies or securities. Foreign currency writedowns came to EUR 16.098 million (–EUR 238.081 million), securities writedowns to EUR 27.906 million (+EUR 19.746 million), writedowns on derivatives to EUR 0.101 million (–EUR 0.111 million) and writedowns on participating interests to EUR 0.186 million (–EUR 0.806 million).

The item *Transfer to/from provisions for exchange rate and price risks* results from transfers from the *reserve fund for exchange rate risks* that the OeNB funded up to the end of 1998 with a view to covering unrealized foreign currency losses, which amounted to EUR 16.098 million. Thus, in compliance with Article 69 paragraph 1 Nationalbank Act, these losses did not have an impact on profit. However, in view of the assessment of risk associated with non-domestic assets, EUR 8.000 million were transferred to the *provisions for exchange rate risks*.

4 Income from Equity Shares and Participating Interests

Net income of EUR 42.316 million from the sale of the OeNB's share in Austrian Payment Systems Services (APSS) was disclosed under income from equity shares and participating interests. This item also records dividend payments of EUR 18.000 million made by Münze Österreich Aktiengesellschaft and of EUR 2.276 million made by the BIS for 2004. The distribution of profit by AUSTRIA CARD-Plastikkarten und Ausweissysteme Gesellschaft m.b.H. resulted in income of EUR 3.350 million, that by APSS in income of EUR 1.900 million. Moreover, this item reflects a transfer of EUR 0.583 million by the ECB that partly reverses the retention of seigniorage income for the coverage of losses in 2004.

5 Net Result of Pooling of Monetary Income

Article 32 of the Statute of the ESCB defines monetary income as the income accruing to the Eurosystem NCBs in the performance of the Eurosystem's monetary policy function. According to the Statute of the ESCB, the amount of each NCB's monetary income is determined by measuring the actual annual

income that derives from the earmarkable assets held against its liability base. Such assets shall be earmarked and the income derived from these assets shall be redistributed among the euro area NCBs in accordance with guidelines to be established by the Governing Council of the ECB (Article 32.2 of the ESCB Statute).

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

The monetary income pooled by the Eurosystem is allocated among NCBs according to the subscribed capital key. The OeNB's net monetary income in 2005, EUR 7.076 million, is calculated as the difference between the monetary income pooled by the OeNB (EUR 278.139 million) and reallocated to the OeNB (EUR 285.215 million). Including a revision for 2004 that had an impact on the result in 2005, EUR 7.053 million were transferred to the OeNB on January 2, 2006.

6 Other Income

The rise in *other income* mainly results from sales of real estate including apartments by the OeNB.

7 Staff Costs

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

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

Salaries net of pension contributions collected from staff members diminished by EUR 0.526 million or 0.6% to EUR 83.293 million against the previous year. The OeNB's outlays were reduced by recoveries of salaries totaling EUR 6.568 million for staff members on secondment to subsidiaries and foreign institutions.

The four members of the Governing Board received emoluments⁷ including remuneration in kind (tax value of the private use of company cars, subsidies to health and accident insurance) totaling EUR 1.042 million (2004: EUR 1.030 million). Table 28 shows a breakdown of these items.

⁷ Limits apply under the Federal Constitutional Act on the Limitation of Remunerations for Public Officials.

Table 28

	Emoluments	Remuneration in kind	Total
	EUR thousand	EUR thousand	EUR thousand
Governor Klaus Liebscher	268	8	276
Vice Governor Wolfgang Duchatzcek	253	10	263
Executive Director Peter Zöllner	246	10	256
Executive Director Josef Christl	238	8	246

The emoluments of the OeNB's President and Vice President amounted to EUR 0.107 million, (2004: EUR 0.106 million plus EUR 0.035 million of back pay for 2003).

The average annual income of an OeNB staff member as calculated on the basis of the specifications of the Court of Audit for income reviews came to EUR 0.077 million in 2005 (2004: 0.076 million EUR).

Table 29 shows the development of staff in full-time equivalents.

Table 29

	December ¹			Annual average ¹		
	2005	2004	change	2005	2004	change
Staff employed in core business areas (expressed in full-time equivalents) ²	947.5	970.3	-22.8	962.8	957.3	+5.5
Total	1,114.5	1,148.5	-34.0	1,131.2	1,161.8	-30.6

¹ Including part-time employees on a pro rata basis.

² Excluding employees on secondment or leave (such as maternity and parental leave).

Statutory or contractual social charges totaling EUR 12.883 million (+EUR 0.055 million) contain municipal tax payments of EUR 2.533 million, social security contributions of EUR 6.484 million and contributions of EUR 3.795 million to the Family Burden Equalization Fund.

10 Banknote Production Services

Expenses for banknote production services result above all from the purchase of euro banknotes from the OeBS.

12 Corporate Income Tax

A corporate income tax rate of 25% (December 31, 2004: 34%) is to be applied to taxable income according to Article 72 Nationalbank Act, which qualifies as income under Article 22 paragraph 1 of the Corporate Income Tax Act.

13 Central Government's Share of Profit

Under Article 69 paragraph 3 Nationalbank Act, the *central government's share of profit* is 90% of the net income for the year after tax, as in previous years; it amounted to EUR 329.409 million (2004: EUR 267.786 million) in 2005.

Governing Board (Direktorium)

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

General Council (Generalrat)

President Herbert Schimetschek
 Vice President Manfred Frey
 August Astl
 Christian Domany (until May 24, 2005)
 Bernhard Felderer
 Philip Göth
 Elisabeth Gürtler-Mauthner
 Manfred Hofmann (from May 24, 2005)
 Herbert Kofler
 Georg Kovarik
 Johann Marihart
 Werner Muhm
 Gerhard Randa
 Walter Rothensteiner
 Johann Zwettler

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

Vienna, March 29, 2006

Report of the Auditors

We have audited the financial statements of the Oesterreichische Nationalbank for the year ending December 31, 2005, in accordance with the generally accepted Austrian auditing standards as recommended by the reports, guidelines and opinions of the Institut Österreichischer Wirtschaftsprüfer. Our due audit has not raised any objections; therefore, we issue an unqualified audit opinion.

In the course of our audit we have found that the accounting records and the financial statements of the Oesterreichische Nationalbank for the year ending December 31, 2005, are presented in accordance with the provisions of the Federal Act on the Oesterreichische Nationalbank 1984 as amended. The financial statements were prepared in conformity with the accounting policies defined by the Governing Council of the European Central Bank, as set forth in the Guideline of the European Central Bank of 5 December 2002 on the legal framework for accounting and reporting in the European System of Central Banks (ECB/2002/10), in conformity with Article 26.4 of the Protocol on the Statute of the European System of Central Banks and the European Central Bank and in line with the above-mentioned national provisions. In our opinion the accounts, in observing said provisions, provide a true and fair picture of the OeNB's financial position on December 31, 2005, and the results of its operations from January 1, 2005, to December 31, 2005. The annual report complies with the provisions of Article 68 paragraph 1 and paragraph 3 of the Federal Act on the Oesterreichische Nationalbank 1984 as amended and as promulgated in Federal Law Gazette I No. 161/2004 and corresponds with the financial statements.

Vienna, March 29, 2006

Pipin Henzl
Certified Public Accountant

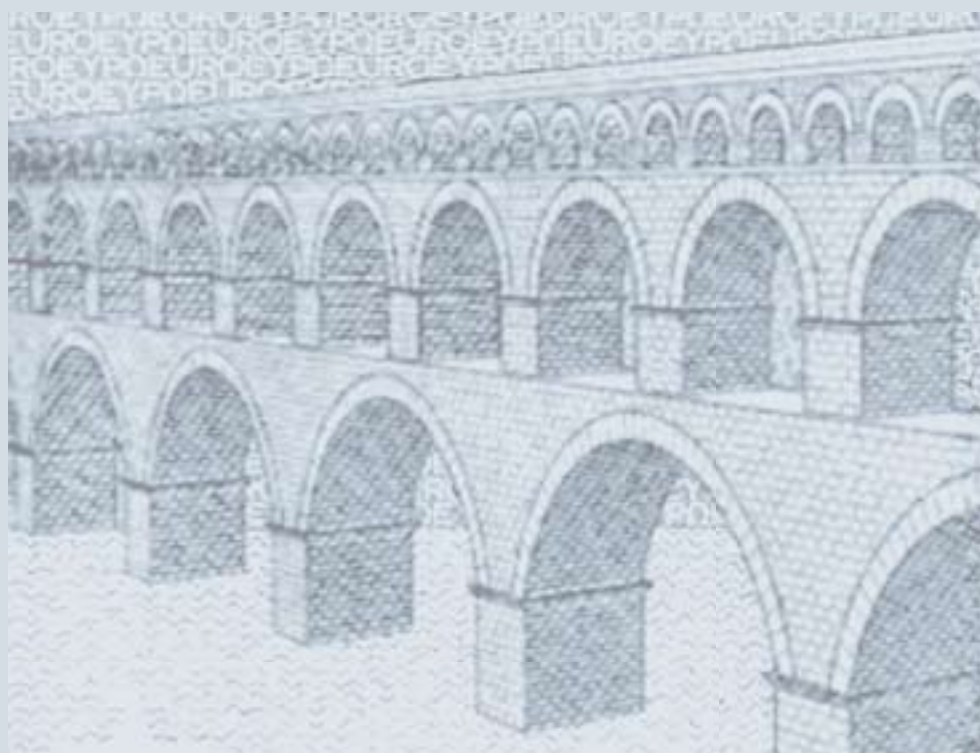
Peter Wolf
Certified Public Accountant

Profit for the Year and Proposed Profit Appropriation

The statutory allocation of OeNB profit to the central government in line with Article 69 paragraph 3 of the Nationalbank Act came to EUR 329.409 million in 2005 (item 13 of the profit and loss account; 2004: EUR 267.786 million). Adjusted for this amount, the balance sheet and the profit and loss account show a Profit for 2005 of EUR 36,601,009.56.

On April 12, 2006, the Governing Board endorsed the following profit appropriation proposal to the General Council:

	EUR	EUR
to pay a 10% dividend		
on the OeNB's capital stock of EUR 12 million		1,200,000.00
to allocate to the Leopold Museum Private Foundation		4,501,718.71
to allocate to the OeNB Anniversary Fund		
for the Promotion of Scientific Research and Teaching:		
funds earmarked for promotion by the OeNB	12,579,460.15	
funds earmarked for the National Foundation		
for Research, Technology and Development	18,319,830.70	30,899,290.85
		36,601,009.56



Report of the General Council (Generalrat) on the Annual Report and the Financial Statements for 2005

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

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

The Financial Statements for the year 2005 were given an unqualified auditors's opinion after examination by the auditors elected by the General Meeting of May 24, 2005, the certi-

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

In its meeting of April 27, 2006, the General Council approved the Annual Report of the Governing Board and the Financial Statements for the business year 2005. The General Council submits the Annual Report and moves that the General Meeting approve the Financial Statements of the Oesterreichische Nationalbank for the year 2005 and discharge the General Council and the Governing Board from responsibility for management during the preceding business year. Moreover, the General Council requests that the General Meeting approve the allocation of the profit for the year in accordance with the proposal made in the notes to the Financial Statements 2005 (page 113).



Notes

Abbreviations, Legend

AG	Aktiengesellschaft (roughly: stock corporation)	IMF	International Monetary Fund
APC	Austrian Payments Council	IT	information technology
APSS	Austrian Payment Systems Services	M3	broad monetary aggregate M3
ARTIS	Austrian Real Time Interbank Settlement (the Austrian RTGS system)	LTROs	longer-term refinancing operations
ATM	automated teller machine	MWh	megawatt hours
ATS	Austrian schilling	NCB	national central bank
Basel II	New Basel Capital Accord	NMS	new EU Member States
BIS	Bank for International Settlements	OeBS	Oesterreichische Banknoten- und Sicherheitsdruck GmbH (Austrian Banknote and Security Printing Works)
BOSS	Bank On-Site Supervision (OeNB)	OECD	Organisation for Economic Co-operation and Development
BSC	Banking Supervision Committee of the ESCB (EU)	OeNB	Oesterreichische Nationalbank
CEBS	Committee of European Banking Supervisors (EU)	ORION	Operationales Risikomanagement in der OeNB (operational risk management at the OeNB)
CEE	Central and Eastern Europe	PEACH	pan-European automated clearing house
CEECs	Central and Eastern European countries	POS	point of sale
CEEI	Conference on European Economic Integration	ROM	Risk-Oriented Reporting System (OeNB)
CFS	Center for Financial Studies	RTGS	Real-Time Gross Settlement
CPI	consumer price index	SDR	Special Drawing Right (IMF)
EBA	Euro Banking Association	SEPA	Single Euro Payments Area
ECB	European Central Bank	SMEs	small and medium-sized enterprises
Ecofin	Council of Economic and Finance Ministers (EU)	SAA	Stabilization and Association Agreement
EMAS	eco-management and audit scheme	SGP	Stability and Growth Pact
EMU	Economic and Monetary Union	SSP	Single Shared Platform (TARGET2)
EPC	European Payments Council	STEP2	Straight-Through Euro Processing (EBA)
ERM II	exchange rate mechanism II (EU)	STUZZA	Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr (Austrian Research Association for Payment Cooperation)
ERP	European Recovery Program	Tacis	Technical assistance to the Commonwealth of Independent States
ESCB	European System of Central Banks	TARGET	Trans-European Automated Real-time Gross settlement Express Transfer
EU	European Union	USD	U.S. dollar
EUR	euro	VaR	Value at Risk
EURIBOR	Euro Interbank Offered Rate	WIFO	Österreichisches Institut für Wirtschaftsforschung (Austrian Institute of Economic Research)
Eurostat	Statistical Office of the European Communities	wiiw	Wiener Institut für internationale Wirtschaftsvergleiche (The Vienna Institute for International Economic Studies)
FMA	Financial Market Authority (Austria)	WTO	World Trade Organization
FSAP	Financial Services Action Plan (EU)		
FSI	Financial Soundness Indicator (IMF)		
GDP	gross domestic product		
GSA	GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H. (Austrian cash services company)		
HICP	Harmonized Index of Consumer Prices		
IFRS	International Financial Reporting Standards		
IHS	Institute for Advanced Studies		
IMBA	Institut für Molekulare Biotechnologie GmbH (Institute of Molecular Biotechnology)		

× = No data can be indicated for technical reasons

.. = Data not available at the reporting date

0 = The numerical value is zero or smaller than half of the unit indicated

– = The numerical value is zero (applicable to the Financial Statements).

Discrepancies may arise from rounding.

Glossary

Austrian Payments Council (APC): information hub and coordination mechanism of the Austrian banking sector with regard to the implementation of the requirements for a Single Euro Payments Area (SEPA) in Austria. Established in May 2005 by the stakeholders of STUZZA (Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr), which include the OeNB, and the Austrian Federal Economic Chamber.

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

Benchmark portfolio: a reference portfolio, often an index, used to measure the performance of an investment portfolio, i.e. the success of investment strategies (relative performance). Benchmarks may also be used in risk control systems, for instance in the form of deviation limits from the asset allocation applying to a benchmark portfolio (relative risk limits).

Capital adequacy: the concept that banks must maintain sufficient and appropriate capital backing to cover their exposure to risks. The capital adequacy frameworks Basel I and Basel II established by the Basel Committee on Banking Supervision (BCBS) prescribe a capital ratio of 8%.

Capital ratio: a measure of banks' capital strength, expressed as the ratio of own funds to risk-weighted assets.

Chinese wall: information barriers between individual units of a company that are designed to prevent the emergence of conflicts of interest.

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

Credit risk: the risk of changes in customers' creditworthiness impacting on a bank's assets.

Convergence criteria: five requirements that are laid down in the Maastricht Treaty and that an EU Member State must fulfill to qualify for participation in Stage Three of Economic and Monetary Union (EMU), i.e. for the introduction of the euro: (1) an inflation rate not more than 1.5 percentage points above that of the three best-performing Member States in terms of price stability, (2) a long-term interest rate not more than 2 percentage points above that of the three best-performing Member States, (3) a government deficit which does not exceed 3% of GDP, (4) a ratio of public debt to GDP which does not exceed 60% of GDP, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace, and (5) currency variations within the normal fluctuation margins of the exchange rate mecha-

nism II (**ERM II**) for at least two years and no devaluation against the currency of any other Member State.

Eligible assets: For the purpose of backing their monetary policy operations with the central bank, euro area credit institutions may use only assets, for instance marketable debt securities, which fulfill the Eurosystem's eligibility criteria. These criteria are specified by the ECB and apply uniformly throughout the euro area.

Emerging market: a term used to describe the economy of a country that is clearly evolving from the state of a developing economy into that of an industrialized economy, having embarked on a broad-based industrialization process. Emerging markets typically considerably outperform industrialized countries in terms of output growth. Several emerging markets, such as China, have virtually turned into "industrial parks" of the western economies; they achieve high labor productivity rates and are in fact serious competitors of the traditional industrialized countries on account of their relatively low wage levels.

ERM II: exchange rate mechanism II. The exchange rate mechanism which provides the framework for exchange rate policy cooperation between the euro area countries and the EU Member States not participating in Stage Three of EMU. It specifies fluctuation bands for the key interest rates of a currency vis-à-vis the euro. The standard fluctuation band amounts to $\pm 15\%$ around the central rate, while narrower bands may be agreed on a case-by-case basis. (see also **convergence criteria**).

European Payments Council (EPC): central decision-making and coordination body of the European banking sector with regard to the implementation of a Single Euro Payments Area (**SEPA**). Among other things, the EPC is responsible for defining uniform operational guidelines for euro credit and debit transactions, and for drafting a framework for card payment processing. Established by European banks and banking associations in June 2002.

Excessive deficit procedure: a mechanism defined in Article 104 of the Treaty and Protocol No 20 on the excessive deficit procedure that requires EU Member States to maintain budgetary discipline; the **Stability and Growth Pact** substantially extended and accelerated this procedure. It defines criteria for a budgetary position to be considered as an excessive deficit and sets out the steps to be taken when a Member State has not fulfilled the budget balance or government debt criteria.

Fixed rate tender: a procedure in which the central bank provides liquidity to, or withdraws liquidity from, the market on the basis of bids submitted by competing counterparties. Specifically, counterparties bid the amount of money they wish to transact at the rate specified by the central bank.

Hedge funds: (largely) unregulated investment vehicles, typically domiciled in offshore centers, which pursue broad asset allocation strategies, charge incentive fees and are not subject to any investment restrictions.

HICP: Harmonised Index of Consumer Prices. In line with Treaty provisions, price convergence among the EU Member States is to be measured in terms of a harmonised index of consumer prices. The HICP, which is computed by Eurostat, is the result of these standardization efforts and the key inflation indicator for the monetary policy of the Eurosystem. As laid down by the Governing Council of the ECB, the Eurosystem targets a price stability objective of an annual HICP increase of below, but close to 2%.

IFRS: International Financial Reporting Standards. IFRSs have replaced the International Accounting Standards (IAS) as a reporting format for consolidated financial statements. The application of IFRSs, which have been developed by the International Accounting Standards Board (IASB), has been mandatory for all companies listed in the EU since 2005.

Inflation-indexed bonds: typically, fixed-income bonds that cut out inflation risk by indexing the underlying principal to inflation. For example, an annual inflation rate of 5% would cause the underlying principal of a bond to increase from 100 units to 105 units. As a result, and given a coupon rate of 5%, the interest payment due would increase from 5 units to 5.25 units. In other words, it is not the interest rate that changes with inflation. What happens is that the underlying principal of the bond changes, which results in a higher interest payment when multiplied by the given coupon rate.

Liquidity: the ability to raise the funds required to meet payment obligations or deadlines anytime, or to take out new loans. Liquidity may also refer to the volume of liquid assets, to the ability of an asset to be turned into cash (asset liquidity) or to the liquidity of an entire market (market liquidity).

Lisbon strategy: the reform agenda introduced by the Lisbon European Council in March 2000 that aims at making the EU the most competitive and dynamic knowledge-based economy in the world by 2010.

M3: a broad monetary aggregate that comprises M1 (currency in circulation and overnight deposits), M2 (M1 plus short-term savings and time deposits) as well as marketable instruments, in particular repurchase agreements, money market fund shares/units and debt securities with a maturity of up to and including two years issued by MFIs. M3 has been assigned a prominent role in the monetary policy strategy of the Eurosystem. M3 developments in the euro area are monitored against a reference value of 4.5%; this is the annual growth rate of M3 over the medium term that is consistent with the maintenance of price stability.

Major Loans Register: information system maintained by the OeNB to monitor banks' exposure to large loans and meet the information needs of banks and banking supervisors in this respect. Article 75 of the Austrian Banking Act obliges credit and financial institutions as well as insurance companies to report to the OeNB, on a monthly basis, all credits and credit lines granted that exceed the sum of EUR 350,000.

Market risk: the risk of financial market fluctuations (e.g. changes in interest rates, stock prices or exchange rates) impacting on an entity's assets and liabilities.

Memorandum of Understanding (MoU): agreement reached between two authorities on cooperation principles and information-sharing procedures regarding issues of common interest.

New Legal Framework for Payments in the Internal Market: EU-wide legal framework for payment services designed to establish a single European payment area, codify the currently fragmented Community law provisions on payment services, allow competition on equal terms for payment system providers, provide adequate protection of payment service users, ensure security of payments, increase the efficiency of payment systems and guarantee legal certainty for all parties in the payment process.

Off-site analysis: qualitative and quantitative evaluation of the (risk management and balance sheet) data that banks report to the OeNB and the Financial Market Authority (FMA) using a set of different methods. It is geared towards detecting problematic developments as early as possible and initiating counter-measures.

On-site inspection: thorough examination of individual banks, during which supervisors largely work on the premises of a given bank. By reviewing relevant business areas, supervisors thus cross-check the data reported by banks against firsthand information in as much detail as is required to assess the need for supervisory action.

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

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

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

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

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

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

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

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

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

Stability and Growth Pact (SGP): framework annexed to the EU Treaty, adopted in 1997 and reformed in 2005, that is meant to help prevent excessive public deficits. The primary goal of the SGP is the achievement of balanced general government budgets over the medium term.

STEP.AT: extension of the OeNB's **STEP2** access point that will offer Austrian banks efficient and cost-effective clearing services for national interbank transactions from mid-2007.

STEP2: the first and, to date, only **PEACH** for intra-EU credit transfers, which started operation in April 2003 and had 97 direct and 1,581 indirect participants in March 2006. With this system, the Euro Banking Association (EBA) offers credit institutions a technical infrastructure for cost-efficient and swift processing of transactions that meet specific requirements. Transactions must, for instance, be in euro, and both the International Bank Account Number (IBAN) and Bank Identifier Code (BIC) must be correctly indicated on the payment order. The Oesterreichische Nationalbank has been providing access to STEP2 since November 3, 2003.

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

Systemic risk: the risk that several credit institutions may develop financial difficulties at the same time.

TARGET: Trans-European Automated Real-time Gross settlement Express Transfer. A gross settlement system that processes large-value euro payments in real time, which consists of the national RTGS systems of 16 EU Member States, the ECB payment mechanism (EPM) and an Interlinking system connecting the individual TARGET components. The ARTIS system operated by the Oesterreichische Nationalbank is the Austrian RTGS system connected to TARGET.

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

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

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

Variable rate tender: a procedure in which the central bank provides liquidity to, or withdraws liquidity from, the market on the basis of bids submitted by competing counterparties. In a variable rate tender, the central bank specifies only a minimum bid rate in advance, and counterparties bid the amounts of money they wish to transact at rates proposed by them.

Volatility: the propensity of a security price, an exchange rate or an index to vary over time. Volatility is an important indicator for investments, because the anticipated fluctuation of an asset price will affect the expected profit or loss.

Yield spread: difference between interest rates paid on bond markets. Investors will be interested not only in differences at a given point but also in developments over time. Yield spreads are calculated above all for interest rate differentials between (1) individual countries (2) securities with different maturities and (3) instruments of issuers with different underlying credit risks (e.g. government bonds and corporate bonds).

Periodical Publications of the Oesterreichische Nationalbank

For further details see www.oenb.at

Monetary Policy & the Economy quarterly

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

Statistiken – Daten & Analysen quarterly

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

econ.newsletter quarterly

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

For further details see www.oenb.at/econ.newsletter

Financial Stability Report semiannual

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

Focus on European Economic Integration

semiannual

The English-language publication *Focus on European Economic Integration* is the successor publication to *Focus on Transition* (published up to issue 2/2003). Reflecting a strategic regional research priority of the OeNB, this publication is a channel for communicating our ongoing research on Central and Eastern European countries (CEECs) as well as Southeastern European (SEE) countries ranging from economic country studies to studies on central banking issues and related topics. One of the purposes of publishing theoretical and empirical studies in the *Focus on European Economic Integration*, which are subject to an external refereeing process, is to stimulate comments and suggestions prior to possible publication in academic journals.

Workshops – Proceedings of OeNB Workshops

three to four
issues a year

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

Working Papers

about ten papers a year

The OeNB's *Working Paper* series is designed to disseminate, and provide a platform for discussing, findings of OeNB economists or outside contributors on topics which are of special interest to the OeNB. To ensure the high quality of their content, the contributions are subjected to an international refereeing process.

Economics Conference (Conference Proceedings)

annual

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

**Conference on European Economic Integration
(Conference Proceedings)**

annual

This series, published in English by a renowned international publishing house, reflects presentations made at the OeNB's annual conference on Central, Eastern and Southeastern European issues and the ongoing EU enlargement process (formerly East-West Conference).

For further details see *ceec.oenb.at*

Annual Report

annual

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

Intellectual Capital Report

annual

The *Intellectual Capital Report* has been published since 2003 as a review of the OeNB's intellectual capital and its use in the OeNB's business processes and services. The report provides an integrated view of the strategically important management of human, relational, structural and innovation capital; it clarifies the relationships between different types of capital and describes various determinants that influence the OeNB's intellectual capital. The findings of the report serve to assess the consistency of the OeNB's intellectual capital with its knowledge-based strategic orientation.

Photographs



Danube bridge, Tulln



Ghega railway viaduct, Semmering



Nonntal bridge, Salzburg



Schottwien valley bridge



Art Nouveau bridge at Döbling, Vienna



Ottenstein reservoir bridge

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OUR MANDATE AND RESPONSIBILITIES

Mandate

The Oesterreichische Nationalbank (OeNB) is the central bank of the Republic of Austria and, as such, an integral part of the European System of Central Banks (ESCB). In this capacity, the OeNB acts on the basis of full personal, financial and institutional independence. The OeNB's aims and actions are guided by the fundamental principles security, stability and trust. The primary task of the Eurosystem, and hence of the OeNB, is to maintain price stability in the euro area and thus the euro's purchasing power.

Responsibilities

Monetary Policymaking

- Participation by the OeNB's governor in decision-making in the Governing Council and General Council of the European Central Bank (ECB)
- Conduct of extensive economic analysis and research

Monetary Policy Operations – Reserve Management

- Conduct of monetary policy operations with Austrian banks
- Conduct of minimum reserve operations and monitoring of Austrian banks' minimum reserve holdings
- Management of the OeNB's own reserve assets and the reserves transferred to the ECB
- Participation in Eurosystem foreign exchange interventions

Financial Stability and Banking Supervision

- Participation in the prudential supervision of Austrian banks and payment systems oversight to secure financial stability
- Risk analysis of financial markets and banks

Provision of Statistics

- Compilation of statistics – above all monetary, interest rate, prudential and external trade statistics (e.g. balance of payments, banking statistics and financial accounts)

Cash Supply

- Provision of Austrian businesses and consumers with banknotes and coins
- Securing a smooth cash circulation
- Contributing to counterfeiting prevention through public information programs

Payment Services

- Provision and operation of efficient and sound clearing and payment systems within the European Community and with other countries

National and International Cooperation

- Close cooperation with national bodies, e.g. the Financial Market Authority, the Government Debt Committee and the Statistics Advisory Board (Statistikrat)
- Representation in a wide range of bodies of the Eurosystem, the ESCB and the European Union
- International monetary policy cooperation and participation in international financial institutions (International Monetary Fund, Bank for International Settlements)

Communications

- Serving as a communications interface between the Eurosystem on the one hand and the general public, Austrian policymakers and the business community on the other hand
- Pursuit of an active and comprehensive communications policy

SELECTED INDICATORS FOR THE OeNB

	2005	2004
Business indicators		
<i>As on December 31</i>	<i>EUR thousand</i>	
Net currency position	12,206,230	10,813,585
Banknotes in circulation	15,128,006	13,416,144
Total assets	46,389,785	35,583,064
Operating profit	488,013	450,818
Corporate income tax	122,003	153,278
Central government's share of the OeNB's profit	329,409	267,786
Profit for the year	36,601	29,754
	<i>Absolute figures</i>	
Full-time equivalent employment in core business areas	947.5	970.3
Intellectual capital indicators	<i>Number</i>	
Number of inquiries to OeNB hotlines	33,535	33,193
Newsletter subscriptions	12,834	11,250
OeNB publications	67	57
Research cooperation projects with external partners	42	38
Number of working visits to national and international organizations	25	14
Environmental performance indicators		
Heat consumption, kWh/m ²	66	73
Electricity consumption, MWh per employee	8.3	8.4
Use of recycled paper, %	90	90

Source: OeNB.

OUR MISSION STATEMENT

In 2005, the national central banks of the independent Eurosystem (including the OeNB) published a joint mission statement that enshrines the following key objectives and values:

We in the Eurosystem have as our primary objective the maintenance of price stability for the common good. Acting also as a leading financial authority, we aim to safeguard financial stability and promote European financial integration.

In pursuing our objectives, we attach utmost importance to credibility, trust, transparency and accountability. We aim for effective communication with the citizens of Europe and the media. We are committed to conducting our relations with European and national authorities in full accordance with the Treaty provisions and with due regard to the principle of independence.

We jointly contribute, strategically and operationally, to attaining our common goals, with due respect to the principle of decentralisation. We are committed to good governance and to performing our tasks effectively and efficiently, in a spirit of cooperation and teamwork. Drawing on the breadth and depth of our experiences as well as on the exchange of know-how, we aim to strengthen our shared identity, speak with a single voice and exploit synergies, within a framework of clearly defined roles and responsibilities for all members of the Eurosystem.

The OeNB's mission statement complements the Eurosystem's mission statement and transposes it to Austrian requirements. The main messages are:

As the central bank of the Republic of Austria, the OeNB serves the Austrian and European public.

To build and maintain trust in the OeNB, we take pride in performing our tasks professionally, drawing on the high competence and motivation of our employees.

Our products and services are customer oriented to ensure their value to our customers and partners; they are provided efficiently and cost effectively as a result of ongoing market-oriented product and process innovation.

We are cooperative, solution-oriented and reliable partners in our relations with customers and associates.

Our employees' commitment, motivation, creativity, willingness to learn, team spirit and mobility – the success factors of our work now and in the future – are the hallmarks of our working style.

ORGANIZATION CHART

President Herbert Schimetschek	Vice President Manfred Frey
Office of the General Council Richard Mader, Head	

Governing Board

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¹ Environmental Officer Johann Jachs
As of April 27, 2006

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

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