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IMF Executive Board Concludes Article IV Consultation with Austria

On September 9, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

After a string of strong years, Austria's open economy started to slow down in 2008. As a result of the downturn and a generous stimulus package, consisting mostly of lasting tax cuts, deficits and debt are expected to rise and remain high in the medium term. The Austrian banking system is strongly exposed to Central, Eastern, and Southeastern Europe (CESE). The authorities have been implementing a large banking stabilization package, including public capital injections and guarantees.

The economy is projected to shrink considerably in 2009, with a recovery expected to start in 2010. Exports and investment declined strongly already, and more recently consumption has been affected as well. Inflation is expected to remain low this year, with a slight increase in 2010. The uncertainties surrounding the outlook are considerable.

The underlying fiscal position has deteriorated significantly as a result of policy measures. The 2009/10 budget includes a stimulus package of 1.5 percent of GDP in 2009 and an additional 0.4 percent of GDP in 2010. The stimulus and automatic stabilizers will widen the deficit to 4.2 percent of GDP in 2009 and 5.6 percent of GDP by 2010. Absent consolidation measures,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

deficits are projected to remain above 3 percent of GDP throughout the forecast horizon. Debt is projected to rise above 80 percent of GDP by 2012.

Risks in the financial sector arise from the economic downturn—both in Austria and CESE—and the financial crisis. While Austrian banks have access to a solid base of domestic deposits and have had relatively little exposure to U.S.-based structured securities, vulnerabilities arise from their significant involvement in CESE. A particular risk stems from the extent of foreign currency loans made by their subsidiaries in the region. This exposes them to indirect credit risk through the foreign exchange exposure taken on by unhedged borrowers. Vulnerabilities also arise from credit risk on loan portfolios in Austria at a time of economic downturn, including rising unemployment.

Executive Board Assessment

Executive Directors noted that, following several years of strong growth performance, Austria's economy is now experiencing the full impact of the global financial crisis and the decline in world trade. The economy is expected to shrink substantially in 2009, and, while a recovery is expected to start in 2010, the outlook is uncertain.

Directors welcomed the sizeable and timely fiscal stimulus measures, although it was generally felt that they could have been better targeted. Directors also observed that the measures included in the package are largely permanent. The stimulus, in combination with large automatic stabilizers and financial sector support, will therefore result in a sharp rise in public debt.

Against this backdrop, Directors encouraged the authorities to prepare a credible fiscal consolidation plan which would strengthen the market's confidence in fiscal sustainability, and contribute to a lowering of borrowing costs. They recommended that debt be brought back on a downward path to accommodate the costs of population aging and avoid crowding out the private sector. Directors encouraged the authorities to work towards an early agreement on plans for fiscal consolidation, so that implementation can start when the economy recovers.

Directors noted that since taxation levels in Austria remain relatively high, expenditure measures should have priority, with a focus on administration at lower levels of government, continued pension reform, and efficiency gains in education and health. They welcomed the establishment of a Working Group on Fiscal Consolidation and looked forward to the early development of specific recommendations. Directors also welcomed this year's introduction of a medium-term budget, and encouraged the authorities to adopt more ambitious ceilings consistent with long-term sustainability. They called for further structural reform over the medium term to boost potential growth and labor market participation.

Directors commended the authorities for their timely and effective response to the financial crisis. They welcomed the ample provision of liquidity to the financial system, the sizeable banking support package, and the strengthened financial sector supervision, including cooperation with foreign supervisors. While these measures, along with the solid deposit base of Austrian banks, have helped to support financial stability, continued contingency planning and close monitoring of exposures to Central, Eastern, and Southeastern Europe (CESE), including the risks posed by foreign currency lending, are needed.

In light of this, Directors welcomed the use of stress tests to identify banks' vulnerabilities. They noted that the recent tests indicate that the capital ratios of all systemic banks would remain above minimum regulatory requirements under a range of shocks. Directors advised the authorities to repeat these tests at regular intervals and use them as input for discussions with the banks about the need for possible stronger capital buffers.

Directors noted that the major banks have stated the intention to support their subsidiaries in Eastern Europe. They welcomed the active role of the Austrian banks and authorities in the European Bank Coordination Initiative (the "Vienna Initiative").

Directors advised the authorities to continue monitoring the insurers' and pension funds' vulnerability to falling asset markets. Government initiatives to consider reforms to the private pension system are welcome. Directors also supported continued efforts to strengthen the regulatory framework in response to crisis lessons, and in line with EU and wider international initiatives. Gaps in the Financial Market Authority's powers, for example its ability to levy significant fines, should be filled.

Austria: Selected Economic Indicators, 2005–10

	2005	2006	2007	2008	2009	2010
					Projections	
Real economy						
Real GDP (change in percent)	2.5	3.5	3.5	2.0	-4.0	-0.3
Domestic demand (change in percent)	1.9	2.3	1.7	1.1	-2.6	-0.1
CPI (period average, percent change)	2.1	1.7	2.2	3.2	0.5	1.0
Unemployment rate (in percent)	5.2	4.8	4.4	3.9	5.3	6.4
Gross national saving (percent of GDP)	24.6	25.4	26.0	26.2	23.2	22.4
Gross domestic investment (percent of GDP)	22.5	22.6	22.9	22.7	21.1	20.9
Public finance (in percent of GDP)						
General government balance (ESA 95 basis)	-1.7	-1.7	-0.7	-0.5	-4.2	-5.6
General government balance (EDP basis) 1/	-1.6	-1.6	-0.5	-0.4	-4.2	-5.5
General government debt	63.9	62.3	59.5	62.6	70.2	75.5
Interest rates (in percent)						
Three-month interbank rate	2.2	3.1	4.3	4.6	…	…
10-year government bond	3.4	3.8	4.3	4.3	…	…
Balance of payments (percent of GDP)						
Trade balance (goods)	-0.6	0.1	0.5	-0.1	-1.1	-1.5
Current account balance	2.0	2.8	3.1	3.5	2.1	1.5
Fund position (as of June 30, 2009)						
Holdings of currency (percent of quota)					81.5	
Holdings of SDRs (percent of allocation)					111.1	
Quota (millions of SDRs)					1,872	
Exchange rates						
Exchange rate regime			Member of euro area			
Euro per U.S. dollar	0.80	0.80	0.73	0.68	…	…
Nominal effective rate (2000=100)	105.3	105.5	107.0	107.9	…	…
Real effective rate (1990=100) 2/	106.9	103.8	105.4	106.6	…	…

Sources: Austrian authorities; Haver; and IMF staff projections and calculations.

1/ Maastricht Excessive Deficit Procedure (EDP) include revenues from swaps.
2/ Based on relative normalized unit labor cost in manufacturing.