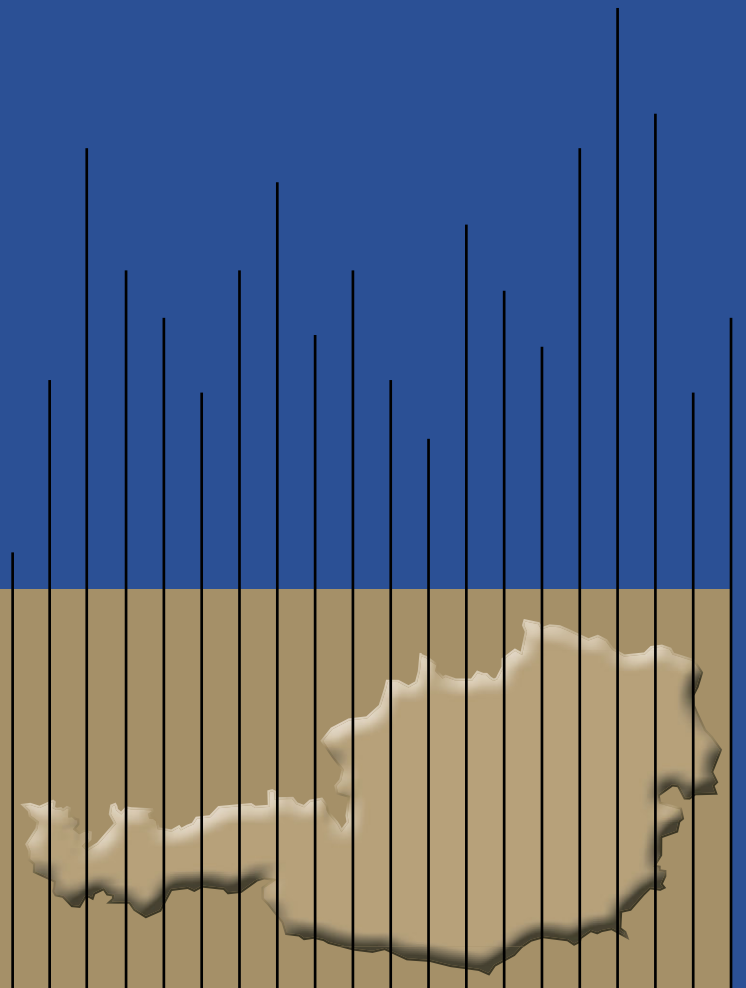


# FACTS ON AUSTRIA AND ITS BANKS



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*Cut-off date: April 10, 2018.*

# Key indicators for the Austrian economy

Cut-off date for data: April 10, 2018.

Table 1

## Key indicators

	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	2017	2018	2019	2020
<b>Economic activity</b>									
<i>EUR billion (four-quarter moving sums)</i>									
Nominal GDP	353.8	356.9	360.8	365.3	370.0	370.0	387.4	402.3	416.3
<i>Change on previous period in % (real)</i>									
GDP <sup>1</sup>	0.7	0.9	0.8	0.9	0.9	3.0	2.8 <sup>1)</sup>	1.9	1.6
Private consumption	0.4	0.3	0.4	0.4	0.4	1.5	1.6	1.4	1.2
Public consumption	0.3	0.1	0.2	0.5	0.6	1.3	2.0	1.1	0.8
Gross fixed capital formation	1.0	1.5	1.5	1.2	0.8	4.8	2.9	2.0	1.9
Exports of goods and services	1.4	2.1	1.5	1.3	1.9	5.9	5.0	4.2	4.0
Exports of goods	1.7	2.3	1.4	0.7	1.3	5.6	5.0	4.1	4.0
Imports of goods and services	1.1	2.0	1.5	1.1	1.3	5.2	4.1	3.5	3.6
Imports of goods	1.1	1.5	1.2	0.7	0.8	4.1	3.9	3.5	3.6
<i>% of nominal GDP</i>									
Current account balance	x	x	x	x	x	1.9	2.1	2.6	3.1
<i>Annual change in %</i>									
<b>Prices</b>									
HICP inflation	0.5	2.2	2.2	2.2	2.4	2.2	2.1	1.9	2.0
Compensation per employee	1.8	1.7	1.5	1.7	1.6	1.6	2.8	2.5	2.2
Unit labor costs	1.5	0.9	0.4	0.0	-0.0	0.3	1.7	1.8	1.5
Productivity	0.3	0.7	1.1	1.7	1.7	1.3	1.0	0.7	0.6
<i>Annual change in %</i>									
<b>Income and savings</b>									
Real disposable household income	0.5	-0.2	0.2	-0.1	-0.4	0.6	1.6	1.5	1.2
<i>% of nominal disposable household income</i>									
Saving ratio	x	x	x	x	x	6.4	-	-	-
<i>Change on previous period in %</i>									
<b>Labor market</b>									
Payroll employment	0.4	0.4	0.6	0.4	0.7	1.9	1.9	1.3	1.1
<i>% of labor supply</i>									
Unemployment rate (Eurostat)	5.8	5.7	5.5	5.4	5.5	5.5	5.1	5.1	5.0
<i>% of nominal GDP</i>									
<b>Public finances</b>									
Budget balance	x	x	x	x	x	-0.7	-0.5	-0.1	0.2
Government debt	x	x	x	x	x	78.6	75.0	72.0	69.0

Source: OeNB, Eurostat, Statistics Austria.

<sup>1</sup> Taking into account the latest developments, we expect an upward revision for GDP growth in 2018/19 compared to the December 2017 forecast.

Note: All data for 2018–2020 are based on the OeNB's December 2017 forecast; the forecast for the saving ratio is no longer valid due to historical data revisions. X=data not available.

Table 2

## Key indicators for Austrian banks

	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	2014	2015	2016	2017
<b>Austrian banking system – consolidated</b>									
<b>Structure<sup>1</sup></b>									
<i>EUR billion</i>									
Total assets	946.3	968.7	962.0	950.8	948.9	1078.0	1056.8	946.3	948.9
Exposure to CESEE <sup>2</sup>	193.3	206.5	203.0	206.4	210.1	184.8	186.4	193.3	210.1
Number of credit institutions in Austria	672	670	669	651	628	764	738	672	628
Number of inhabitants per bank branch in Austria	2,216	2,262	2,297	2,315	2,328	1,999	2,096	2,216	2,328
<b>Solvency<sup>1</sup></b>									
<i>EUR billion</i>									
Equity capital <sup>3</sup>	80.0	80.1	82.3	82.2	83.2	87.6	87.8	80.0	83.2
<i>% of risk-weighted assets</i>									
Solvency ratio <sup>3</sup>	18.3	18.2	18.6	18.4	18.4	15.6	16.3	18.3	18.4
Common equity tier 1 ratio (CET-1) <sup>3</sup>	14.9	14.8	15.2	15.0	15.1	11.7	12.8	14.9	15.1
<i>% of selected balance sheet items</i>									
Leverage <sup>4</sup>	7.6	7.5	7.8	7.9	7.5	6.1	6.3	7.6	7.5
<b>Profitability<sup>1</sup></b>									
<i>EUR billion</i>									
Net result after tax	5.0	1.5	3.4	5.1	6.6	0.7	5.2	5.0	6.6
<i>%</i>									
Return on assets (annualized) <sup>5</sup>	0.6	0.7	0.8	0.8	0.8	0.0	0.6	0.6	0.8
Cost-to-income ratio	74.5	70.0	65.6	64.3	64.7	69.1	62.8	74.5	64.7
<b>Credit quality<sup>1</sup></b>									
<i>%</i>									
Loan loss provision ratio	3.1	3.0	2.9	2.7	2.4	4.5	4.2	3.1	2.4
Nonperforming loan ratio (NPL ratio)	4.9	4.9	4.6	4.2	3.8	7.0	6.6	4.9	3.8
<b>Credit developments</b>									
<i>%</i>									
Annual growth of credit to nonbanks in Austria	1.6	1.3	1.8	2.2	2.9	0.7	1.1	1.6	2.9
Share of foreign currency loans in Austria	9.0	8.7	8.1	7.1	6.5	11.1	10.2	9.0	6.5

## Austrian subsidiaries in CESEE

	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	2014	2015	2016	2017
<i>EUR billion</i>									
Net profit/loss after tax (aggregated)	2.4	0.6	1.5	2.2	2.6	0.7	2.0	2.4	2.6
<i>%</i>									
Return on assets (annualized) <sup>5</sup>	1.3	1.3	1.6	1.5	1.3	0.2	0.7	1.3	1.3
Cost-to-income ratio	52.7	57.3	53.0	52.4	53.3	52.7	51.1	52.7	53.3
Loan loss provision ratio	6.5	6.0	4.3	3.9	3.4	7.4	7.6	6.5	3.4
Nonperforming loan ratio (NPL ratio)	8.6	8.1	6.2	5.5	4.8	11.8	11.5	8.6	4.8
Share of foreign currency loans <sup>1</sup>	30.0		28.0		27.0	43.0	38.0	30.0	27.0
Loan-to-deposit ratio <sup>1</sup>	80.2	79.2	80.3	80.5	79.1	96.6	88.4	80.2	79.1

## Financial assets of households and nonfinancial corporations

	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	2014	2015	2016	2017
<b>Households</b>									
<i>EUR billion</i>									
Financial assets	625.9	632.0	636.7	639.7	646.3	592.8	607.4	625.9	646.3
Financial liabilities (loans)	178.2	178.3	179.2	180.9	181.9	167.4	173.0	178.2	181.9
of which foreign currency loans	21.2	20.5	19.2	17.5	16.5	25.4	24.4	21.2	16.5
of which foreign currency housing loans	17.8	17.2	16.1	14.8	13.9	19.5	19.2	17.8	13.9
<b>Nonfinancial corporations</b>									
<i>EUR billion</i>									
Financial assets	502.0	512.6	511.4	515.7	527.6	460.4	467.6	502.0	527.6
Financial liabilities	737.0	750.8	755.4	765.8	779.0	696.6	703.5	737.0	779.0
of which loans and securities (other than shares and other equity)	325.4	329.2	327.6	330.0	332.2	305.6	314.7	325.4	332.2
of which shares and other equity	229.5	229.6	230.3	235.6	248.2	223.2	220.4	229.5	248.2
<i>EUR billion (four-quarter moving sums)</i>									
Gross operating surplus and mixed income	79.8	81.3	82.6	84.5	85.7	76.6	79.9	79.8	85.7

Source: OeNB, Statistics Austria.

<sup>1</sup> Due to the restructuring of the CESEE business of UniCredit Bank Austria in 2016, data comparability is limited.

<sup>2</sup> CESEE exposure of majority Austrian-owned banks (BIS definition).

<sup>3</sup> Capital ratios are based on CRD IV definitions from 2014 onward, which limits comparability with earlier measures.

<sup>4</sup> Defined according to Basel III provisions from 2014 onward.

<sup>5</sup> End-of-period profit/loss expected for the full year after tax and before minority interests as a percentage of average total assets.

Note: X = data not available.

## Austrian economy among top performers in the euro area

- Austria's economy is booming: GDP grew by 3.0% in 2017, and growth will be at least as strong in 2018, according to the OeNB's most recent assessment for the full year. Thus, the Austrian economy is growing faster than the German and the euro area economies in both years. The upswing is broad based: both domestic and external demand have been providing substantial contributions to growth, which is also attributable to the fact that the Austrian economy is highly diversified and its sectoral structure is well balanced.
- The healthy upturn has led to a sustained decrease in unemployment. The unemployment rate (EU definition) dropped from 6.2% to 5.2% between summer 2016 and February 2018; current forecasts expect it to decline further. Austria maintains an excellent record of social stability, which rests on high employment, low unemployment by international standards and a low frequency of strikes.
- Recording an average inflation rate of 1.8% since the introduction of the euro in 1999, Austria has been among those countries that have successfully maintained price stability in line with the euro area's definition (i.e. HICP inflation at a rate "below, but close to, 2% over the medium term"). In its current outlook, the OeNB expects the inflation rate in Austria to come to 2.0% in 2018 as a whole. This means that the inflation difference between Austria and the euro area will narrow slightly.
- The Austrian real estate market has been buoyant since the mid-2000s. Starting from a low level, residential property prices rose by 62% between 2008 and 2017. According to the OeNB fundamentals indicator for residential property prices, this development is broadly in line with economic fundamentals.
- Austria's saving ratio dropped sharply after the economic crisis and stood at 6.4% in 2017. Financial assets held by households totaled EUR 646.3 billion or 175% of GDP. The household sector's debt ratio stood at slightly above 50% of GDP in the third quarter of 2017. Corporate debt in Austria equaled 389% of gross operating surplus or 90.5% of GDP (Q3 2017), which is below the euro area average.
- Given stable price competitiveness as measured by the real effective exchange rate, Austrian exporters benefited greatly from the current pickup in global trade. On the back of robust growth in important export markets, like Germany and Central, Eastern and Southeastern Europe (CESEE), Austrian nominal goods exports expanded by 8.2% in 2017 compared to the previous year.
- Austria's foreign trade in goods is well diversified both by region and product type. In 2017, more than half of foreign trade took place with other euro area countries and was therefore not directly affected by exchange rate risks. After Germany, which accounted for an export share of more than 30% in 2017, CESEE is Austria's most important export market. The share of goods exports to this region rose from 15% in 1996 to 21% in 2017.
- The steady string of current account surpluses seen since 2002 (2017: 1.9% of GDP) confirms the international competitiveness of the Austrian economy. Austria's net international investment position is positive, standing at EUR 22.3 billion (6.0% of GDP) in 2017.
- Austria's budget balance ratio improved to -0.7% of GDP in 2017 (2016: -1.6%). The improvement is the result of the very good economic environment and the further decline in interest expenses. In line with the lower budget balance, the debt ratio improved from 83.6% in 2016 to 78.6% in 2017, which was primarily due to higher GDP growth in 2017 as well as the winding down of assets held by state-owned "bad banks."
- Austria continues to maintain an AAA rating with DBRS and holds an AA+ rating with Standard & Poor's, Fitch and Moody's (Aa1). The high confidence in the Austrian economy among international investors is reflected in the fact that Austrian government bonds currently have a negative yield up to a duration of four years.

### Austrian banks benefit from benign economic environment and adaptation of business models

- Austrian banks benefited from the benign economic environment, recording historically low loan loss provisions and increased profits. The adaptation of their business models are starting to prove effective.
- In 2017, Austrian banks' net profit was EUR 1.6 billion up on the previous year, totaling EUR 6.6 billion. Despite this solid performance, additional measures to enhance banks' cost efficiency and risk-bearing capacity are called for.
- Austrian banks' capitalization has improved significantly since the onset of the financial crisis in 2008. At end-2017, their consolidated CET1 ratio was in line with the EU average.
- Credit growth in Austria gained momentum in 2017. At the same time, the credit quality reported by Austrian banks has improved, with respect to both their domestic business and their CESEE exposure, with CESEE subsidiaries accounting for the larger part of the improvement.
- Banks in Austrian majority ownership hold 67% of their consolidated foreign claims against CESEE, with the Czech Republic and Slovakia accounting for the largest exposures.
- The improvement in the economic environment in CESEE had a positive impact on Austrian banks' subsidiaries, with their aggregate end-of-period profit increasing by 12% year on year to EUR 2.6 billion in 2017, mostly owing to a reduction in loan loss provisions, especially in Russia and in the Czech Republic. These two countries also accounted for the largest profit contributions.
- The measures taken by the Austrian supervisory authorities to curb foreign currency lending continue to have a positive impact, as reflected in the declining volume of outstanding foreign currency loans to households and nonfinancial corporations: since 2008, this amount has decreased by 68% (in exchange rate-adjusted terms) to EUR 19.8 billion in January 2018. Given that foreign currency loans and loans with repayment vehicles continue to be associated with risks, the OeNB recommends that banks together with foreign currency borrowers evaluate the latter's risk-bearing capacity and, if necessary, take measures to reduce their exposure to these risks.
- Due to changed legal and institutional conditions, the supervisory sustainability package has been adjusted. The original objectives set out in the sustainability package relating to capital requirements as well as recovery and resolution planning have been accomplished. The monitoring of foreign subsidiaries' stable local funding will continue to play a key role in preventing excessive credit growth and maintaining financial stability.
- Under a new law adopted in 2017, supervisors have been equipped with an extended macroprudential toolkit for containing systemic risks in real estate financing. At present, the OeNB sees no need for using any of the new instruments available in this toolkit, but it considers compliance with sustainable lending standards imperative.
- In the area of banking supervision, the work of previous years, also undertaken in cooperation with the ECB under the Single Supervisory Mechanism (SSM), continues to bear fruit. Moreover, the finalization of the Basel III reform package in 2017 has created more clarity about the future regulatory framework. Due to the diverse structure of the Austrian banking system, comprising both a number of large institutions and many small institutions, the OeNB advocates more proportionality in banking regulation. Regulatory requirements should differ depending on a bank's size and the risk inherent in its business model.
- External assessments of the Austrian banking sector have improved, reflecting banks' efforts to adapt their business models and to strengthen their risk-bearing capacity as well as the measures taken by the supervisory authorities. Moody's raised its outlook on Austria's banking system to "positive" from "stable" in August 2017, and Standard and Poor's followed suit in October 2017. The reasons given for the improved assessment were the reduction in the CESEE exposure, the decrease in the amount of outstanding foreign currency loans in Austria and CESEE, higher capitalization, high provisions for nonperforming loans and prudential lending standards. The macroprudential initiatives launched in Austria were also positively acknowledged.

# 1 Austria ranks among the top economies in the euro area

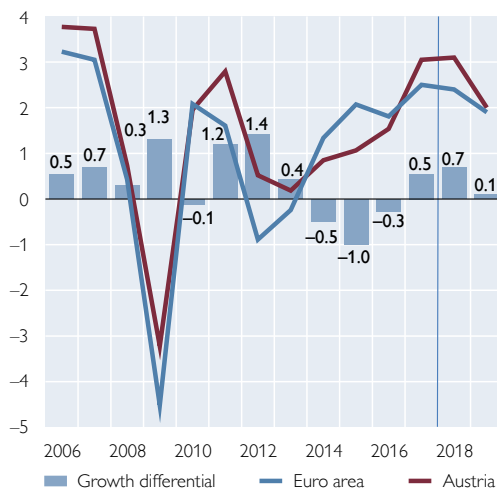
## 1.1 Austria is one of the best performing advanced economies worldwide Austrian economic growth around 3% in 2017 and 2018

At the beginning of 2016, the Austrian economy embarked on a gradual recovery. Buoyed by lively investment activity and healthy private consumption growth, domestic demand was the major driver of growth at first. From the second half of 2016 onward, export activity picked up markedly as global trade was recovering. The combination of strong domestic and foreign demand resulted in the strongest economic momentum since the boom before the onset of the global financial and economic crisis. With real GDP growth coming to 3.0% in 2017, the Austrian economy outpaced GDP growth in the euro area for the first time since 2013. It also exceeded that of Germany, Austria's most important trading partner. The outlook for the first half of 2018 remains promising. Many economic indicators stand near their historic highs and signal a continuation of strong economic growth. Based on the latest developments and most recent data releases, economic growth in 2018 as a whole will be at least as strong as in the previous year – indicating a possible upside revision compared to the OeNB's December forecast. As a result, Austria will again report stronger growth than the euro area and Germany in 2018.<sup>1</sup>

Chart 1

### Growth differential between Austria and the euro area

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

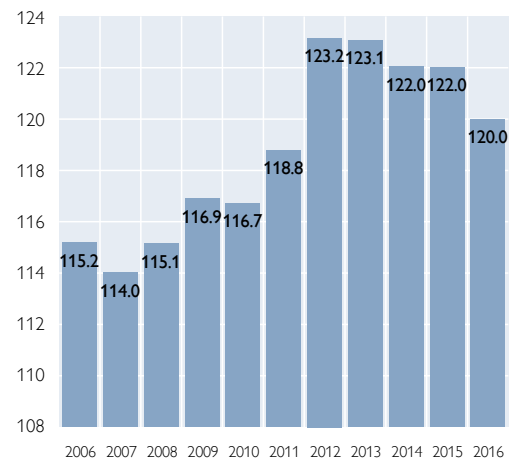


Source: Eurostat, WIFO, ECB, OeNB.

Note: Euro area 2018 and 2019: ECB projection of March 2018. Austria 2018 and 2019: update of the OeNB December 2017 Outlook.

### Austrian GDP per capita relative to the euro area

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



<sup>1</sup> The IMF World Economic Outlook (WEO) of April 2018 forecasts Austria's real GDP growth to come to 2.6% and 1.9% in 2018 and 2019, respectively. In the OeNB's opinion, the IMF is still underestimating 2018 growth by around ½ percentage point. This is also in line with the current assessment of the Austrian research institutes (WIFO and IHS), which also expect a growth rate of 3.0% for 2018.

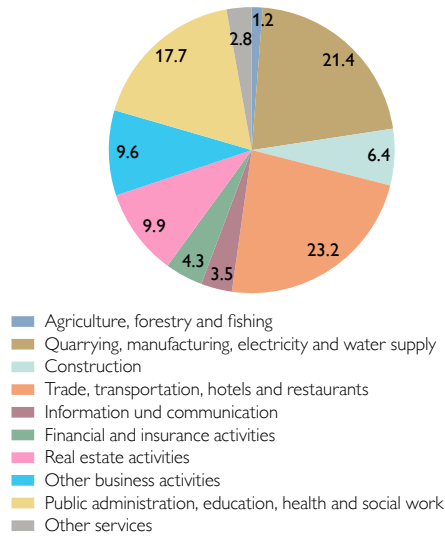
### Sectoral structure of the Austrian economy is well balanced

Given that Austria is a highly developed economy, the tertiary sector plays a crucial role. Private sector services (information and communication, financial and insurance activities, real estate activities, other business activities and other services) contribute the largest share – slightly below 30% – to gross value added, followed by activities classified under “quarrying, manufacturing, electricity and water supply” as well as “trade, transportation and hotels and restaurants,” which account for slightly more than 20% each. Furthermore, manufacturing in Austria is characterized by a high diversity of industries. At 6½%, construction’s contribution to gross value added is high by European standards.

Chart 2

#### Gross value added in Austria in 2017

% of total gross value added, at current prices



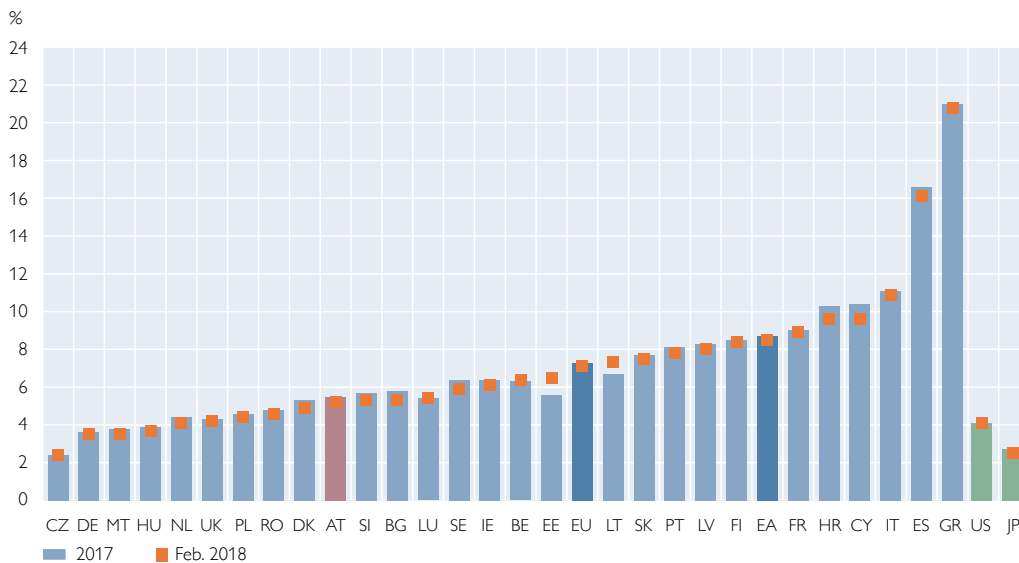
Source: Statistics Austria.

### Upswing leads to sustained decrease in unemployment

As the economy gathered momentum in 2016, employment growth accelerated, reaching 1.9% in 2017 – its highest rate since 2011. Since mid-2016, the economic upswing has been robust enough to keep unemployment firmly on a downward path even though labor supply keeps rising strongly. The jobless rate dropped from

Chart 3

#### Unemployment rates



Source: Eurostat.

Note: GR, UK: Nov. 2017, EE, HU, JP: Dec. 2017, IE: Feb. 2018.



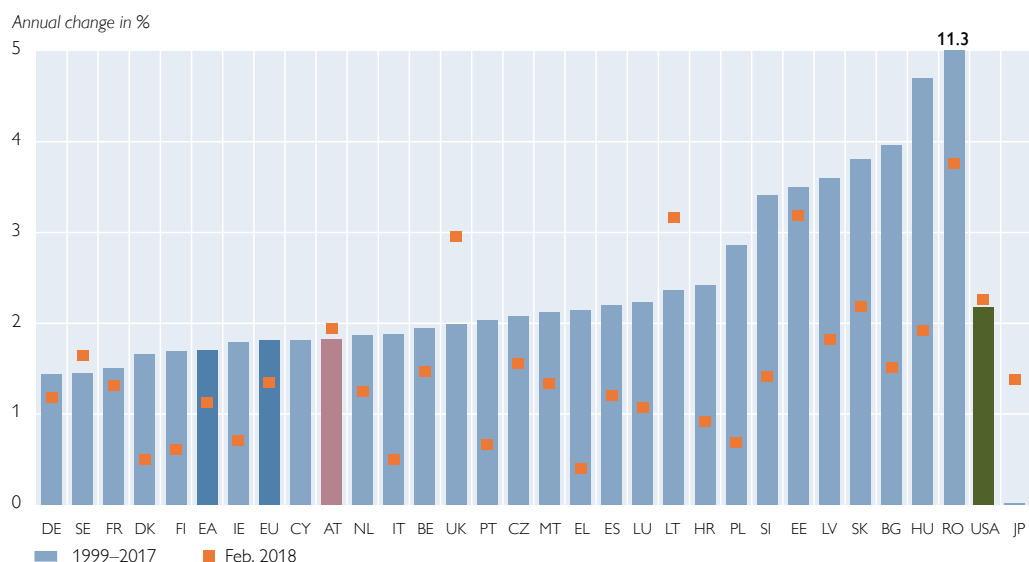
6.2% to 5.2% in February 2018. In an EU-wide comparison, Austria ranked among the Member States with the lowest unemployment rates in 2017. The Austrian labor market is characterized by a high level of flexibility (in European terms) and a balancing of interests between employers and employees. Hence, Austria is also among the best performers worldwide in rankings of alternative indicators that measure, for instance, social stability (such as the frequency of strikes).

### Inflation difference vis-à-vis the euro area narrowing gradually in 2018

Recording an average inflation rate of 1.8% since the introduction of the euro in 1999, Austria has been among those countries that have successfully maintained price stability in line with the Eurosystem's definition (i.e. HICP inflation at a rate "below, but close to, 2% over the medium term").

Chart 4

#### HICP inflation rate



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

Note: JP and UK: Jan. 2018.

Since 2011, the Austrian inflation rate has continuously been higher than the euro area average (0.7 percentage points) and the inflation rate in Germany (0.6 percentage points). The main cause for this differential can be found in the service sector. Within the service sector, about half of the inflation differential vis-à-vis Germany is solely attributable to catering services (especially restaurants, cafes). Although the difference in inflation rates is low, the weight of catering services in the Austrian HICP basket is significantly higher, which reflects different consumption patterns. In addition, differences in the development of publicly administered prices (and indirect taxes) account for another part (0.2 percentage points) of the inflation differential vis-à-vis Germany. In 2017, HICP inflation in Austria was 2.2%, 0.7 percentage points above the corresponding rate of the euro area and 0.5 percentage points above that of Germany. For 2018, the OeNB expects a small decline in HICP inflation to 2.0%, while the Eurosystem expects euro area inflation

to fall somewhat to 1.4% (both as of March 2018). This will slightly reduce the inflation differential between Austria and the euro area.

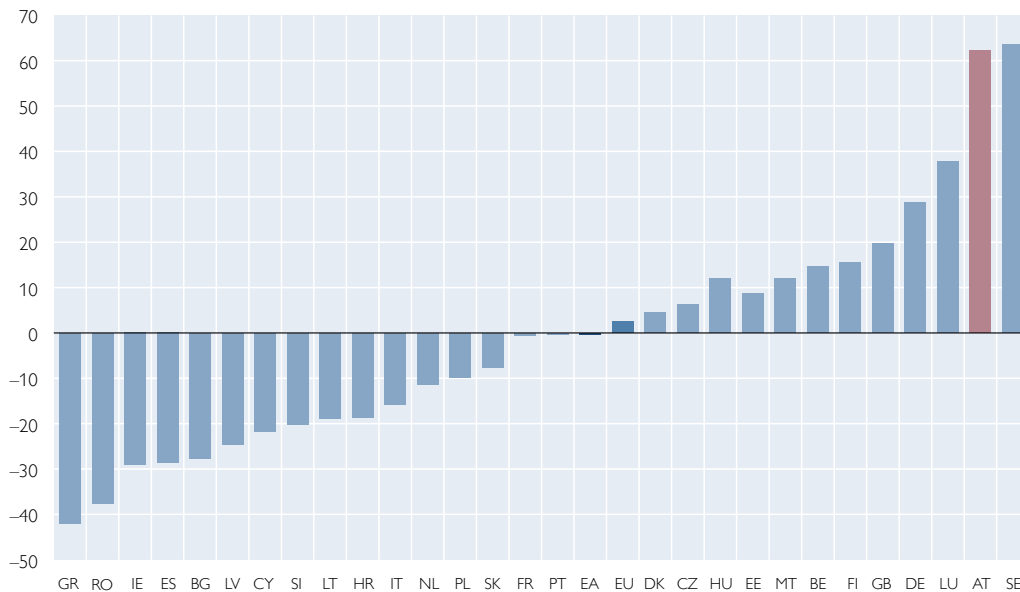
### Strong growth of Austrian residential property prices but no signs of overheating

The Austrian residential property market has been buoyant since the mid-2000s. Starting from a comparatively low level, residential property prices rose by 62% between 2008 and 2017. However, current market developments in Austria are markedly different from the severe developments seen in some other euro area countries in the past, where residential property price growth went hand in hand with a surge in mortgage lending, and the ensuing bursting of the real estate bubble caused disruptions in the financial sector.

Chart 5

#### Change in house prices in EU Member States between 2008 and 2016

Change on 2008 in %



Source: ECB.

Note: Prices of new and existing dwellings (current prices).

In Austria, residential property price growth reached 3.8% in 2017. Compared to 2016 (+7.3%), house price inflation moderated. The increase in residential property prices in Austria is largely attributable to fundamentals, as reflected in the OeNB's fundamentals indicator for residential property prices. The demographic developments seen in recent years have driven up housing demand. Furthermore, due to low interest rates, residential property has become a more popular form of investment. At the same time, lending growth has been moderate in Austria. Housing loans to households expanded in nominal terms by 4.7% in 2017. Austrian households' debt is low – by international standards – and stable. In the past decade, a large part of housing loans was taken out in foreign currency (especially in Swiss francs). The foreign exchange risk associated with such loans is declining now, however, as the share of foreign currency loans in total housing loans has also

diminished significantly recently. At the same time, the interest rate risk of new housing loans has been decreasing. The share of variable rate loans (with an initial rate fixation period of up to 1 year) in new loans dropped from 84% in 2014 to 52% in 2017. Also, Household Finance and Consumption Survey (HFCS) data show that Austrian households' debt-servicing capacity is strong by international standards. Finally, owing to the comparatively high share of rental accommodation in total housing in Austria, households are less affected by residential property price developments than those in other EU countries.

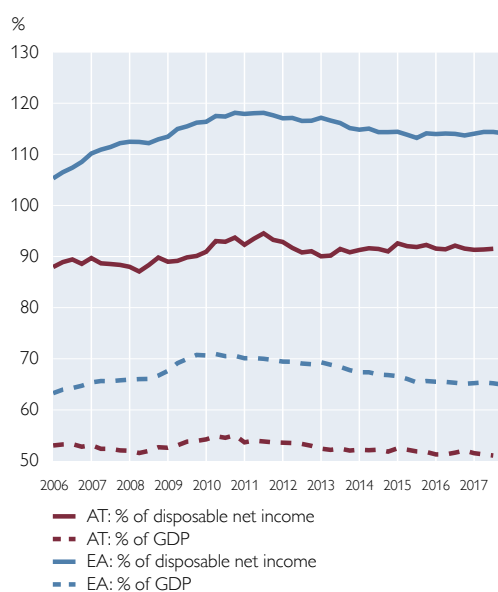
### Household and corporate sectors: high levels of financial assets, low debt

In 2017, households saved about 6.4% of their net disposable income. With total financial assets amounting to some EUR 646.3 billion (174.6% of GDP) at the end of 2017, the household sector is a key supplier of capital to other sectors in Austria.

Households' debt totaled slightly above 50% of GDP in the third quarter of 2017, which is clearly below the euro area average of 65.3%. Likewise, at 389.2% of gross operating surplus or 90.5% of GDP, corporate debt in Austria was lower than the euro area average (466.8% and 102.1%, respectively) in the third quarter of 2017.

Chart 6

#### Household debt

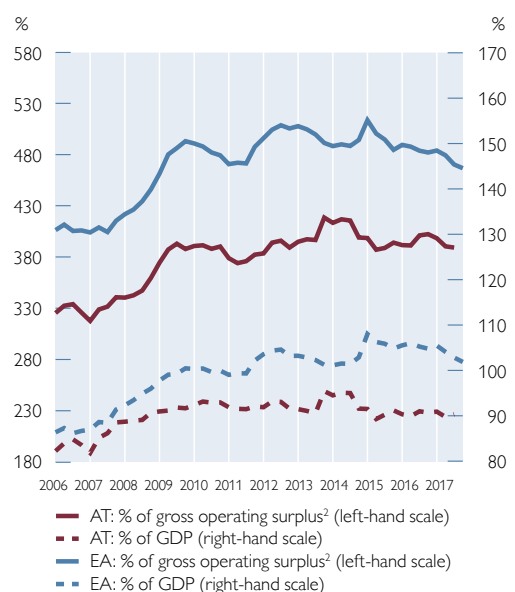


Source: ECB.

<sup>1</sup> Short- and long-term loans, money and capital market instruments.

<sup>2</sup> Including mixed income of the self-employed.

#### Corporate debt<sup>1</sup>



## 1.2 Continued current account surpluses confirm international competitiveness of Austrian economy

### Price competitiveness of Austrian economy stable

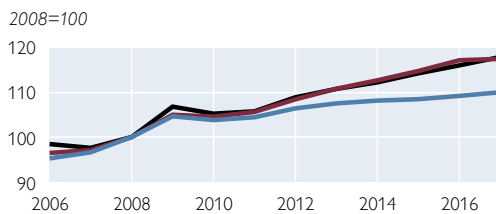
The Austrian economy's price competitiveness as measured by the real effective exchange rate (deflated by unit labor costs for the total economy) has hardly changed over the past ten years. The real effective exchange rate has appreciated

by only 4% since 2006. This must be seen against the backdrop of unit labor costs having increased slightly more in Austria and Germany than in its trading partner countries in the euro area. While productivity per hour in Austria, Germany and the euro area expanded almost at the same pace, hourly wage growth in the euro area was slower than in Austria and Germany. Given the stable level of price competitiveness, Austrian exporters have benefited greatly from the current pickup in global trade. On the back of robust growth in important export markets – like Germany and CESEE – in 2017, Austrian nominal goods exports expanded by 8.2% year on year.

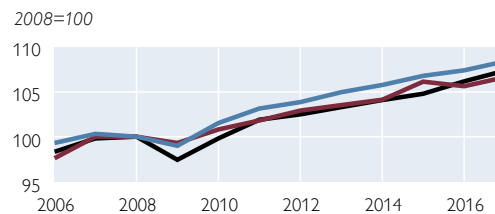
Chart 7

### International competitiveness

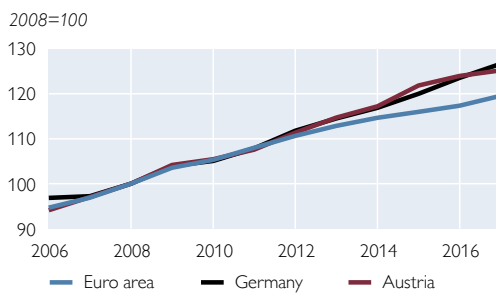
#### Unit labor costs



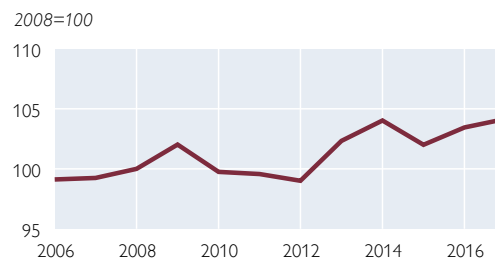
#### Productivity per hour worked



#### Compensation per hour worked



#### Real effective exchange rate<sup>1)</sup>



Source: Eurostat.

<sup>1)</sup> Deflated by unit labor costs.

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

In 2017, more than half of Austria's goods exports went to the euro area, which meant that they were not exposed to any direct exchange rate risk. Among Austria's trade partners in the euro area, Germany is still the most important one by far, with a share of 30% in Austria's total goods exports, followed by Italy, which accounts for a share of 6.4%. Furthermore, CESEE is a very important export market for Austria. Exports to the region have expanded rapidly in the past years. While the share of goods exported to the euro area has declined since 1996, the share of goods exported to CESEE has steadily increased (1996: 15%, 2017: 21%). Given that CESEE's growth advantage vis-à-vis the euro area has recently widened again (to 1½ percentage points), the region will definitely remain a central growth market for Austrian exporters in the near future. Next to CESEE, the U.S.A., Switzerland and Asia rank among Austria's most important export markets outside the euro area.

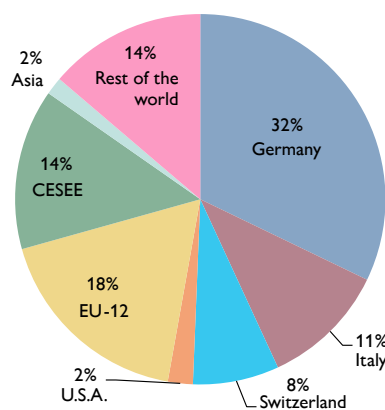
The sectoral structure of Austria’s external trade follows the pattern typically observed in highly industrialized nations. At 40%, machinery and transport equipment make up the lion’s share of Austria’s goods exports. Other important pillars of Austrian export activity include manufactured goods, chemicals and commodities and transactions not classified elsewhere, which together account for some 47% of goods exports.

U.S. President Trump signed two proclamations on March 8, 2018, imposing a tariff of 25% on steel imports and 10% on aluminum imports. However, EU countries will be exempted from these tariffs for the time being. Steel exports account for 3.2% (EUR 0.3 billion) of total Austrian goods exports to the U.S.A., and aluminum exports for 1.6% (EUR 0.15 billion). Overall, iron and steel as well as aluminum account for no more than 0.2% and 0.1%, respectively, of total Austrian exports. Due to these comparatively low shares, the direct macroeconomic effects of U.S. steel and aluminum tariffs on the Austrian economy would be low.

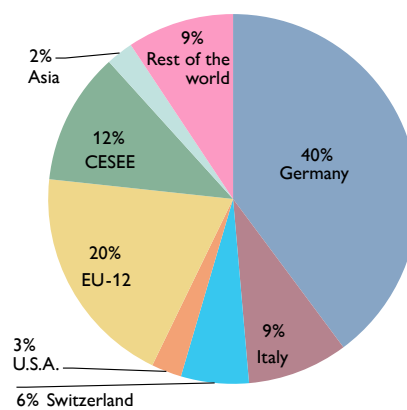
Chart 8

**Regional pattern of Austrian goods exports 1980–2017**

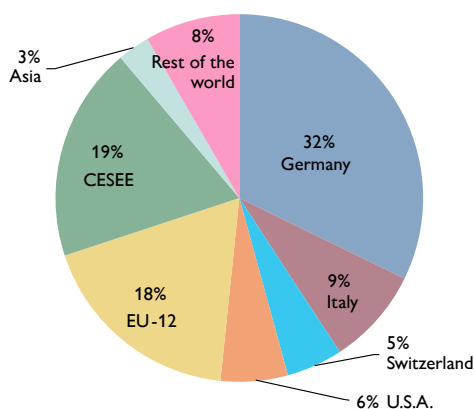
**1980**



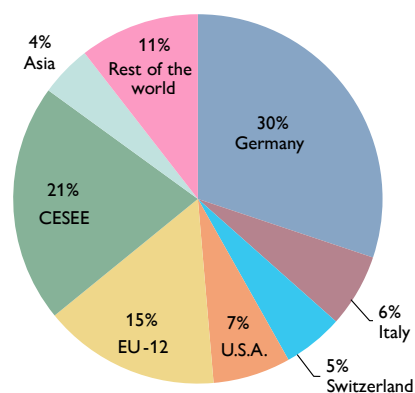
**1992**



**2004**



**2017**



Source: Statistics Austria.

Note: Asia: CN, JP, KR; EU-12: BE, DK, FI, FR, GR, IE, LU, NL, PT, ES, SE, UK;

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

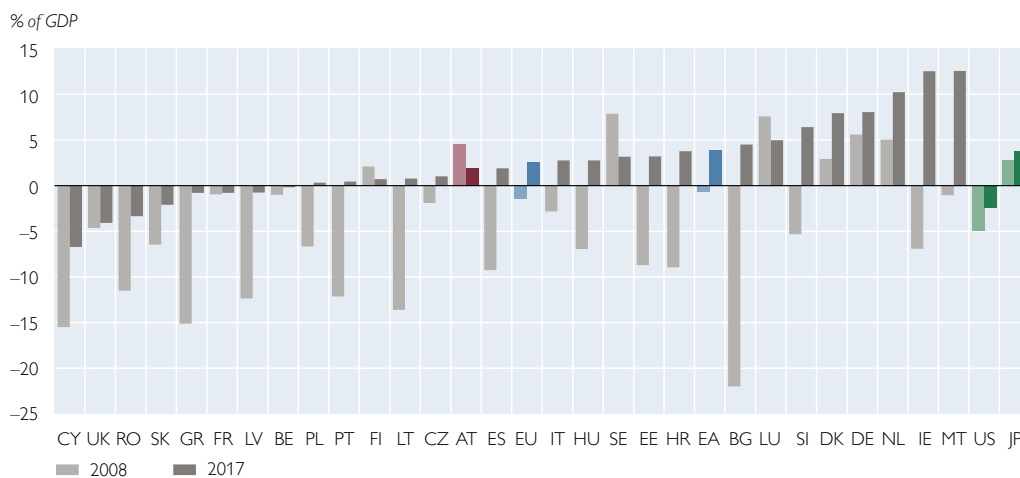
Next to goods exports, which make up 70% of total exports, services exports (30%) also play an important role in the Austrian economy. In recent years, services exports have grown more strongly than goods exports. This was substantially driven by the tourism sector: Overnight stays have seen new record highs. Other services exports, e.g. exports of business-related services, expanded vigorously as well: According to the technology balance of payments, Austria has turned into a net exporter of technology-related know-how transfers of EUR 3.6 billion or 1% of GDP.

### Current account surpluses confirm Austria's international competitiveness

Austria has constantly recorded current account surpluses since 2002. In 2017, the current account surplus amounted to EUR 6.9 billion or 1.9% of GDP. This positive result was driven by a plus in the balance of services and an improvement in the primary and secondary income balances, which compensated for the decline in the goods balance. In light of the strong competitiveness of the Austrian economy and the recently observed significant pickup in global trade, all forecasts currently predict that Austria will continue to post current account surpluses in the coming years.

Chart 9

### Current account balances of EU Member States, the U.S.A. and Japan



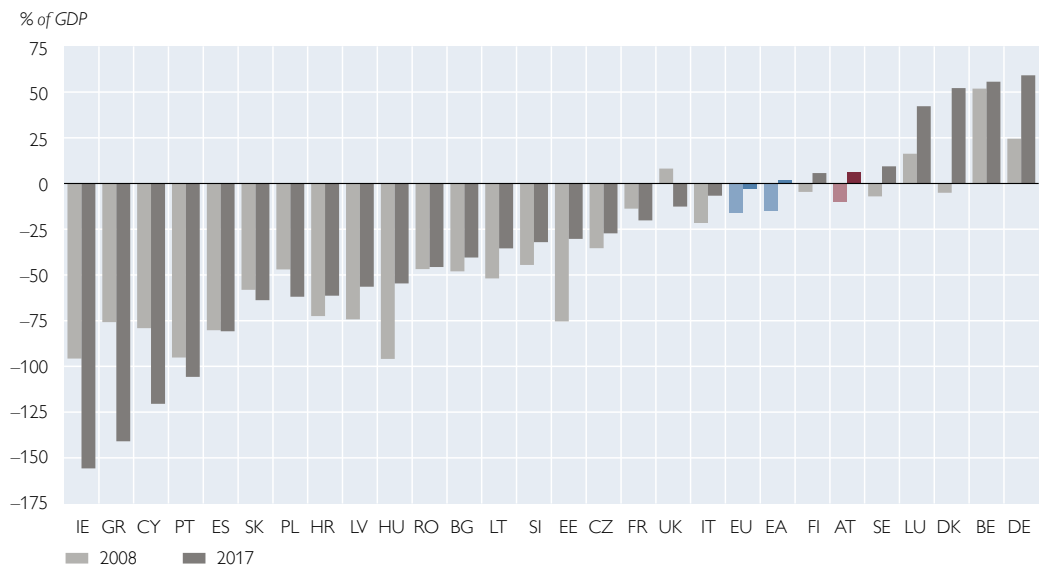
Source: Eurostat.

Note: U.S.A. and Japan: averages derived from European Commission and IMF data.

### Austria's net international investment position positive since 2013

Due to its sustained current account surplus – since 2002 Austria has recorded a cumulated surplus of just above EUR 110 billion – Austria has steadily improved its net international investment position (IIP) in recent years. In 2013, its net IIP entered positive territory for the first time. In 2017, Austria's net IIP came to EUR 22.3 billion (6.0% of GDP). This compares with a positive net IPP of 1.7% of GDP for the euro area and a negative net IPP of 3.0% for the EU.

### Net international investment position



Source: Eurostat, ECB (SDW).

Note: DK and HR: IIP value of Q3 2017. EU value (2017) based on preliminary data for DK and HR.

### 1.3 Significant decline in Austria's budget deficit and debt thanks to good economic situation

The general government budget balance improved and reached  $-0.7\%$  of GDP in 2017, following a temporary deterioration in 2016 ( $-1.6\%$  of GDP). Since 1980, the budget deficit had invariably been larger than in 2017, with the sole exception of 2001, when it also stood at  $-0.7\%$  of GDP. The notable improvement in 2017 is essentially attributable to the very good economic situation and the continued decline in interest expenses. Improving the nominal general government budget balance further is also the declared objective of the federal government. In his budget speech of March 2018, the Federal Minister of Finance announced that the government is aiming for a balanced budget in 2019. The expected benign economic environment will help achieve this objective, despite a number of expansive fiscal measures (e.g. increased tax relief for families with children).

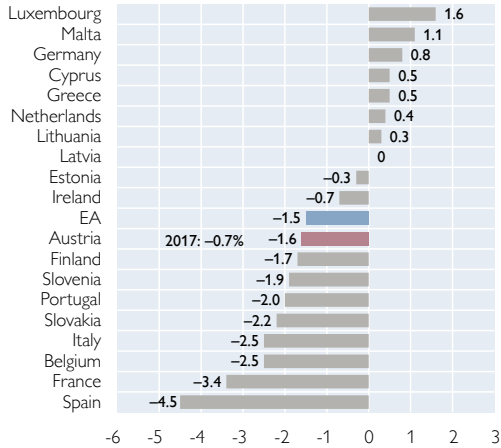
Government debt as a share of GDP has been on a downward path since 2016. The sharp decline in 2017 – by almost 5 percentage points to  $78.6\%$  of GDP – can be traced to two factors: high GDP growth and low interest rates on the one hand, and the winding down of assets held by state-owned bad banks on the other. In his budget speech, the Minister of Finance declared that the government intends to reduce the debt ratio further, to just above  $70\%$  of GDP by 2019 and toward a level of  $60\%$  of GDP by 2022.

Chart 11

## Budget balances of EU Member States in 2016

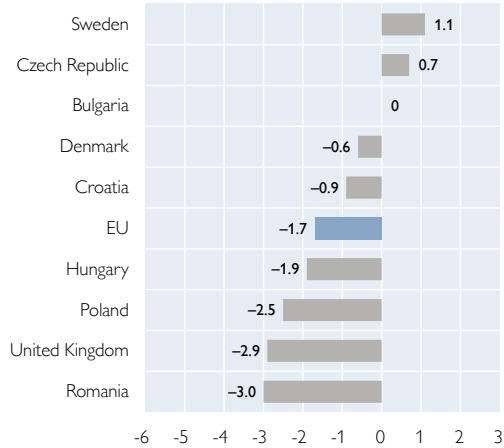
### Euro area countries

% of GDP



### Non-euro area countries

% of GDP



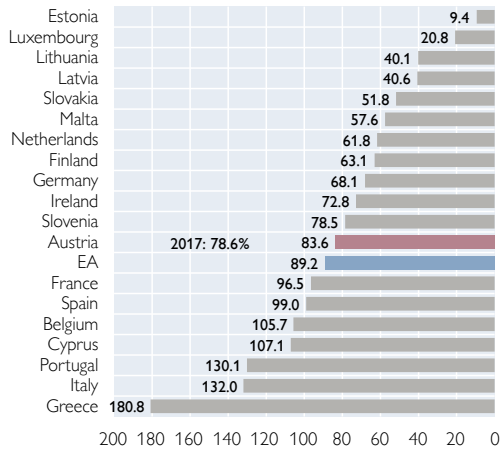
Source: Eurostat.

Chart 12

## Public debt of EU Member States in 2016

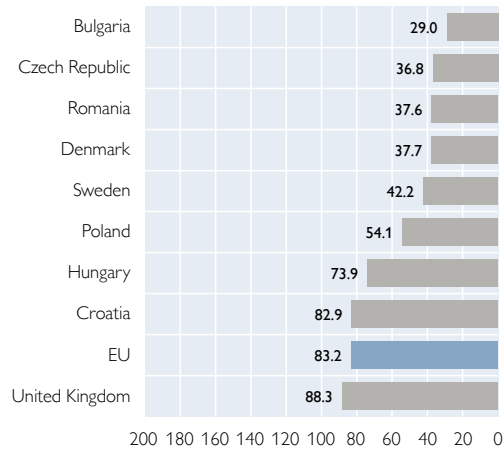
### Euro area countries

% of GDP



### Non-euro area countries

% of GDP



Source: Eurostat.

## Austria achieved a structural budget balance of $-0.5$ of GDP in 2017

Under the preventive arm of the Stability and Growth Pact, which is part of the European fiscal framework, Austria is required to achieve a structural budget balance of  $-0.5\%$  of GDP. According to the Federal Ministry of Finance's stability program (update for 2017 to 2022), Austria was right on target in 2017. For 2018,



however, a deterioration of the structural budget balance is expected<sup>2</sup> on account of tax cuts implemented by the current government (reduction of VAT on overnight accommodation, reduction of contributions to unemployment insurance for small income earners) as well as sustained effects of expansive measures adopted under the previous government.

Given that some of the expansive measures adopted under the previous government are set to expire and interest expenses have been declining, it will be possible to meet the medium-term budgetary objective from 2019 onward without additional saving measures, despite the increased tax relief for families with children.

Table 3

### EU fiscal governance requirements

	Release	2013	2014	2015	2016	2017	Source	Requirement
		% of GDP						
<b>Budget balance</b>	March 2018	-2.0	-2.7	-1.0	-1.6	-0.7	Statistics Austria	>= -3% of GDP
<b>Public debt</b>	March 2018	81.0	83.8	84.3	83.6	78.6	Statistics Austria	from 2017: reduction of difference to 60% of GDP by an average 1/20 per year.
<b>Structural balance</b>	March 2018	-1.7	-0.8	-0.3	-1.0	-0.5	EC, Statistics Austria	MTO (target value) is -0.5% of GDP

Source: Statistics Austria, European Commission (EC), Austrian Ministry of Finance.

### Top external assessment of the Austrian economy

Due to difficult (mainly external) economic conditions, most European countries have lost their AAA ratings. Austria continues to maintain an AAA rating with DBRS and holds an AA+ rating with Standard & Poor's, Fitch and Moody's (Aa1). The high confidence in the Austrian economy among international investors is reflected in the fact that Austrian government bonds currently have a negative yield up to a duration of four years.

<sup>2</sup> The European fiscal framework allows governments to deduct expenditures related to refugees and counter-terrorism measures from the structural budget balance. The structural deficit ratios the Minister of Finance referred to in his speech were already adjusted for these expenditures and therefore lower.

## 2 Austrian banks benefit from benign economic environment and adaptation of business models

### 2.1 Profitability and capitalization need to be strengthened further

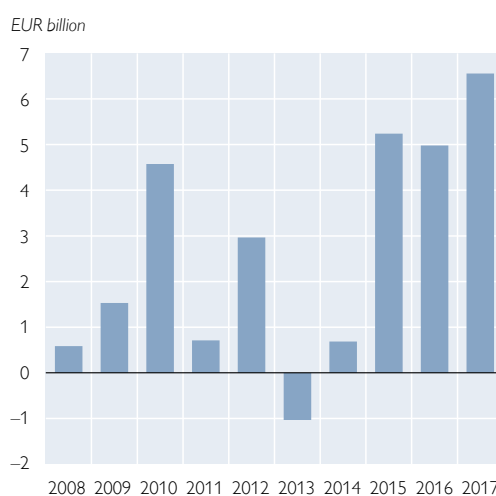
#### Benign economic environment has positive impact on profitability but banks should go ahead with reforms

Over the past few years, financial stability in Austria has been substantially strengthened through supervisory measures as well as banks carrying out restructurings and adapting their business models. Still, the Austrian banking sector continues to face major challenges such as the low interest rate environment. The economic environment improved in 2017, as reflected by low credit risk provisions and increased profitability. At the end of 2017, Austrian banks' net profit for the year was EUR 1.6 billion up on 2016, totaling EUR 6.6 billion. While credit growth gained momentum in 2017, net interest income stagnated at the previous year's level on account of the low interest environment. This notwithstanding, net interest income remained the most important income component. The prevailing low interest rate level increases debt sustainability, especially for borrowers with variable rate loans, but at the same time may entail risks to credit quality if interest rates were to rise. Also, weaker-than-expected economic growth is another potential risk to bank profitability; therefore, it remains to be seen whether the current credit risk level proves sustainable.

In any case, additional measures to enhance banks' cost efficiency and their risk-bearing capacity are called for to achieve a sustainable level of operational profitability. The current benign macroeconomic environment should be used by

Chart 13

#### Consolidated net profit of Austrian banks



Source: OeNB.

Table 2

#### Aggregated profit and loss account of Austrian banks

	2010	2011	2012	2013	2014	2015	2016	2017
<i>EUR billion</i>								
Net interest income	20.4	20.4	19.3	18.6	19.3	18.3	14.6	14.5
Fee and commission income	7.7	7.6	7.3	7.6	7.7	7.7	6.6	6.9
Trading income	1.0	0.8	1.1	0.7	0.4	-0.0	0.1	0.1
Operating profit	13.5	10.4	12.1	8.0	8.8	10.5	5.7	8.1
Net result after tax	4.6	0.7	3.0	-1.0	0.7	5.2	5.0	6.6

Source: OeNB.

Note: Comparability with previous figures is limited for figures as of end-2016 due to the restructuring of UniCredit Bank Austria in 2016.

banks to move forward with adjusting their business models. These are important steps toward safeguarding an efficient, resilient banking sector that guarantees a stable and modern supply of credit and financial services.

### Credit quality continues to improve

Given the brighter economic environment, Austrian banks' credit quality continued to improve in 2017. Both the consolidated nonperforming loan (NPL) ratio as well

Box 1

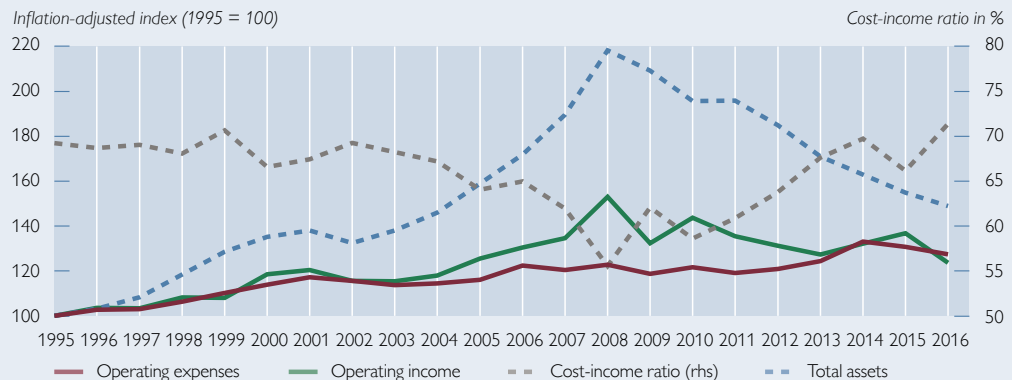
#### OeNB study looks into Austrian banks' profitability over past two decades<sup>1</sup>

A study published in the OeNB's Financial Stability Report 34 analyzed the profitability of the Austrian banking sector (on an unconsolidated basis) from 1995 to 2016, showing that domestic banks are still facing challenges despite increasing profits and a (relative) decline in operating expenses. The surge in profits seen before the crisis of 2008–09 took place on the back of declining interest margins and was also reflected in an expansion of bank balance sheets. Pressure on interest margins was particularly high for smaller banks and those that relied more heavily on the domestic market. However, interest margins have recovered somewhat since 2009. Net fees and commissions income, which is the second important component of banks' operating income, was highly cyclical in the period under review; also, it was found to be clearly influenced by banks business models. Fee income from payments rose at most banks in the entire period under review. Operating expenses also increased steadily (mostly driven by inflation), but staff costs declined recently. The latter account for about half of operating expenses, other administrative expenses make up about one-third.

In 2016, the cost-income ratio of Austrian banks stood at around 70%, i.e. at about the same level as in 1995 (which marks the start of the period reviewed in this study). It reflects, in particular, income growth (and hence total asset growth) and shows that banks' adaptations of their business models have not had an impact yet. Smaller banks with a local business focus recorded above-average cost-income ratios, but there has been some visible effects of efficiency-enhancing efforts (e.g. mergers within bank sectors). The banking sector's return on assets recently returned to its pre-crisis level, which, however, is first and foremost attributable to historically low loan loss provisions.

Box Chart 1

#### Austrian banks' cost-income ratio in comparison to total assets, operating expenses and income over time



<sup>1</sup> Kavan, S. et al. 2017. Profitability of Austrian banks' domestic business from 1995 to 2016: driving forces, current challenges and future opportunities. In: Financial Stability Report 34. Vienna: OeNB. 52–67.

as the NPL ratio for the domestic business alone dropped further, to 3.8% and 2.8%, respectively. Austrian banks' subsidiaries in CESEE once again posted the sharpest decrease in their NPL ratio, which improved markedly to 4.8%.

### Capitalization levels in line with European average

Austrian banks' capitalization improved significantly in the past few years. A comparison with European peers shows that at 15.1% the Austrian banking system's consolidated common equity tier 1 (CET1) ratio is in line with the EU average (September 2017: 15.0%). Nevertheless, given their specific risk profile, domestic banks must continue to improve their risk-bearing capacity.

Table 3

#### Capital ratios of the Austrian banking sector on a consolidated basis

	2010	2011	2012	2013	2014	2015	2016	2017
	% of risk-weighted assets							
Total capital adequacy ratio	13.2	13.6	14.2	15.4	15.6	16.3	18.3	18.4
Tier-1 capital ratio	10.0	10.3	11.0	11.9	11.8	12.9	15.0	15.4
Common equity tier-1 ratio <sup>1</sup>	9.4	9.8	10.7	11.6	11.7	12.8	14.9	15.1

Source: OeNB.

<sup>1</sup> Basel III definition since 2014.

## 2.2 Austrian banks' foreign business continues to focus on CESEE

At the end of 2017, the consolidated foreign claims of banks in Austrian majority ownership<sup>3</sup> totaled EUR 316 billion (see chart 14), with claims on CESEE accounting for some 67% thereof. As regards the aggregate CESEE-related claims of EU-15 banks, the Austrian banking sector's share added up to about 22% at the end of September 2017 (latest available data, see chart 15).

### CESEE subsidiaries: improved profitability supported by comparatively low risk provisions

Austrian banks' subsidiaries in CESEE benefited from relatively benign economic conditions, posting an aggregate profit for the year of EUR 2.6 billion (see chart 16), up 12% on the previous year. This rise was mainly attributable to the substantial reduction in loan loss provisions – in particular by subsidiaries in Russia and the Czech Republic. Subsidiaries operating in these two countries also provided the largest profit contributions in 2017, whereas subsidiaries in Russia and Hungary posted the highest increase in profit. Austrian banks in the Czech Republic and Slovakia saw comparatively high credit growth.

## 2.3 Macroprudential measures continue to bear fruit

### Steep decline in foreign currency loans continues

Austria implemented macroprudential measures early on. In 2003, the Financial Market Authority (FMA) established Minimum Standards for the granting of foreign

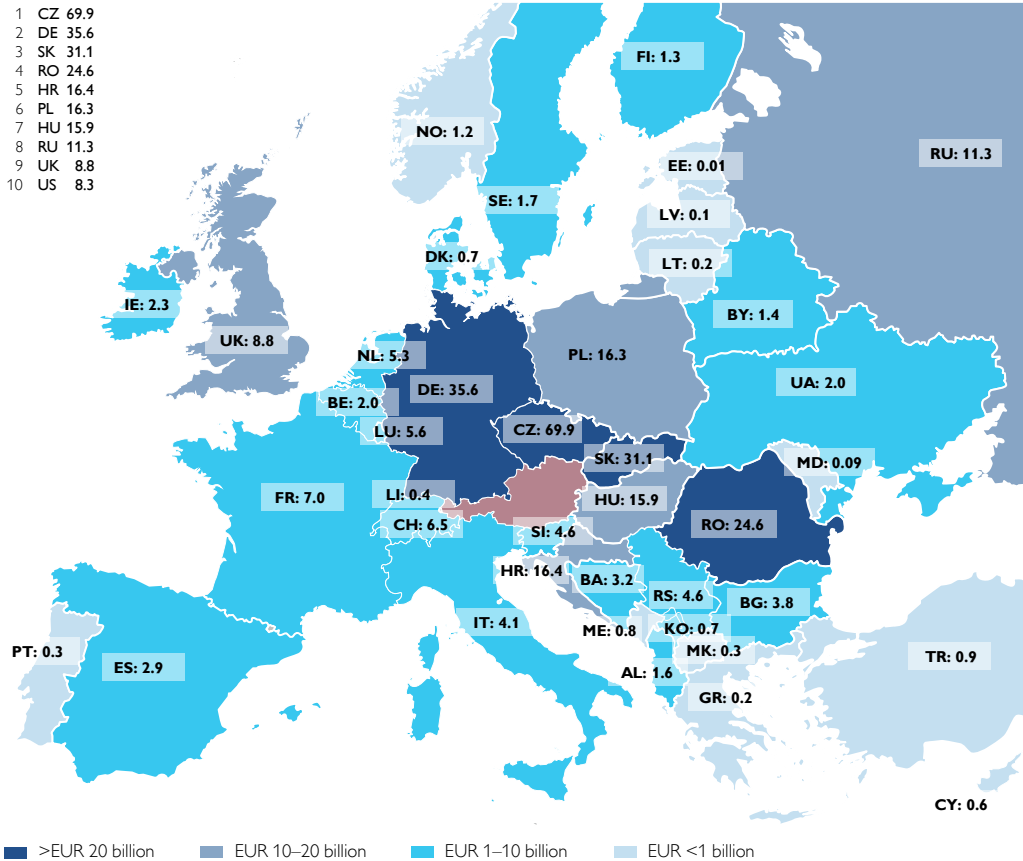
<sup>3</sup> Consolidated foreign claims (immediate counterparty basis) as defined by the Bank for International Settlements (BIS). Data on a preliminary basis.

Chart 14

### Austrian banks' consolidated foreign claims (immediate borrower basis)<sup>1</sup>

EUR billion

- 1 CZ 69.9
- 2 DE 35.6
- 3 SK 31.1
- 4 RO 24.6
- 5 HR 16.4
- 6 PL 16.3
- 7 HU 15.9
- 8 RU 11.3
- 9 UK 8.8
- 10 US 8.3



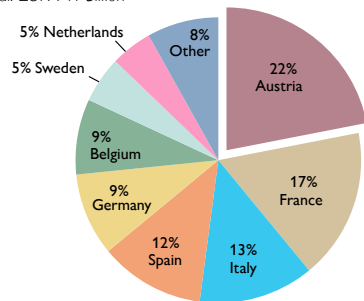
Source: OeNB, Q4 2017 (preliminary data).

<sup>1</sup> In majority domestic ownership.

Chart 15

### EU-15 banks' shares in total exposure to CESEE (Q3 2017)

Total: EUR 941 billion



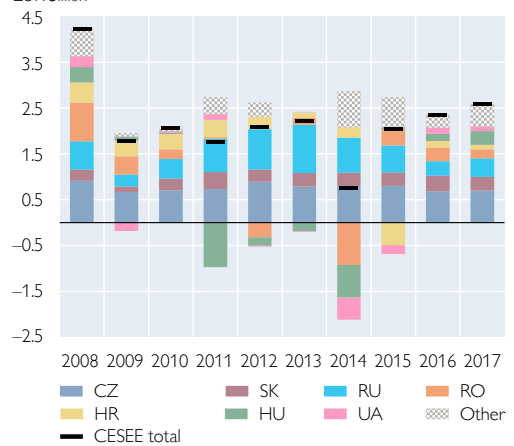
Source: BIS.

Note: Data include banks in majority domestic ownership.

Chart 16

### Net results of Austrian banks' subsidiaries in CESEE

EUR billion



Source: OeNB.

Note: From 2016 onward figures do not include subsidiaries of UniCredit Bank Austria.

Box 2

### Business model adjustments led to visible results, but further efforts required

In an environment characterized by relatively low growth, complex and expensive structures, low interest rates, low interest margins and the challenges of digitalization, Austrian banks have come under increasing pressure to adjust their business models. Restructurings, for instance at UniCredit Bank Austria AG, Raiffeisen Zentralbank Österreich AG/Raiffeisen Bank International and Volksbank, have changed the size, strategic focus and risk profile of the Austrian banking sector, with positive implications for financial stability.

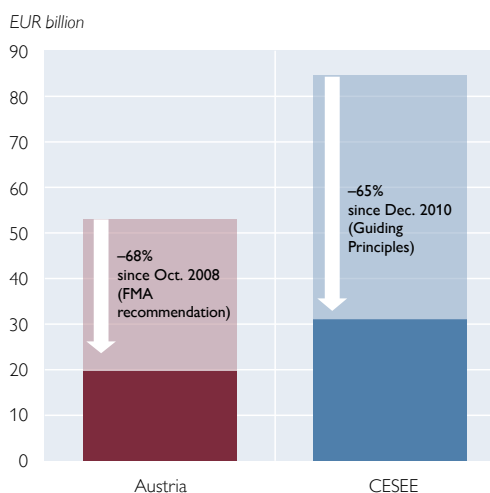
The sector's total assets contracted by 16% between mid-2010 (when a peak was recorded) and 2017, and its foreign exposure by 26% (from Q3 2008). Moreover, between 2007 and 2017, the number of banks dropped by more than one-fourth to 628, and the number of branch offices by 14% to 3,768. The decrease in the number of branch offices also resulted in a 20% reduction in branch density; while in 2007, there had still been one bank branch per 1,933 inhabitants, ten years later, one bank branch served 2,328 on average. Furthermore, the number of banking sector employees fell by almost 6% over the past ten years. However, Austrian banks still lag behind their European competitors in this respect. At the same time, banks increased their capitalization and hence also their resilience. Throughout this adjustment process, banks maintained a stable supply of credit to the economy. As Austrian banks carried out restructurings, the geographical distribution of their CESEE exposure also changed: while activities in countries like the Czech Republic and Slovakia gained in importance, economically more volatile countries like Russia and Ukraine played a lesser role.

currency loans and loans with repayment vehicles, which were reviewed in early 2017. The new FMA Minimum Standards, which entered into force on June 1, 2017, substantially expand banks' obligations to provide sufficient information to borrowers; they also include new requirements aimed at improving market transparency and a new chapter on risk provisions to be made by banks.<sup>4</sup>

In October 2008, the FMA published a recommendation to Austrian banks to stop issuing foreign currency loans to households that do not have any income in the loan currency. Since then, the amount of outstanding foreign currency loans has decreased by 68% (exchange rate adjusted), coming to EUR 19.8 billion in January 2018. Nevertheless, the risks to households holding foreign currency loans and repayment vehicle loans remain high. Around three-quarters of foreign currency loans to households are bullet

Chart 17

### Foreign currency loans granted by Austrian banks in Austria and CESEE<sup>1</sup>



Source: OeNB.

<sup>1</sup> Loans to households and nonfinancial corporations.

Note: Percentage values are FX-adjusted changes since the launch of macroprudential measures in Austria from October 2008 (FMA recommendation) to January 2018, in CESEE from December 2010 (Guiding Principles) to December 2017.

<sup>4</sup> The first version of the FMA Minimum Standards was published in October 2003. The standards were expanded and amended in 2010 and 2013. The FMA Minimum Standards in force since June 1, 2017, are accessible at: <https://www.fma.gv.at/download.php?d=2885>.

loans linked to repayment vehicles. A survey on foreign currency loans and loans with repayment vehicles that the OeNB conducted in spring 2017 in cooperation with the FMA showed that at end-2016 the shortfall<sup>5</sup> had equaled around 32% of the outstanding volume of repayment vehicle loans. This survey is scheduled to take place again in spring 2018 to ensure an ongoing monitoring of outstanding foreign currency loans, especially those linked to repayment vehicles. As foreign currency loans and repayment vehicle loans are still associated with risks, the OeNB recommends that banks advise borrowers about their risk-bearing capacity and, if necessary, take measures to reduce borrowers' exposure to these risks.

The amount of foreign currency loans issued by Austrian banks' CESEE subsidiaries also continues to decline. Between end-2010 and December 2017, the volume of outstanding foreign currency loans contracted by 65% (exchange rate adjusted) to EUR 31 billion. These figures show that the supervisory measures taken (FMA Guiding Principles of December 2010) have had a positive impact. The restructuring of UniCredit Bank Austria AG also contributed to the above contraction.

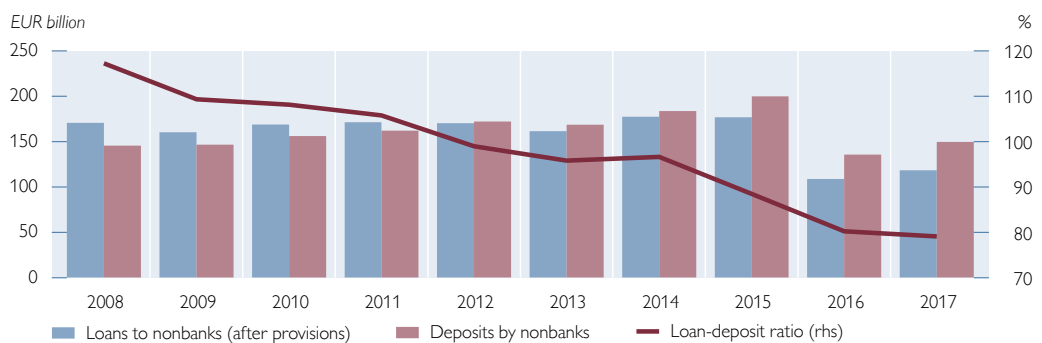
### Revised sustainability package contributes to financial stability

In 2017, the OeNB and the FMA revised their supervisory guidance published in 2012 with the aim of strengthening the sustainability of the business models of major internationally active banks. The original guidance, also referred to as "sustainability package," was designed to support a stable, local refinancing base of Austrian banks' foreign subsidiaries, strengthen parent institutions' or groups' capitalization and ensure the timely development of recovery and resolution plans.

These objectives have been accomplished. The sustainability package has successfully strengthened financial stability in Austria without weakening subsidiaries' lending activities. Due to changes in legal and institutional conditions – not least through the establishment of the banking union as well as the implementation of a resolution regime and macroprudential capital buffers – the objectives of the sustainability package in terms of capital requirements as well as recovery and resolution

Chart 18

### Local funding situation of Austrian subsidiaries in CESEE



Source: OeNB, variable bank sample (e. g. without UniCredit BA subsidiaries since 2016).

<sup>5</sup> The shortfall is the difference between the outstanding loan amount in euro and the forecast value of the repayment vehicle upon maturity.

planning have been accomplished. The monitoring of foreign subsidiaries' stable local funding will continue to play a key role in preventing excessive credit growth and maintaining financial stability. The OeNB's ongoing analysis confirms that Austrian CESEE subsidiaries currently have a balanced funding base. At end-2017, the loan-to-deposit ratio stood at 79%, compared with 106% in 2011.

### **Systemic risk buffer strengthens financial stability**

Since January 1, 2016, the systemic risk buffer<sup>6</sup> (SyRB) has applied to 11 banks at the consolidated level.<sup>7</sup> The activation of the buffer had been proposed by the OeNB and recommended by the Financial Market Stability Board (FMSB). 2017 saw the first review of the SyRB. The review showed that banks were building up capital without constraining lending in Austria and their core markets in CESEE. Improvements from a systemic risk perspective were found in terms of capitalization, sector size, foreign exposure as well as owner and group structures. At the same time, banks had not made major progress in increasing their structurally weak profitability. In sum, the fundamental assessment that led to the activation of the SyRB remains unchanged despite some improvements.

Given that systemic risks may manifest themselves both at the consolidated and the unconsolidated level and that, in particular within cross-border banking groups, capital allocation in crisis situations would not be flexible, the FMSB recommended, in September 2017, that seven institutions meet the SyRB also at the unconsolidated level.<sup>8</sup> In addition, it was recommended that the buffer be applied to an additional two institutions at the consolidated level. The overall SyRB review will be completed by the end of the first half of 2018.

Every year the OeNB evaluates the importance of individual banks for the Austrian financial system to ascertain whether their malfunctioning or failure would trigger systemic risks. On this basis, the OeNB recommended that the FMSB leave unchanged both the level of the O-SII buffer (other systemically important institutions buffer)<sup>9</sup> and the scope of banks covered by the buffer. At the moment, the O-SII buffer requirements have no impact on the identified banks' prudential requirements because banks subject to both the SyRB and the O-SII only have to apply the higher of these two buffers.

Based on regular OeNB analyses in 2017, the FMSB recommended that the FMA maintain the countercyclical capital buffer rate at 0% of risk-weighted assets as no signs of excessive credit growth had been identified. The CCB is intended to counteract risks arising from the credit cycle (especially excessive credit growth).

<sup>6</sup> *The systemic risk buffer (SyRB) has been designed to mitigate long-term noncyclical systemic risks. Its activation was recommended by the FMSB in June and September 2015. At the end of the phase-in period, i.e. from January 1, 2019, the SyRB will amount to up to 2% of risk-weighted assets.*

<sup>7</sup> <https://fmsg.at/en/publications/warnings-and-recommendations/2015/recommendation-4.html>.

<sup>8</sup> <https://fmsg.at/en/publications/warnings-and-recommendations/2017/recommendation-fmsg-4-2017.html>.

<sup>9</sup> *The O-SII buffer is prescribed for banks whose malfunctioning or failure may trigger a systemic risk which could entail serious negative consequences for the financial system and the real economy (Article 23c in conjunction with Article 2 para. 41 Austrian Banking Act).*



### **Expansion of macroprudential toolkit to cover real estate financing increases supervisors' scope for action**

On June 29, 2017, the Austrian parliament adopted a bill establishing the legal basis for using macroprudential tools for containing systemic risks in real estate financing, responding to calls for such a bill by both the OeNB and the FMSB as well as international institutions, including the IMF, the ECB and the European Systemic Risk Board (ESRB). The toolkit<sup>10</sup> enables supervisors to prescribe minimum requirements for lending standards in terms of loan-to-value ratios, debt service-to-income ratios and debt-to-income ratios or loan maturities. The FMA will be able to activate these instruments from July 1, 2018, at the earliest. They can be applied to new lending, either individually or in combination. Also, it will be possible to impose additional restrictions or apply the measures in a differentiated manner (in terms of scope, exemptions, materiality thresholds). In passing the bill, the legislator had followed the FMSB's advice to the Federal Minister of Finance issued – on the initiative of the OeNB – in June 2016. The OeNB supported the Federal Ministry of Finance in developing the specifics of the bill to contribute to its rapid adoption. The comprehensive macroprudential toolkit makes it possible to take preventive action tailored to the nature and level of systemic risk. The aim of this approach is to ensure that the quality of outstanding loans will not deteriorate in the long run through weaker lending standards.

At the moment, the OeNB does not see the need to make use of macroprudential tools to limit systemic risks in connection with residential property financing. With a view to long-term stability, however, the OeNB remains convinced that compliance with sustainable lending standards in real estate financing is necessary to prevent the build-up of systemic risks. The OeNB will continue to closely monitor the sustainability of lending standards and, if deemed necessary, recommend that the FMSB further specify its relevant communication of September 2016<sup>11</sup> and/or take necessary measures.

### **2.4 Ratings of Austrian banking sector improve**

External assessments of the Austrian banking sector have improved, reflecting banks' efforts to adapt their business models and to strengthen their risk-bearing capacity as well as the measures taken by the supervisory authorities. Moody's raised its outlook on Austria's banking system to "positive" from "stable" in August 2017, and Standard and Poor's followed suit in October 2017. Fitch confirmed its sovereign rating with a "stable outlook" in January 2018. The reasons given for the improved assessment were the reduction in the CESEE exposure, the decrease in the amount of outstanding foreign currency loans in Austria and CESEE, higher capitalization, high provisions for nonperforming loans and prudential lending standards. Furthermore, Austrian banks' exposure to higher-risk countries such as Russia and Ukraine decreased, also thanks to the transfer of UniCredit Bank Austria AG's CESEE business to its parent institution. The rating agencies also positively acknowledged the macroprudential initiatives launched in Austria

<sup>10</sup> These tools are laid down in Article 22b Austrian Banking Act.

<sup>11</sup> In September 2016, the FMSB underlined the importance of banks complying with sustainable lending standards in real estate financing; in particular, banks were called upon to apply conservative loan-to-value ratios and to ensure that debt levels are in line with borrowers' capacity to pay back their loans also under stress scenarios.

(including the activation of the systemic risk buffer, the law on a macroprudential toolkit for real estate financing, measures to support sustainable lending standards).

## 2.5 Major Austrian banks under the SSM

### Division of tasks in decentralized supervisory system has proved effective

Since November 4, 2014, the ECB – in close cooperation with the national competent authorities (i.e. the FMA and the OeNB in the case of Austria) – has been responsible for the integrated supervision of banks in the euro area under the Single Supervisory Mechanism (SSM).<sup>12</sup> The 118 banks currently classified as significant under the SSM<sup>13</sup> account for about 85% of euro area banks' total assets. At present this group includes six Austrian banks,<sup>14</sup> whose assets together amount to almost 55% of domestic banks' consolidated assets.

The OeNB actively contributes its expertise and experience to ongoing work under the SSM. In various areas, analytical methods and instruments developed by the OeNB are used (e.g. tools to evaluate recovery plans and to assess capital and liquidity adequacy, interest rate risk proxies). Furthermore, the OeNB takes part in cross-border on-site inspections of foreign banking groups.

### Improving capital levels

Austria's major banks directly supervised by the ECB significantly improved their capital levels over the past few years. Between 2014 and September 2017, the common equity tier 1 (CET1) ratio (fully loaded) increased from 10% to 13%, taking into account all transitional arrangements. In the same period, the SSM average increased from 11% to 13.9%. At 6.5%, Austrian banks' leverage ratio (non-risk-weighted capital ratio) is considerably higher than the SSM average (5.2%), however.<sup>15</sup>

### Reduction of nonperforming loans<sup>16</sup> in the European banking system

High stocks of nonperforming loans (NPLs) remain one of the key challenges of banking supervision in Europe. In the EU-28, loans totaling EUR 910 billion are currently considered to be nonperforming (which equals an NPL ratio of 4.4%), with NPL ratios varying widely across countries (see chart 19). The NPL ratio is particularly high in Greece (46.7%), Cyprus (32.1%), Portugal (14.6%), Italy (12.1%) and Ireland (11.2%). In Austria, the NPL ratio currently stands at 3.8%.

A number of initiatives on how to deal with NPLs have been launched at the European level over the past few months. In its capacity as the competent supervisory

<sup>12</sup> SSM Supervisory Manual, March 2018. Guide to banking supervision, November 2014.

<sup>13</sup> See the ECB's website for an up-to-date list of supervised entities.

<sup>14</sup> Erste Group Bank AG, Raiffeisen Bank International AG, BAWAG Group AG, Raiffeisenbankengruppe OÖ Verbund eGen, Volksbank Wien AG and Sberbank Europe AG. Raiffeisen-Holding NÖ-Wien and VTB Bank (Austria) AG are no longer classified as significant institutions as of the beginning of 2018. Raiffeisen-Holding NÖ-Wien had remained below the criterion relating to size – total assets of at least EUR 30 billion – for three consecutive years. And Russian-owned VTB consolidated its European business, relocating its headquarters to Frankfurt, Germany; its former Austrian subsidiary was turned into a branch office.

<sup>15</sup> ECB – Supervisory Banking Statistics, third quarter 2017.

<sup>16</sup> Bank loans are considered nonperforming when at least 90 days have passed without the borrower paying the agreed installments or the borrower is assessed as unlikely to pay their credit obligations. Such loans therefore require loan loss provisions.

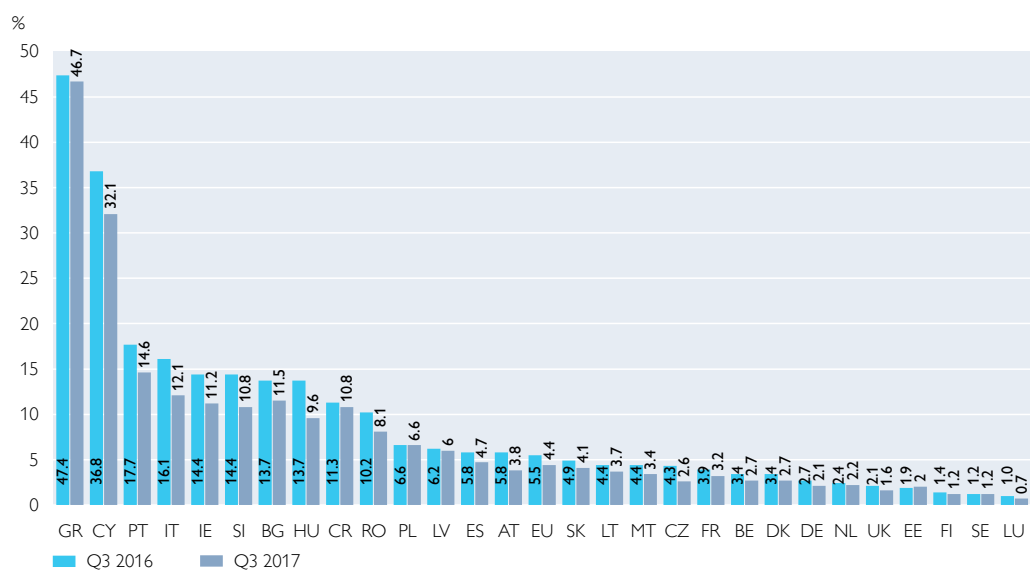
authority, the ECB, together with the European Commission,<sup>17</sup> published a number of proposals on taking preventive action against a renewed increase in NPLs in Europe. The initiatives aim at tackling NPLs in a more timely and decisive way, given that NPLs necessitate higher risk provisions and, as a result, limit banks' lending capacity and also have an effect on banks' regulatory capital requirements.

In March 2018, the ECB published an addendum to its 2017 guidance to banks on nonperforming loans. The addendum describes supervisory expectations regarding the timely provisioning for loans that are classified as nonperforming starting from April 1, 2018. Significant banks in the euro area are advised to generally ensure full prudential provisioning after two years (for unsecured loans) or seven years (secured loans). The addendum is not legally binding but serves as a basis for the supervisory dialogue between the significant institutions and the ECB in its capacity as the competent supervisory authority. Also, the addendum is meant to complement future EU legislation.

In mid-March 2018, the European Commission presented a comprehensive package of measures to reduce NPLs.<sup>18</sup> The Commission's proposals must now go through the European legislative process before becoming binding for banks.

Chart 19

### Reduction of nonperforming loans as a percentage of total loans



Source: Communication of the European Commission: Second Progress Report on the Reduction of Non-Performing Loans in Europe – March 2018.  
Note: Ratio includes total loans and advances.

<sup>17</sup> Communication from the European Commission: Second Progress Report on the Reduction of Non-Performing Loans in Europe.

<sup>18</sup> See [http://europa.eu/rapid/press-release\\_IP-18-1802\\_en.htm](http://europa.eu/rapid/press-release_IP-18-1802_en.htm).

### **Austria: decrease in and adequate provisioning for NPLs thanks to stringent supervision**

Austrian banks have successfully improved their credit quality over the past few years. The share of NPLs in the sector's consolidated loans (excluding interbank loans) shrank from 8.7% at end-2012 to 3.8% at end-2017. This reduction was achieved by writing off or realizing NPLs and also by selling off NPL portfolios. The share of nonperforming household and corporate loans dropped particularly strongly at Austrian banks' subsidiaries in CESEE (from 13.9% at end-2012 to 4.8% at end-2017); in Austria, the ratio fell slightly from an already low level (from 4.7% to 2.8% over the same period). In addition, Austrian banks have a high consolidated coverage ratio (loan loss provisions to NPLs) – 63.8% – compared with their European peers (50.7%).<sup>19</sup> As a consequence, Austrian banks are unlikely to face an additional burden resulting from new requirements relating to NPL provisioning.

## **2.6 Crisis management**

Bank resolution in Austria is based on the Bank Recovery and Resolution Directive (BRRD) and the Bank Recovery and Resolution Act (BaSAG), by which the BRRD is enacted in national law. According to the BaSAG, the FMA is the competent resolution authority, with the OeNB – like under the dual supervisory regime – providing essential support. The main tasks of the OeNB include preparing information and providing the basis for decisions in connection with work on resolution plans and economic analyses in relation to the resolution of credit institutions. Furthermore, the OeNB regularly conducts impact analyses to ascertain the effects of decisions in resolution planning on both the credit institution in question and financial stability. At the OeNB, these tasks are carried out by an independent unit in cooperation with other divisions.

## **2.7 New developments in regulation**

### **European banking sector legislation**

In November 2016, the European Commission presented a comprehensive legislative package to largely complete the regulatory agenda proposed in response to the financial crisis. This set of measures includes changes in supervision, e.g. capital requirements,<sup>20</sup> and revisions of legislation for resolution. The legislative proposals were submitted to both the European Council and the European Parliament. If the political negotiations in the trilogue meetings (of the European Commission, the European Council and the European Parliament) start while Bulgaria holds the presidency of the EU Council in the first half of 2018, they may be concluded under Austrian presidency in the second half of the year. Austria attaches particular importance to the following topics: proportionality in regulation, ensuring the credibility and feasibility of the supervisory review process, cooperation between supervisory and resolution authorities (e.g. as regards the minimum requirement for own funds and eligible liabilities – MREL) and workable legal provisions for

<sup>19</sup> Coverage ratios: *Communication of the European Commission: Second Progress Report on the Reduction of Non-Performing Loans in Europe – March 2018.*

<sup>20</sup> *Capital Requirements Directive (CRD), Capital Requirements Regulation (CRR).*

the supervision of financial holding companies. The current state of negotiations reflects Austria's priorities to a satisfactory degree.

### **Increasing complexity of banking regulation calls for more proportionality**

If applied correctly, the principle of proportionality allows supervisors to adjust the degree of regulation of a bank to its business model's riskiness. Austria's banking sector is very diverse, comprising both a number of large institutions (with a low degree of concentration by international standards) and many small institutions. The majority of small banks (437 institutions<sup>21</sup>) have total assets of less than EUR 500 million. Against this background, the OeNB has looked into the question of how the principle of proportionality could be applied more broadly to the regulation of very small banks with simple, low-risk business models. The conditions under which the regulatory burden could be reduced in line with the principle of proportionality should be laid down in an EU regulation or directive, thereby becoming legally binding. For instance, small and less complex institutions should see an easing of requirements under pillar 2 (supervisory review process) and pillar 3 (market discipline/disclosure requirements). There are also proposals to simplify reporting and monitoring requirements, which include, for instance, the reduction of the scope and level of detail of recovery and resolution plans and remuneration rules). Eventually, the banks concerned should be relieved of some of their regulatory burden.

### **Concluding the reforms of Basel III**

The 2010 capital framework developed by the Basel Committee on Banking Supervision (BCBS) has been subject to a comprehensive revision over the past few years. The aim was to make the framework (Basel III) simpler but also more responsive to risk and to increase the comparability of capital measures.<sup>22</sup> Above all protracted discussions about the redesign of the capital floor framework (output floor) for banks that use internal models delayed the conclusion of these reforms originally planned for end-2016.<sup>23</sup> Based on the agreement achieved in December 2017 banks using internal models will be subject to an output floor of 72.5% of the capital requirement calculated on the basis of the standard model. This implies that the advantages of internal model-based approaches remain limited. According to an initial assessment,<sup>24</sup> Austrian banks are expected to be affected by this rule only to a moderate extent because the majority of banks uses the standardized credit risk approach to calculate adequate capital charges for credit risk and larger banks that use the internal ratings-based approach<sup>25</sup> have a comparatively high

<sup>21</sup> As of March 26, 2018 (Q3 2017).

<sup>22</sup> The Basel capital and liquidity standards have been implemented in EU law through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD). Both the CRR and the CRD have been applicable since January 1, 2014.

<sup>23</sup> Already in 2016, the BCBS reached agreement on the revision of the standardized approach for credit risk, the internal ratings-based approach and the new standardized approach for operational risk.

<sup>24</sup> A reliable assessment of the implications of the Basel III reforms for Austrian banks can be made only after the EBA has completed a quantitative impact study (QIS). The QIS was launched in the first quarter of 2018.

<sup>25</sup> In principle, there are two ways for banks to calculate their capital charges: the standardized approach or the internal ratings-based (IRB) approach.

RWA density<sup>26</sup>. The revised standards will be applicable only from 2022 on, with transitional arrangements for some rules. The recommendations of the BCBS are yet to be implemented in European law.

### **Establishment of a common European deposit insurance scheme**

The European Commission proposed to set up a common European deposit insurance scheme (EDIS), which will represent the third pillar of the banking union, already in 2015. In October 2017, it provided fresh impetus to the initiative by publishing a communication which included some changes to the original proposal. Instead of implementing EDIS in three stages, as originally envisaged, the phase-in should take place in two stages (reinsurance and coinsurance), the European Commission suggested. At the final stage, the protection of bank deposits will be fully financed by EDIS through banks' contributions to a common deposit insurance fund, which is to be administered by the Single Resolution Board. The amount to be built up gradually until 2024 is EUR 43 billion. The level of protection for individual depositors will remain the same as now: EUR 100,000 per depositor per bank.

Until the completion of EDIS, national deposit insurance systems will continue to play a central role. In 2014, a harmonized European framework<sup>27</sup> was created for this period, which was written into Austrian law with the Act on Deposit Guarantee Schemes and Investor Compensation (ESAEG). The ESAEG lays down that a common Austrian deposit insurance system must be created by January 1, 2019, which all banks will be required to join. This means that the five different deposit insurance systems currently in force in Austria will continue to be operated by the five responsible trade associations at the Austrian Economic Chamber until December 31, 2018. However, by way of exception, individual banks may also set up an institutional protection scheme subject to approval by the Financial Market Authority, provided they meet certain preconditions, such as a minimum level of deposits. In other words, several deposit insurance schemes may continue to coexist in Austria even beyond December 31, 2018.

<sup>26</sup> The RWA density is the ratio of risk-weighted assets (RWA) to total assets.

<sup>27</sup> Directive 2014/49/EU on deposit guarantee schemes.

### 3 Annex of tables

Table A1

#### Real GDP<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Annual change in %										
Austria	-3.8	1.8	2.9	0.7	0.0	0.8	1.1	1.5	2.9	2.6	1.9
Euro area	-4.5	2.1	1.6	-0.9	-0.2	1.3	2.1	1.8	2.3	2.4	2.0
EU	-4.3	2.1	1.7	-0.4	0.3	1.8	2.3	2.0	2.4	2.5	2.1

#### Consumer price indices<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Annual change in %										
Austria	0.4	1.7	3.6	2.6	2.1	1.5	0.8	1.0	2.2	2.2	2.2
Euro area	0.3	1.6	2.7	2.5	1.4	0.4	0.0	0.2	1.5	1.3	1.6
EU	1.0	2.1	3.1	2.6	1.5	0.5	0.0	0.3	1.7	1.8	1.8

#### Unemployment rates<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	% of labor force										
Austria	5.3	4.8	4.6	4.9	5.4	5.6	5.7	6.0	5.5	5.2	5.1
Euro area	9.6	10.2	10.2	11.4	12.0	11.6	10.9	10.0	9.1	8.4	8.1
EU	9.0	9.6	9.7	10.5	10.9	10.2	9.4	8.6	7.6	x	x

#### Current account balances<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	% of GDP										
Austria	2.6	2.9	1.6	1.5	1.9	2.5	1.9	2.1	1.9	2.5	2.0
Euro area	0.4	0.4	0.8	2.2	2.8	3.0	3.7	3.6	3.0	3.2	3.1
EU	-0.1	-0.0	0.4	1.2	1.7	1.7	2.2	2.2	2.3	2.4	2.4

#### Budget balances<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	% of GDP										
Austria	-5.3	-4.4	-2.6	-2.2	-2.0	-2.7	-1.0	-1.6	-0.7	-0.3	-0.2
Euro area	-6.3	-6.2	-4.2	-3.6	-3.0	-2.6	-2.1	-1.5	-1.0	-0.7	-0.6
EU	-6.6	-6.4	-4.6	-4.2	-3.3	-3.0	-2.4	-1.7	x	x	x

#### Government debt ratios<sup>1</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	% of GDP										
Austria	79.6	82.4	82.2	81.7	81.0	83.8	84.3	83.6	78.6	x	x
Euro area	78.5	84.0	86.2	89.6	91.5	92.0	90.1	89.1	86.6	84.4	81.9
EU	72.7	78.3	81.0	83.7	85.6	86.5	84.5	83.2	x	x	x

Source: Eurostat, OeNB, ECB.

<sup>1</sup> The data for 2018 to 2019 are based on the IMF World Economic Outlook forecast (April 2018).

Note: x = data not available.

Table A2

**General government interest payments**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	% of GDP									
Austria	3.1	2.9	2.8	2.7	2.6	2.4	2.3	2.1	1.8	1.6

**Household debt**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	% of disposable net income									
Austria	90.1	93.7	93.3	91.1	90.8	91.0	92.3	91.6	x	x
Euro area	116.2	118.1	117.6	116.6	115.1	114.4	114.2	113.9	x	x
	% of GDP									
Austria	53.9	55.0	53.6	53.0	52.0	51.8	51.8	52.1	x	x
Euro area	70.8	70.6	69.8	68.9	67.8	66.8	65.6	65.2	x	x

**Corporate debt<sup>1</sup>**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	% of gross operating surplus <sup>2</sup>									
Austria	387.9	390.3	382.2	389.2	418.5	399.0	394.0	402.3	x	x
Euro area	493.1	479.2	487.4	505.3	491.3	494.5	484.9	480.3	x	x
	% of GDP									
Austria	91.8	93.1	92.2	91.7	95.5	91.7	91.3	90.8	x	x
Euro area	100.6	100.0	102.3	103.3	101.3	103.0	104.9	104.3	x	x

**Residential property price index**

	2013	2014	2015	2016	2017	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17
	Index 2000=100									
Austria excluding vienna	141.1	145.4	152.9	166.7	174.9	166.5	169.3	176.5	175.0	178.8
Vienna	196.3	204.6	209.2	217.2	220.4	219.4	220.0	220.1	221.6	220.1
	Annual change in %									
Austria excluding Vienna	2.7	3.1	5.1	9.1	4.9	5.2	3.5	4.2	4.5	7.3
Vienna	8.7	4.2	2.2	3.8	1.5	3.4	-0.1	2.4	3.4	0.3

Source: OeNB, Austria Immobilienbörse, Prof. Wolfgang Feilmayr, Department of Spatial Planning, Vienna University of Technology, Statistics Austria, ECB.

<sup>1</sup> The data for 2017 to 2018 are based on the IMF World Economic Outlook forecast (October 2017).

Note: x = data not available.



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