INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/50

AUSTRIA

February 2016

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR AUSTRIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Austria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 10, 2016 consideration of the staff report that concluded the Article IV consultation with Austria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 10, 2016, following discussions that ended on December 14, 2015 with the officials of Austria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 19, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Austria.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/58
FOR IMMEDIATE RELEASE
February 12, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Austria

On February 10, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV consultation[1] with Austria.

Austria is stable and affluent. It has weathered the global financial crisis well, and output and employment have recovered to pre-crisis levels. The budget deficit has been well contained in recent years. Nevertheless, as in other countries, budget support for bank restructuring and resolution has ratcheted up public debt, which stands now at about 86 percent of GDP. Crisis legacies also still weigh on the balance sheets of large Austrian banks, which must raise profitability and further improve capital cushions.

Following the lackluster growth in recent years, Austria’s economy is projected to expand by 1.4 percent in 2016, driven by a large personal income tax cut, recovering investment, and accelerating exports. Unemployment, although rising, is expected to remain moderate, while headline inflation will gradually reach 2 percent in the medium term. The main risks to the outlook stem from lower-than-expected growth in important trading and financial partners in the euro area and emerging markets.

The elevated public debt level leaves little fiscal room for absorbing increasing aging cost or further reducing high labor taxes. Broad reform-based expenditure cuts in areas with obvious inefficiencies, such as health care, education, and subsidies, as well as further pension reforms, would allow rapid debt reduction and additional cuts in labor taxation.

The surge in refugee inflows offers both risks and opportunities. Historically, Austria has always received a sizeable number of immigrants. The unrest in the Middle East, however, has propelled the estimated number of asylum seekers in 2015 to an exceptional 90,000, or about 1 percent of

[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.

Austria's population. While the influx of refugees is posing numerous challenges, their successful integration can help reignite potential growth and eventually reduce fiscal imbalances.

In the financial sector, large Austrian banks are changing their business models by focusing more on core markets and improving efficiency to raise profitability and capital ratios. This is necessary and timely as capital cushions, while improving, appear thin in comparison with peers. The authorities have been revamping the regulatory and supervisory framework in line with the implementation of the EU Banking Union. Considerable progress has also been made in the resolution of nationalized banks.

Executive Board Assessment[2]

Executive Directors commended Austria for preserving macroeconomic and financial stability after the global financial crisis. While the outlook is positive, resolving post-crisis legacies and ensuring the successful integration of refugees requires further reforms. Directors encouraged the authorities to address these challenges over the medium term through fiscal consolidation, structural reforms to increase productivity growth and labor force participation, and measures to further strengthen the financial sector.

Directors noted that the high public debt to GDP ratio constrains the room for fiscal maneuver, especially in the context of the projected increase in age-related spending. While a neutral fiscal stance in the near term would support economic activity and facilitate the integration of refugees, over the medium term fiscal policy should target a structural surplus until public debt falls below 60 percent of GDP. Directors suggested that this fiscal consolidation be delivered through efficiency-boosting reforms in health care, education, and subsidies as well as further pension reforms. They recommended combining these reforms with tighter links between revenue and expenditure at the subnational level. Sufficient expenditure rationalization would also create room for further reducing the tax burden on labor.

Directors commended Austria's efforts to absorb and integrate accepted asylum seekers. They noted that these flows create challenges but also provide opportunities to improve the fiscal position and raise growth over the medium term. Directors encouraged the authorities to sustain and strengthen their efforts to swiftly and effectively integrate immigrants into the labor force. More broadly, they recommended product and service market reforms to boost potential growth by raising total factor productivity and labor force participation.

Directors commended the significant progress made in revamping the regulatory and supervisory framework and in bank resolution. Nevertheless, banking sector resilience can be strengthened

[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

further, and Directors underlined the need to continue to monitor and reassess large banks' capital cushions, which remain low relative to peers. In this context, they welcomed plans to phase in a systemic capital surcharge and recommended that the authorities implement additional measures, if needed, to ensure adequate capital buffers in the banks. Directors also underscored the need for banks to proactively mitigate risks from their cross-border exposures and domestic mortgage loans in foreign currency. They supported an expansion of the macroprudential toolkit with respect to real estate-specific instruments. Regarding the ongoing wind-down of a restructured bank, Directors stressed the importance of balancing the benefits of a quick resolution with risks associated with a retroactive change of contracts.

Austria: Selected Economic Indicators, 2010–15

	2011	2012	2013	2014	2015	2016
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	2.8	0.8	0.3	0.4	0.7	1.4
Total domestic demand	2.9	0.3	-0.4	-0.2	0.5	1.1
Consumption	0.9	0.5	0.2	0.3	0.5	1.1
Gross fixed capital formation	6.7	1.3	-0.3	-0.2	-0.5	1.4
Net exports (growth contribution in pp)	0.1	0.3	0.4	0.5	0.3	0.3
Exports of goods and nonfactor services	6.0	1.7	0.8	2.1	1.1	3.2
Imports of goods and nonfactor services	6.2	1.1	0.0	1.3	0.6	3.0
Output gap (percent of potential GDP)	0.2	-0.1	-0.8	-1.6	-1.4	-0.9
Unemployment (in percent; Eurostat definition)	4.6	4.9	5.3	5.6	5.8	6.2
Prices						
Consumer price index (period average)	3.6	2.6	2.1	1.5	0.8	1.4
General government finances (percent of GDP)						
Revenue	48.3	48.9	49.7	50.0	50.3	49.4
Expenditure	50.8	51.1	50.9	52.7	51.9	51.2
Balance (EDP-definition)	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8
Structural Balance 1/	-2.5	-1.7	-1.0	-0.3	-0.2	-1.0
Gross debt (end of period)	82.1	81.6	80.8	84.2	86.2	85.4
Balance of payments						
Current account (percent of GDP)	1.6	1.5	2.0	1.9	2.6	2.6

Sources: Austrian authorities; and IMF staff estimates and projections.
1/ The structural balance excludes the following one-offs (as percent of GDP): (a) capital transfers to banks: 0.2 in 2011; 0.5 in 2012; 0.5 in 2013; 1.6 in 2014; 0.6 in 2015; 0.2 in 2016; (b) flood related expenditure: 0.1 in 2013; (c) revenues from the sale of mobile telecommunication licenses: 0.6 in 2013; (d) tax revenues from treaties with Switzerland and Luxembourg: 0.1 in 2012; 0.2 in 2013; 0.1 in 2014; (e) revenue from the adjustment in EU contributions: 0.1 in 2014.

INTERNATIONAL MONETARY FUND

AUSTRIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

February 10, 2016

KEY ISSUES

Context: Austria weathered the global financial crisis well, with a short-lived recession and quickly recovering output and employment. It remains stable and affluent. However, the high public debt and the low potential growth need to be addressed through a decisive push for reforms.

Outlook and risks: Growth is expected to pick up, helped by the 2016 tax reform, strengthening sentiment, and buoyant exports. Inflation and unemployment, although rising, are set to stay low. Potential growth slowdown in trading partners in the euro area and emerging markets poses the main downward risks.

Fiscal policies: The general government deficit has been well contained in recent years. However, budget support for bank restructuring and resolution has pushed public debt above 86 percent of GDP. Moreover, the labor tax wedge remains high even after the personal income tax cut in 2016. Broad reform-based expenditure cuts in areas with obvious inefficiencies, such as health care, education, and subsidies, as well as further pension reforms, would allow rapid debt reduction and additional cuts in labor taxation.

Migration: Compared with other EU countries, Austria is receiving a large number of asylum seekers relative to its population, which is generating growing but manageable fiscal pressures. After a good start, sustained efforts to integrate immigrants quickly must continue to realize the potential benefits of immigration for growth and public finances. These efforts should be coupled with further structural reforms to raise productivity growth and labor force participation.

Financial sector: Financial repair has advanced considerably, but needs to be completed. The focus should be on raising bank capital and addressing remaining risks stemming from exposure to some difficult CESEE markets and domestic Swiss franc loans. Expanding the macroprudential toolkit with real estate-specific instruments would limit risks to banks' asset portfolios if real estate price bubbles emerge. Wind-down units of resolved banks need to complete the asset disposal process efficiently.

Approved By
Mahmood Pradhan (EUR) and Catherine Pattillo (SPR)

Discussions took place in Vienna from December 3–14, 2015. The staff team comprised Mr. Nikolay Gueorguiev (head), Ms. Nicoletta Batini and Messrs. Siegfried Steinlein and Ara Stepanyan (all EUR). Ms. Terri Chen provided research and Ms. Luisa Calixto administrative support from headquarters. Mr. Just (OED) participated in the discussions. The mission met with Minister of Finance Schelling, OeNB Governor Nowotny, Labor and Social Affairs Minister Hundstorfer, Minister of Arts, Culture, Constitution and Media Ostermayer, other senior officials, parliamentarians, and representatives of the social partners, the banking sector and think tanks.

CONTENTS

ANNEXES

CONTEXT

1. **Austria has recovered from the global financial crisis, but the crisis' legacy still weighs on bank and public sector balance sheets.** Both output and employment exceed pre-crisis levels. However, most CESEE–active Austria-based banks needed government support, and three mid-sized banks had to be fully or partly nationalized and subsequently resolved. Budget support for bank restructuring and resolution has been the main driver in pushing up general government debt relative to GDP by almost one third to 86 percent between 2007 and 2015.

2. **Major banks have been striving to strengthen their capital and profitability positions amid regulatory and supervisory reforms.** Capital cushions of major banks, while improving, remain thin in comparison with peers and profitability is recovering only slowly (Figure 4). To address these challenges, large banks are refocusing their business models on core markets and engaging in cost-cutting strategy to prop up profitability and capital. In parallel, the authorities have been revamping the regulatory and supervisory framework in line with EU Banking Union requirements. These developments do not seem to hamper credit supply, as the stable but low credit growth in the past few years has been moving in line with domestic demand (Figure 5).

3. **Despite lackluster growth, economic slack is limited as potential growth has fallen as well.** Growth stagnated below 1 percent in 2012–14 due to trade and confidence spillovers from the euro area crisis, weak recovery in CESEE, and geopolitical tensions further to the East (Figure 1). Staff estimates that potential growth has dropped below 1 percent as well, constrained by limited investment, stagnant labor input in terms of hours worked, and lack of productivity growth (Figure 9). As a result, the output gap never exceeded 1½ percent, unemployment, although rising, remained below 6 percent, and core inflation was at nearly 2 percent in December 2015 (the headline inflation was 1.1 percent owing to falling fuel prices).

4. **The surge in refugee inflows into EU countries has significantly affected Austria.** The authorities expect asylum applications to reach an exceptional 90,000 in 2015, some 1 percent of Austria's population, placing it third in the EU by the number of asylum seekers per 1000 inhabitants. While Austria has historically had a sizeable share of immigrants in the population, the immigrant inflow has strengthened since 2011 reflecting the labor market liberalization for workers from the EU's New Member States and unrest in the Middle East.

5. **The governing coalition of Social Democrats and the right-of-center People's Party holds a constructive dialogue on economic policy issues.** The coalition was re-elected in December 2013 with a small parliamentary majority and confirmed several fiscal expenditure reform steps that had been taken previously. In spite of diverging views on several policy issues, the coalition was able to agree on an income tax reform in spring 2015. Discussions on further pension reforms and the implementation of an already decided education reform are planned for early 2016.

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, SPILLOVERS, AND RISKS

6. **Growth is set to pick up.** Growth is estimated at 0.7 percent in 2015, a slight improvement over the ½ percent average in 2012–14, on the back of strengthening external and domestic demand. In 2016, staff projects further growth acceleration to 1.4 percent on the back of the large personal income tax cut, recovery in investment as business sentiment improves, and a further pick-up in exports thanks to the weaker euro. While the pick-up in growth would support continuing employment expansion, unemployment would still rise to 6½ percent by 2017, elevated by higher migration-related labor supply, and then decline to some 6¼ percent in the medium term. Potential growth should slightly exceed 1 percent by 2019–20 supported by a pick-up in investment and a boost to employment from the recent tax reform and integration of refugees in the labor market. Headline inflation is expected to gradually rise to 2 percent in the medium term.

7. **Adverse developments abroad could reduce growth and bank profits** (see Risk Assessment Matrix, p.7). Lower-than-expected growth in the euro area or emerging markets would predominantly be transmitted via the strong export and financial ties with Germany, Italy, and CESEE, adversely affecting public debt dynamics and bank profitability. Other banking sector risks include higher bank taxation in CESEE. On the upside, stronger ECB easing could support growth mainly through its effects on the euro and consumer and business confidence. Moreover, should oil prices stay low for longer than expected, disposable income and private consumption would get a boost while headline inflation may surprise on the downside.

8. **As regards outward spillovers, efforts to rebuild capital could weigh on Austrian banks' willingness to lend in CESEE.** Going forward, cost rationalization and asset-reduction efforts could constrain credit growth in some host countries if sustained over a longer period and if other banks do not pick up the slack.

9. **Austria's external position is broadly in line with fundamentals and desirable policies.** Austria's current account surplus is expected to settle around 2½ percent of GDP in 2015 and over the medium term, at the average over the past ten years (Figure 3). A broadly stable real exchange rate has contributed to Austria's satisfactory export performance. Austria's IIP is slightly positive, giving it an intermediate position among euro area countries. The IMF External Balance Assessment (EBA) finds that the current account balance in 2015 is somewhat below the norm, with the policy gap—mainly too high health expenditures as a proxy for social benefits in general—explaining about half the difference. While EBA finds the REER modestly overvalued in mid-2015 (by 9 percent), this is mainly due to an unexplained residual (6¾ percent).

10. **Staff's macroeconomic projections are consistent with those of the Ministry of Finance while the central bank (OeNB) and some research institutes are more optimistic.** The 2016 budget is based on a macroeconomic framework similar to staff's, including growth of 1.4 percent, unemployment of 6 percent, and consumer price inflation at 1.7 percent. The central

bank predicts growth of 1.9 percent in 2016, driven by a strong fiscal expansion based on an underfinanced 2016 income tax reform and higher expenses for refugees. With the same growth drivers, two research institutes (IHS and WIFO) have recently revised their growth forecast for 2016 up to 1.6–1.7 percent. Projection differences for inflation between these institutions and staff are small.

11. The authorities broadly agreed on the risks identified by staff. In particular, they pointed to external risks to growth stemming from developments in emerging markets. Some also noted the risk of financial sector bubbles and misallocation of capital as a potential unintended consequence of the low interest rate environment in the euro area and supported staff's recommendation for expanding the macroprudential toolkit from this perspective (see below).

POLICY DISCUSSIONS

12. The discussions focused on the three major areas, in which further progress could be made to enhance the economy's resilience to shocks and raise growth :

- **Restoring fiscal buffers via structural fiscal reforms.** While Austria's public debt level is not an outlier in the euro area, it is much higher than pre-crisis. The need to regain space for fiscal maneuver given also the expected rise in age-related public spending calls for further reform-based fiscal consolidation in the medium term.

- **Fostering rapid integration of immigrants and implementing additional structural reforms to boost potential growth.** A surge of asylum seekers is pressuring public spending in the short term but can help propel the economy's productive potential and improve public finances in the medium term. In addition, Austria would benefit from further structural reforms to raise productivity growth and labor force participation.

- **Further strengthening financial sector resilience and resolving remaining crisis legacy issues.** Building on progress already made, capital and profitability levels of some major banks could be strengthened further, while the well-advanced resolution of banks nationalized during the crisis needs to be completed.

Risk Assessment Matrix[1]				
Source of Risk	**Likelihood of Risk**	**Time Horizon**	**Expected Impact**	**Policy Response**
Tighter or more volatile global financial conditions, due to: • sharp asset price decline and decompression of credit spreads; • surge in US dollar	**Medium** **High**	**Short-term** **Short-term**	**Medium** More expensive bank funding and credit; safe-haven flows into sovereign bonds. **Medium** Higher exports and growth; limited balance sheet effects.	Agree with banks to increase capital buffers further to mitigate risk perceptions. Monitor balance sheet effects.
Sharper-than-expected global growth slowdown: • in China • in other large emerging/frontier markets; • structurally weak growth in key advanced and emerging economies (weak demand and low inflation in euro area and Japan; tighter financing conditions and insufficient reforms in EMs);	**Low/ Medium** **Medium** **High/ Medium**	**Short/ Medium Term** **Short Term** **Medium Term**	**Medium/High** Lower exports and growth. Lower bank profits and higher NPLs if CESEE are affected will reduce banks' ability to generate capital through retained earnings. Rising public debt relative to GDP will present a difficult dilemma – how to consolidate fiscal accounts without weakening growth further.	Structural reforms to strengthen domestic demand and potential growth, including through the rapid integration of migrants. Carefully designed fiscal consolidation emphasizing measures that exact minimal toll on output (e.g., raising property taxes and the effective retirement age). Strengthen monitoring of banks' loan quality and capital needs, including by stress tests tailored to the more adverse environment.
Dislocation in capital and labor flows, in particular heightened risk of fragmentation/security dislocation in part of the Middle East, Africa, and Europe.	**High**	**Short Term**	**Medium** More migrant flows; more oil price volatility.	Strengthen integration policies; decrease oil consumption, including by environmentally friendly taxation.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

A. Restoring Fiscal Buffers via Structural Fiscal Reforms

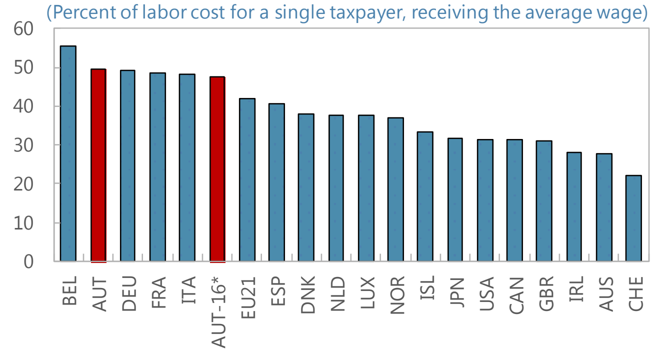
Background

13. General government debt exceeds 86 percent of GDP and is expected to decline only slowly in the next few years (Table 4 and the DSA). Gross debt has increased by almost 20 percentage points of GDP since the global financial crisis (Figure 6). Under the staff baseline, it will still be as high as 78 percent of GDP in 2020, reducing the ability of the public sector to smooth the effects of large unanticipated shocks.

14. Elevated debt levels leave Austria ill-prepared for the increase in age-related spending in the next decades. According to the European Commission's 2015 Ageing Report, ageing implies an expenditure increase of 1.6 percentage points of GDP by 2030 and over 3 percentage points by 2060—2½ percentage points in healthcare and long term care for the elderly and the chronically ill, and ½ percentage points in pensions. Staff simulations of a multi-generational model of Austria confirm these findings. In the absence of reforms, the debt-to-GDP ratio would start rising in the mid–2020s, reaching about 130 percent by 2060.

15. In addition, fiscal space is needed to reduce taxation levels further. Even after the 2016 PIT tax cut, Austria's overall and labor tax revenue remains considerably above the OECD's advanced countries average (OECD ACA) (Figure 8). Further cuts in labor taxes, especially the hefty social security contributions, would reduce the still high labor tax wedge and thus support employment and growth.

Labor Tax Wedge, 2014
(Percent of labor cost for a single taxpayer, receiving the average wage)



* AUT-16 is calculated by applying the 2016 personal income tax schedule to the wage structure of 2014.
Sources: OECD and IMF staff calculations.

16. A high expenditure-to-GDP ratio and expenditure inefficiencies suggest considerable room for savings. Austria leads OECD countries in terms of public expenditure relative to GDP (52.7 percent of GDP in 2014 compared to the OECD ACA of 45.8 percent), while the outcomes achieved with this level of spending are not better, and in some cases are worse than best results in this group. The largest share of expenditure (42 percent, 5 percentage points above the OECD ACA) comprises social protection. Moreover, education spending per student exceeds the OECD ACA by about 30 percent, while health spending per capita is about 20 percent higher than the OECD ACA after adjusting for demographic factors. Spending on general public services and economic affairs exceeds the average in terms of GDP by around one-fifth as well.

17. An ambitious tax reform in 2016 coupled with the fiscal costs related to the wave of asylum seekers may jeopardize the authorities' deficit targets. The structural balance fell below ½ percent of GDP in 2014–2015 (Table 1), and tax revenues have been buoyant in 2015, a trend that is expected to carry over to next year. However, a personal income tax reform that mainly cuts the entry tax rate from 36½ percent to 25 percent has come into effect in 2016. The tax cut amounts to over 1 percent of GDP in 2016 and 1½ percent of GDP from 2017 onwards, with about half of its financing relying on anti-fraud tax administration measures with uncertain yield. In addition, financing of the envisaged cuts in social security contributions in 2017–18 (¶21) is yet to be specified. As a result, staff projects that, absent additional measures, the authorities' headline deficit targets for 2016–20 will be exceeded by 0.4 percent of GDP a year on average (table below). Furthermore, while staff's baseline includes an estimated 0.3–0.5 percent of GDP in expenditure to cope with the ongoing refugee inflows in 2016-20, the high uncertainty around these estimates is a risk to the deficit projections.

Austria: Authorities' Medium-term Budget Targets and Staff Baseline

percent of GDP (unless otherwise indicated)

	2015	2016	2017	2018	2019	2020
Headline balance						
Authorities' targets 1/	-1.9	-1.4	-1.3	-0.9	-0.5	-0.5
Staff projections (baseline)	-1.6	-1.8	-1.4	-1.3	-1.0	-1.0
Staff recommendations 2/	...	-1.4	-1.0	-0.6	-0.1	0.2
Structural balance						
Authorities' implied targets 1/	-0.5	-0.7	-0.9	-0.8	-0.4	-0.5
Staff projections (baseline)	-0.2	-1.0	-1.0	-1.1	-1.0	-1.0
Staff recommendations	...	-0.7	-0.5	-0.2	0.2	0.5

Sources: Austrian Ministry of Finance and staff projections.

1/ From the 2015 Stability program. Structural balances are assessed using staff's output gap projections.

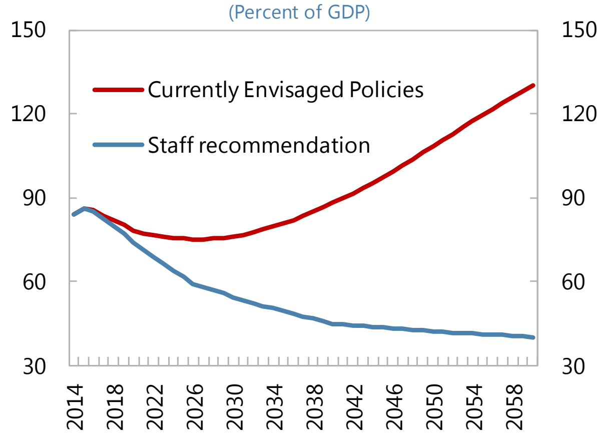
2/ This line reflects the effect of staff recommendations on the output gap.

Policy Discussions

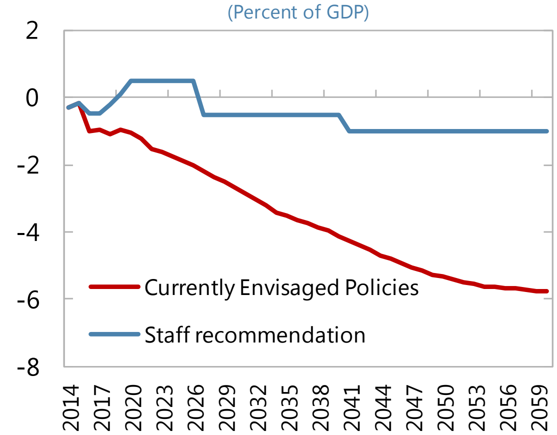
18. **Staff recommended that fiscal policy aim to strike a balance between supporting activity in the near term and rebuilding fiscal buffers in the medium term.** To this end, the authorities should start with a broadly neutral fiscal stance in 2016–17 (relative to their 2015 structural target) while the output gap is still open and large refugee-related spending needs to be accommodated (table above). The authorities should then continue with a modest structural

adjustment of ⅓ percentage points of GDP per year in 2018–20.[2] This implies a 1¼ percent of GDP higher headline fiscal balance than the baseline by 2020 (text table on p. 9) and is well within reach provided that at least part of the feasible expenditure savings of about 4 percentage points of GDP are realized (see below).[3] Once achieved, this surplus should be maintained until debt falls below 60 percent of GDP (projected for 2026). Thereafter, the authorities could revert to their MTO target (a structural deficit of ½ percent of GDP). Once debt falls well below 60 percent of GDP and ageing costs decline (projected for 2040), the MTO target can be relaxed to a deficit of 1 percent of GDP.

Austria: Debt Dynamics Under Alternative Fiscal Stance Scenarios
(Percent of GDP)



Austria: Structural Balance–Fiscal Stance Scenarios
(Percent of GDP)



Sources: Austrian authorities; EC; IMF WEO; and IMF staff calculations and projections.

1/ The trajectory "Currently Envisaged Policies" shows debt dynamics in 2014-2060 under the staff's baseline projections and currently envisaged policies after 2020. From the mid-2020s, debt rises faster than nominal GDP, driven by ageing and healthcare costs and snow-balling interest expenditure.

2/ The trajectory "Staff Recommendation" assumes that a structural surplus of ½ percent of GDP is reached by 2020 and maintained until debt falls below 60 percent of GDP in 2026. Then the structural balance reverts to a deficit of ½ percent of GDP until 2040 and 1 percent of GDP thereafter, consistent with the Fiscal Compact.

3/ The "Staff Recommendation" scenario accounts for the effect of structural adjustment on growth, using a multiplier of 0.5. See Batini, Eyraud and Weber (2012) for the method used to derive this fiscal multiplier.

19. This policy would deliver several benefits:

- It would increase the space for countercyclical fiscal response to any large growth shocks in the next ten years;

[2] Staff estimates that its recommended fiscal adjustment path would reduce the GDP level in 2020 by 0.4 percentage points in real terms relative to the baseline. As this is a demand shock that should not affect potential output (as long as public investment is unaffected by the expenditure cuts and the currently low unemployment does not succumb to hysteresis effects), this loss should be offset by higher growth in a few years after 2020.

[3] The feasible expenditure savings envelope also leaves ample room for financing additional cuts in labor taxation, as discussed in ¶21.

- It would allow absorbing potential materialization of tail risks in Austria's large banking sector while the European Resolution Fund is still being created, as well as other contingent liabilities (e.g., from the sizable export guarantees (over 12 percent of GDP));
- It would help Austria regain its AAA rating, and thus keep borrowing costs low in the long term;
- Importantly, it would also improve Austria's structural fiscal position ahead of rising ageing costs starting in the mid-2020s;
- Finally, by ensuring that fiscal sustainability is firmly entrenched for the long run, it may foster higher consumer and investor confidence and thus support growth.[4]

20. The authorities' views were mixed. The authorities agreed that in the short run a broadly neutral stance was appropriate. They acknowledged risks to the budget, but believed that state institutions and local governments would reduce spending as needed to meet their budget allocations. While some saw merit in further consolidation as recommended by staff, others noted that the Stability Program from April 2015 targeted a structural deficit just below 0.5 percent of GDP throughout the medium term. The next update of the Program will review these targets and the measures to achieve them in view of changing realities and coalition discussions.

21. Further lowering of the tax burden on labor would strengthen employment and growth. In this regard, staff welcomed the planned modest social security contributions cuts in 2017–18, while suggesting that larger cuts would better support employment and growth. The lost revenue could be offset by a combination of expenditure cuts and hikes in consumption and property taxes (e.g., by bringing the property taxes to the OECD ACA level and raising the reduced VAT rates from 10–13 percent to the main rate of 20 percent over time). A revenue-neutral tax rebalancing of this kind will be worth undertaking on its own, independent of expenditure cuts.

22. The authorities agreed that the tax burden of labor was still too high. They maintained that further cuts would depend mainly on the ability to reduce expenditure in parallel, but noted that at present there were no plans to impose new taxes or raise property or consumption taxes.

23. Staff argued that room for further consolidation and tax cuts could be gained by efficiency-boosting reforms in health care, education, pensions, and subsidies. While the authorities already started some reforms of the healthcare and pension systems in 2013, savings are

[4] In the 2014 consultation, staff—led by similar arguments—recommended a structural surplus of ½ percent of GDP to be achieved by 2018 so that debt can fall below 60 percent of GDP already by 2022. Given that growth in 2014–15 disappointed and the output gap widened relative to the 2014 projections, staff sees an argument to recommend a slower pace of adjustment now, even though debt in 2015 is now estimated to be higher than the 2014 projections on a comparable basis.

modest so far.[5] Staff analysis suggests that spending could be reduced by up to 4 percentage points of GDP in the medium term (text table) by increasing efficiency in the provision of key public services where advanced country comparators have found ways to achieve the same or better outcomes with less spending.[6] Against this background, staff recommended the following menu of specific measures:

Austria: Potential Expenditure Savings by 2020

(in percentage points of GDP)

	By 2020
Health care 1/	2.0
Education 1/ 2/	1.0
Pensions and other social protection	0.5
Subsidies	0.5
Total Savings	**4.0**

Source: Staff calculations.

1/ By moving to the efficiency frontier of OECD Advanced Countries.

2/ After setting aside funds to improve outcomes.

- Aligning spending to the OECD ACA could save about a quarter of current health expenditure. Shifting care from hospitals to outpatient services, better matching over time the number of doctors to the population's healthcare needs in line with best practices in advanced countries, and reducing the number of hospital beds (currently 60 percent above the OECD ACA per 1,000 residents) where they are underutilized can go a long way in this direction.

- In education, aligning spending per student to the OECD ACA would save up to 2 percentage points of GDP. Part of these savings should be spent to improve outcomes in certain segments of the education system (e.g., early childhood and tertiary education, where attendance and attainment are below peers' averages, respectively).

- In pensions, indexing the statutory retirement age to longevity would lower total public pension expenditures by 1 percentage point of GDP by 2060. In the shorter run, raising the effective retirement age by (i) enhancing incentives to work longer, (ii) better controlling disability retirement, and (iii) bringing forward the increase in women's retirement age (planned for 2024–2033), while grandfathering employees close to retirement, could produce further (and faster) savings.

- Continuing to reduce subsidies and tax breaks in the transport sector and fossil-fuel industries, and avoiding duplication of subsidies at the federal and state level by introducing more transparency and better targeting at all levels of government.

- Reforming fiscal federalism by strengthening the link between revenue and expenditure at the province and municipalities' level. A key part of the strategy would be to benchmark spending targets for subnational governments to the best domestic and international practices, linking tax

[5] See Annexes 1–2 of Chapter I of the Selected Issues and the EC's Austria Country Report, February 2015.

[6] Austria lies well away from the spending efficiency frontier of peer OECD advanced countries in key areas of spending such as health and education (see Chapter I of the Selected Issues). To reduce the influence of idiosyncratic factors that may affect spending, quality, and effectiveness of services in individual countries, this report compares Austria's spending in these areas to the average spending levels in its OECD peers.

transfers to performance relative to these targets. This would also create powerful incentives to reduce inefficiencies.

24. The authorities agreed that spending could be trimmed in the areas indicated by staff. They argued, however, that doing so is going to be complicated, as in key areas, like healthcare and education, competencies pertain primarily to subnational governments. They added that a number of reforms have already been passed to cap spending (see Appendices 1 and 2 in Chapter I of the Selected Issues), although acknowledged that some measures did not meet saving expectations on several grounds,[7] and other reflected limits given the coalition's members' different perspectives on the matter (e.g., on targets for pensions' statutory and effective retirement age). For pensions, views were especially divided, with some arguing that no more is needed since the pension system is now fully sustainable thanks also to the increase in migration; and others aiming for a bolder agenda ahead of the expected increase in the old age dependency ratio in the next decade. In addition, they argued, negotiations between the federal and subnational governments are underway to review the system of tax equalization, with the aim of better aligning responsibilities and supervisory powers.

B. Migration, Optimizing Integration Policies, and Other Measures to Boost Potential Growth

Background

25. On balance, the immigrants Austria attracts improve the characteristics of its labor force. Immigrants are younger than native-born Austrians, offsetting the loss of labor force created by ageing population. While in secondary education immigrants lag behind the native population, the share of immigrants with tertiary education is comparable with that of native-borns. Austria also appeals to immigrants from other EU countries, and receives more high-skilled migrants than the average for the EU labor recipient countries.

26. Staff's analysis suggests that with the right integration policies, immigrants can boost potential growth and have a positive net fiscal contribution in the long run (see Chapter II of the Selected Issues). Staff's baseline macroeconomic projections reflect increased immigrant inflows of about 1 percent of the working-age population on average in 2014–20. Relative to a scenario based on the pre-2014 migration trends, by 2020 potential GDP growth would be higher by 0.2 percentage points, net pension spending would be lower by 0.3 percent of GDP, and net health-care spending—by 0.1 percent of GDP, with the gains steadily increasing over the long run as more immigrants get employed (Figure 7). The overall net fiscal effect of the increased immigration inflows, taking into account all related expenditure and revenue, will remain a negative 0.2–0.3 percent of GDP in 2016–20 and turn positive in 2023. As regards the labor market, the expected impact on wages and employment of native-born Austrians is small and positive, as the demand

[7] Notably, in healthcare, caps to expenditure under the Health Reform Action Plan for 2013–2016 were formulated in nominal terms. With inflation undershooting the assumptions, caps have not been binding in real terms.

effects created by the expansion of the population outweigh, under the most plausible parameterization, any substitution effects for both low- and high-skilled native-born workers.

27. Staff estimates that potential growth has dropped below 1 percent in 2010–15 compared with 2.5 percent in 1990–2005. This sizeable slowdown, which started before the global crisis, reflects slower accumulation of physical and human capital, declining labor input, and flat total factor productivity (TFP) despite a steady increase in the capital-to-labor ratio (Figure 9). Economic uncertainty since the onset of the financial crisis has depressed investment. While product market regulations are not restrictive, relatively slow adoption of information and communication technologies and excessive regulation in services appear responsible for the stagnation of TFP.

Policy Discussions

28. Staff commended the authorities for their prompt design of measures to promote early and effective integration. These measures, which are already underway, include language training, steps to certify job skills, and the arrangement of temporary accommodation and healthcare. In addition, €70 million are set aside for active labor market policies in 2016. The authorities are aware that there is a long way to go, however, before immigrants are fully integrated in the economy and society.

29. Staff stressed that successful integration based on early, intensive, and sustained policy response is key to reaping the benefits from immigration. In this regard, staff advised strengthening and expanding the measures already in place by:

- reducing legal obstacles to find jobs swiftly, such as restrictions on asylum seekers to take up work while their case is being processed;
- targeting active labor market policies such as training and apprenticeship contracts, work placement programs, and skill-bridging courses to help migrants leverage and build skills;
- working actively with employers to boost refugees' chances of employment;
- further modifying labor taxation of lower-wage workers—a category in which immigrants often fall—to make work more financially attractive than receiving social benefits and thus prevent "inactivity traps";
- providing affordable housing in the areas where labor demand is highest.

30. The authorities concurred that while the influx of refugees poses challenges in the short-term, it is an opportunity in the medium-term. They broadly agreed with staffs' assessment of the economic impact of immigrants for Austria. The authorities noted that the measures they undertook are part of a comprehensive policy agenda —"Fifty Action Points"—to facilitate the integration of immigrants along the lines suggested by staff. This agenda focuses on early provision of language courses, assessment of immigrants' skills, and enabling immigrants to acquire new skills as well as continue their education in Austria. Alongside, apprenticeship programs targeted to refugees are about to be launched. The authorities added that the government's initiative to secure long-term funding from the European Investment Bank for the construction of

30,000 additional dwellings would increase the supply of affordable housing across the country, facilitating the integration of immigrants.

31. Staff also reiterated its previous advice that a strategy to boost potential growth should rely on raising total factor productivity (TFP) and the labor input:[8]

- To boost TFP, staff advised enhanced IT penetration, improved access to financing for start-ups, and reduced administrative barriers for new business. Specifically, lower entry barriers in network industries and easier regulations in professional services and retail trade would improve competition and strengthen innovation, raising Austria's use of high-skilled labor and ICT inputs (Figure 10).

- To propel labor supply, staff recommended further cuts in labor taxation to support a recovery of hours worked by reducing the high marginal effective tax rate between part-time and full-time work. Other measures aimed at strengthening labor force participation include integrating migrant workers, raising the effective retirement age, providing more child care facilities, and buttressing incentives for the retention of older workers in the labor force.

32. The authorities agreed that stagnant TFP growth is responsible for potential growth slowdown. They acknowledged that financing conditions for startups are a problem in Austria and there is a need to facilitate funding for these companies outside the banking sector. Regarding labor supply, the authorities have introduced the so-called part-time retirement to encourage older people to remain in the labor force longer. This gives an opportunity for people of age 62 and higher to reduce their working hours by half instead of early retirement and receive 75 percent of their previous wages, including 25 percent as social assistance.

C. Further Enhancing Financial Sector Resilience and Finalizing Bank Restructuring

Background

33. Capital cushions of the major CESEE-active banks appear thin in comparison with peers, and profitability is recovering only slowly. The CET-1 ratio of the top three banks currently hovers around 11 percent, below their European peers (Figure 4). Profitability have turned positive in 2015, but remains subdued. Profitability in the domestic market has traditionally been low and the current low interest rate environment generates further pressures. In CESEE, profitability remains generally higher, but more volatile, as political and economic shocks take their toll. Examples include state-mandated conversion of Swiss franc loans into other currencies in Hungary and Croatia and the recessions in Russia and Ukraine.

34. Corporate and household debt levels are comparatively low, but household loans in Swiss francs remain a concern. Corporate and household debt is below the euro area average

[8] See IMF Country Report No. 14/278.

(Figure 5). However, the share of Swiss franc loans in total household mortgage loans remains around 20 percent even after a gradual decline since 2007. These bullet loans, the bulk of which start to mature around 2019, are usually accompanied by the accumulation of funds in a "repayment vehicle" to be used when the loan matures. However, the OeNB estimates that the average "repayment gap" for Swiss franc loans has increased to some 23 percent (€6 billion, some 1½ percent of banks' risk-weighted assets) on the back of the Swiss franc's appreciation in 2015. As a mitigating factor, the loans are mostly owed by affluent households.[9]

35. Real estate price dynamics have moderated, although there are signs of overvaluation in Vienna. Annual price increases have dropped below 5 percent recently. On the back of strong price dynamics in previous years (Figure 5), the OeNB's fundamentals-based indicator still suggests an overvaluation of about 20 percent in Vienna.

36. Against this backdrop, large Austrian banks are changing their business models in several dimensions. To rebuild capital buffers, the top three banks have been refocusing their international presence on core markets and activities. The leader in this respect is Raiffeisen Bank International (RBI), which plans to bring its CET-1 ratio to 12 percent of risk-weighted assets (RWA) by end-2017 mainly by selling subsidiaries and scaling down assets in Asia and the US. Moreover, comprehensive cost-cutting strategies are being implemented domestically and in CESEE.

37. So far, these developments would not appear to have hampered credit supply in Austria or the CESEE. In Austria, stable but low credit growth in the past few years has been moving in line with weak domestic aggregate demand. In CESEE, the reduction of overall exposure of Austrian banks since the global financial crisis has been limited. Going forward, there is a risk that cost rationalization and asset reduction efforts could constrain credit growth in some host countries if sustained over a longer period and if credit demand strengthens, but this risk would only materialize if other banks did not fill the void. The risk is reduced if asset reduction takes place through the sale of subsidiaries, which is for instance a major component in the restructuring plan of RBI and was the case in the sale of the SEE subsidiaries of former Hypo Alpe Adria bank. Ultimately, successful restructuring should increase profitability and capital generation capacity in the medium-term and reinforce Austrian banks' ability to support growth and financial stability in the region.

38. In parallel, the authorities have made significant progress in revamping the regulatory and supervisory framework for the banking sector. Key elements of the EU Banking Union have been put in place, including the SSM framework, the Bank Recovery and Resolution Directive (BRRD), and a pre-funded deposit guarantee scheme. On the macroprudential front, the Austrian Financial Market Stability Board (FMSB) was created in 2014 and, upon its recommendation, the Financial Market Authority recently introduced a systemic risk buffer of up to 2 percent of RWA to be phased in over 2016–19. This adds to earlier macroprudential measures focusing on stronger local funding of Austrian banks' subsidiaries abroad and less foreign-currency loans (Annex 1).

---

[9] More than 4/5 of the relevant households earn above median income and almost all of them have above median wealth. Altogether, 4 percent of all Austrian households have foreign-currency-denominated debt.

However, the macroprudential toolkit still lacks sector-specific instruments, such as caps on loan-to-value (LTV), debt-to-income (DTI), and debt-service-to-income (DSTI) ratios for mortgage loans.

39. The resolution of the banks nationalized during the crisis has progressed significantly. The apex institution of the cooperative Volksbanken association was transformed into a wind-down unit with bad assets of around €6 billion (1.8 percent of GDP), and part of Kommunalkredit has been re-privatized. The remaining part of €6.3 billion (1.9 percent of GDP) was merged with the government-owned "bad bank" KA Finanz of similar size. The sale of the CEE network of Hypo Alpe Adria to the U.S. equity fund Advent and the EBRD was completed in July 2015, and a government-owned wind-down entity ("HETA") for the remaining assets had already been established in 2014.

40. However, certain options to resolve HETA raise difficult trade-offs. In March 2015, the Financial Market Authority issued a moratorium until May 2016 on the debt service on €13 billion of HETA debt, €11 billion of which is guaranteed by the Austrian province of Carinthia. The moratorium is the first step of a resolution procedure based on the Austrian transposition law of the European Bank Recovery and Resolution Directive (BRRD). In parallel, the authorities intend to seek agreement on a debt buyback with at least two-thirds of the HETA creditors and impose the negotiated haircut on the rest through a retroactive collective action clause (CAC). Effectively, this would also imply the retroactive voidance of part of Carinthia's guarantees underlying the debt.

Policy Discussions

41. Staff commended the authorities on progress in revamping the regulatory and supervisory framework and bank resolution but emphasized that:

- The systemic capital surcharge is welcome, but banks' capital adequacy will need to be continuously re-assessed. The authorities should swiftly press for alternative measures if banks' capital-building plans falter. They should also stand ready to tighten capital requirements, including by modifying the size and phasing-in the systemic risk buffer, if early warning indicators or stress tests flag intensified future risks.

- Banks should be further encouraged to pro-actively mitigate risks from domestic Swiss franc mortgage loans, for instance by promoting conversion to euro-denominated mortgages with gradual amortization, loan reduction through early repayment, or higher contributions to existing repayment vehicles.

- The macroprudential toolkit should be further strengthened by introducing sector-specific caps on LTV and DTI/DSTI ratios, possibly regionally differentiated. While not binding at present, such caps would be useful if house prices pick up strongly in parts of the country.

- Regarding HETA, the authorities need to judiciously balance the obvious benefits of a quick resolution with the reputational and financial risks associated with a retroactive change of contracts. The latter could, for instance, call into question the credibility of guarantees issued by some subnational bodies and raise funding costs for some banks.

42. The authorities broadly agreed with the staff assessment. They acknowledged the need for some banks to strengthen their capital position, and they plan to carefully monitor the implementation of plans to this effect, standing ready to ask for additional measures in case capital-building objectives are not met. Counterparts were also in favor of further risk-mitigating measures by banks related to Swiss franc loans but noted that debtors would need to agree voluntarily. The authorities welcomed the proposal of sector-specific macroprudential instruments and reported that discussions on the design of such tools have started. As for HETA, the authorities confirmed their preferred solution of a voluntary agreement with creditors, while acknowledging the associated trade-offs.

STAFF APPRAISAL

43. Austria is stable and affluent. With a high income per capita and relatively low unemployment, it is not surprising that Austria attracts immigrants from other EU member states as well as asylum seekers from all over the world.

44. However, growth has stalled and public debt has risen. While output and employment have risen above pre-crisis levels, actual and potential growth has fallen and public debt has risen to 86 percent of GDP. With the ongoing surge of asylum seekers, unemployment is expected to rise.

45. A decisive push for reforms is needed to address these issues and preserve Austrians' high living standards. This requires: (i) a gradual but sustained fiscal consolidation that rebuilds fiscal buffers by cutting inefficient expenditure; (ii) rapid integration of immigrants and other measures to raise productivity and labor force participation, and (iii) vigilance regarding risks in the large financial sector, and efficient asset disposal by wind-down units of resolved banks.

46. The fiscal stance needs to strike a balance between supporting activity and rebuilding buffers. Until the output gap closes, this means a broadly neutral fiscal stance, as envisaged in the 2016 budget. However, complying with the budget plans will likely require additional measures to counteract risks related to the financing of the 2016 personal income tax reform. In the medium term, high public debt and looming ageing costs call for further fiscal consolidation.

47. Moving gradually to a structural surplus of ½ percent of GDP by 2020 and keeping it until the debt-to-GDP ratio reaches 60 percent of GDP would have several advantages. It would regain space early on for countercyclical fiscal policy and the absorption of tail risks, improve Austria's structural fiscal position ahead of rising ageing costs, and allow faster return of the AAA credit rating and sustained low borrowing costs in the long run.

48. Needed fiscal consolidation should be delivered by broad reform-based cuts in large expenditure areas where Austria spends more than peers without achieving better outcomes. Indeed, staff estimates potential savings at 4 percentage points of GDP by 2020. Crucial areas are health care, education, subsidies, and pensions.

49. To reap these gains, a national strategy to reduce costs, fully coordinated across government levels, is essential. A key part of the strategy would be to benchmark spending targets to the best domestic and international practices. A concerted effort should also be made to avoid duplication of services between the various levels of government and ensure their effective and efficient provision.

50. Decisive expenditure reforms would also make room for further reduction of the labor tax wedge. In particular, the high social security contributions could be reduced more substantially beyond the modest cuts envisaged for 2017–18 to support demand for labor and help absorb the rising labor supply. Such cuts are desirable even if expenditure is not reduced sufficiently, and could be financed in a revenue-neutral way by hikes in consumption, wealth, and environment-friendly taxes, which remain below international averages.

51. Efforts to integrate immigrants and advance structural reforms to raise potential growth and improve the fiscal accounts need to be sustained. An early, intensive, and sustained policy response is key for reaping the benefits from immigration, which could raise potential growth by ¼ of a percentage point by 2020 and produce steady fiscal gains in the long term. In addition, as emphasized in previous consultations, policies to raise total factor productivity growth and labor force participation are needed to bolster potential growth.

52. The authorities have made significant progress in revamping the regulatory and supervisory framework of the banking sector. Key elements of the EU Banking Union have been put in place. On the macroprudential front, the Austrian Financial Market Stability Board is up and running and, upon its proposal, a systemic risk buffer will be phased in during 2016–19.

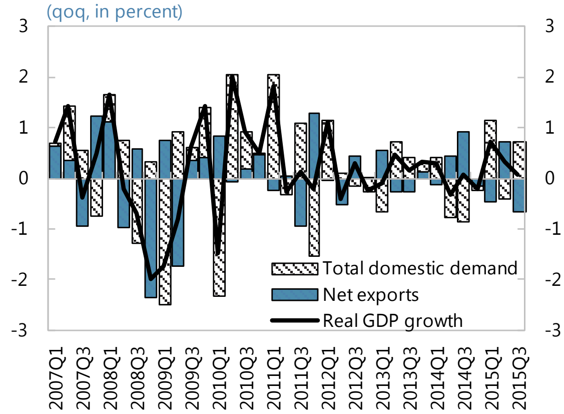
53. Nevertheless, financial sector resilience should be further strengthened. Banks' capital adequacy will need to be continuously monitored and re-assessed. The authorities should swiftly press for alternative measures if banks' capital-building plans falter. They should also stand ready to tighten capital requirements if early warning indicators or stress tests flag intensified future risks. In addition, banks need to be further encouraged to proactively mitigate risks related to Swiss franc mortgage loans. Furthermore, macroprudential preparedness should be strengthened by introducing instruments such as caps on loan-to-value, debt-to-income, and debt-service-to-income ratios for mortgage loans, possibly regionally differentiated.

54. It is recommended that the next Article IV consultation with Austria be held on the standard 12–month cycle.

Figure 1. Recent Economic Developments

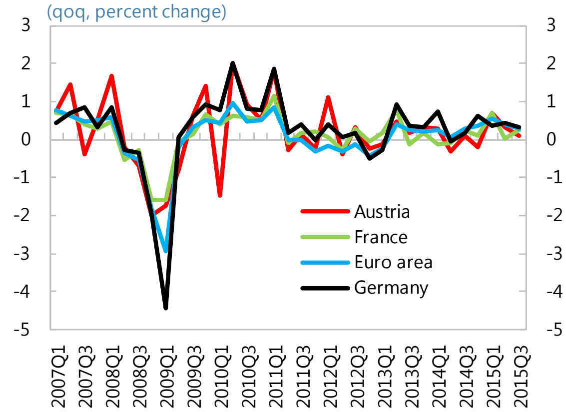
Growth remains positive...

Real GDP Growth and Growth Contributions
(qoq, in percent)



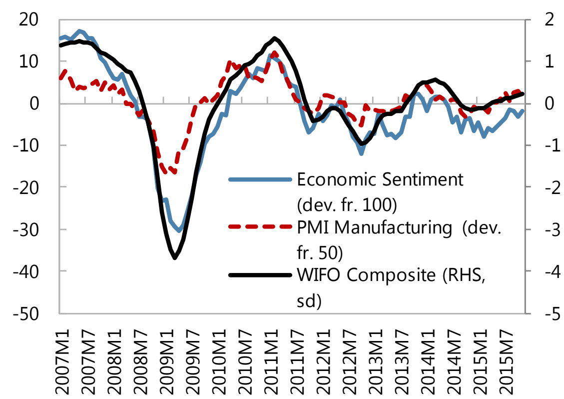
... broadly in line with peers...

Real GDP Growth
(qoq, percent change)



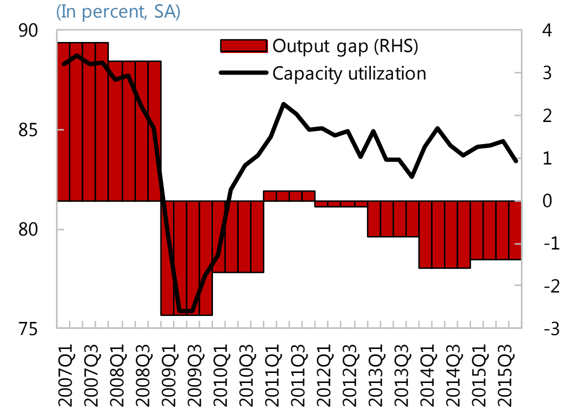
...and appears set to strengthen.

Leading Indicators



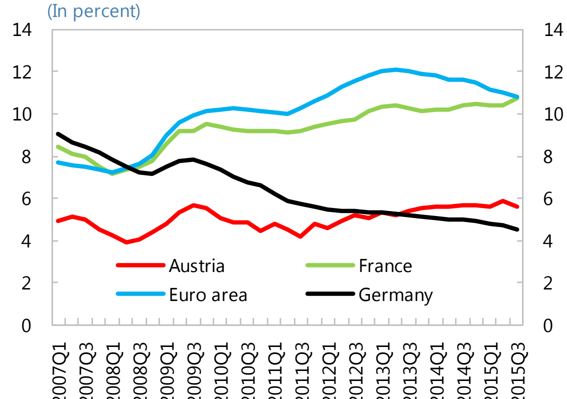
The output gap is moderate.

Capacity Utilization
(In percent, SA)



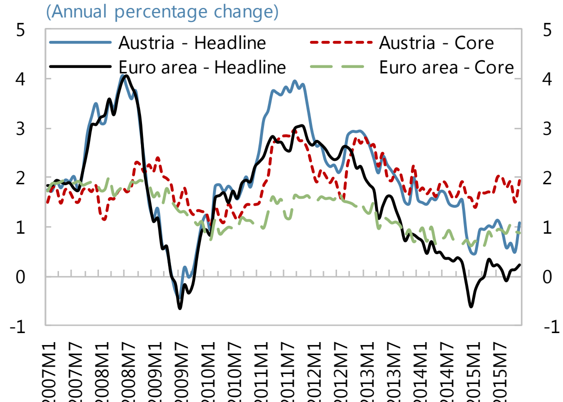
Unemployment, although rising, remains low.

Harmonized Unemployment Rate
(In percent)



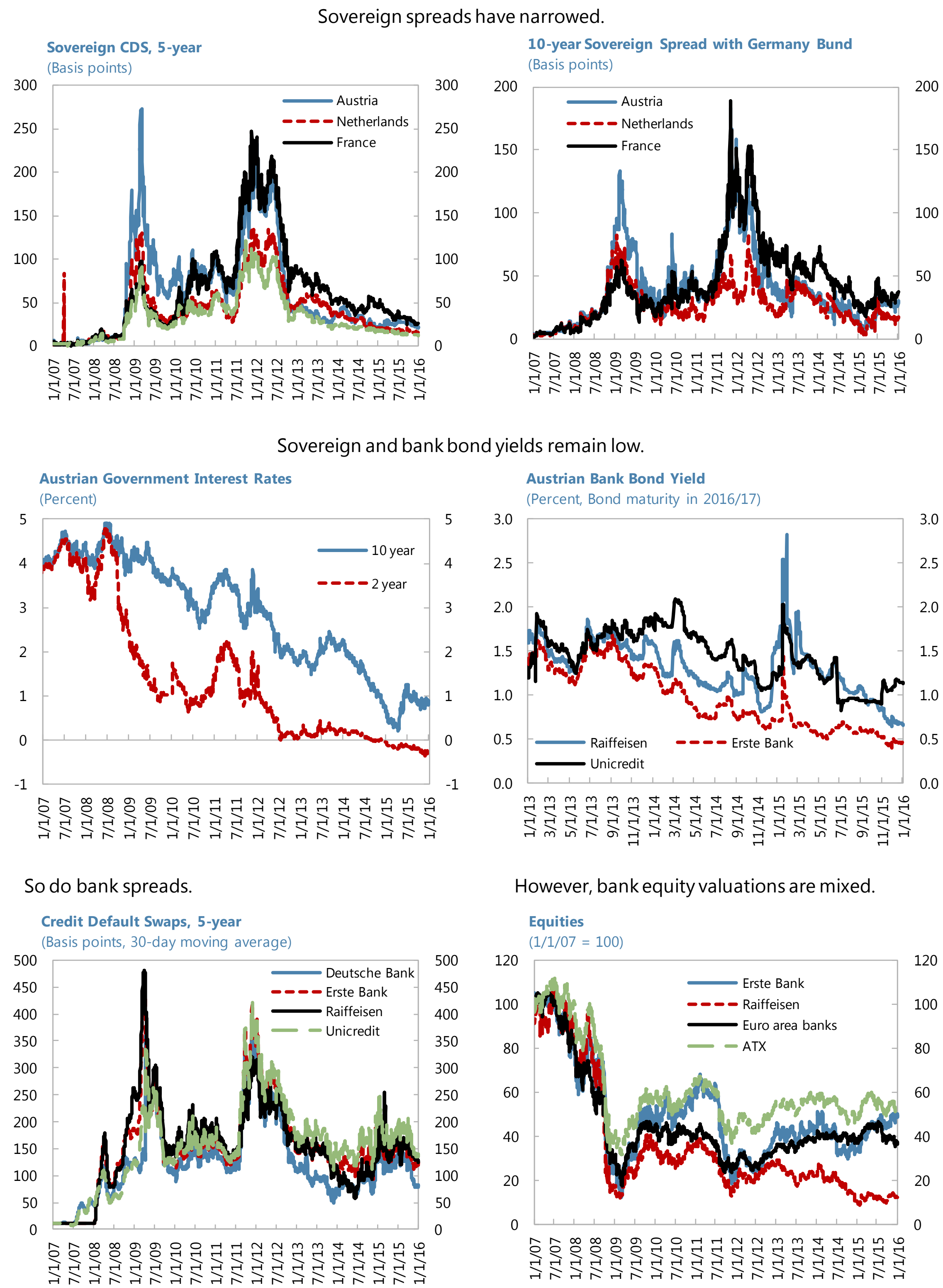
While core inflation is close to 2 percent, headline inflation remains well below the ECB's objective.

Harmonized CPI
(Annual percentage change)



Sources: Austrian authorities; WIFO; Eurostat; Haver Analytics; WEO; and IMF staff calculations.

Figure 2. Selected Financial Market Indicators

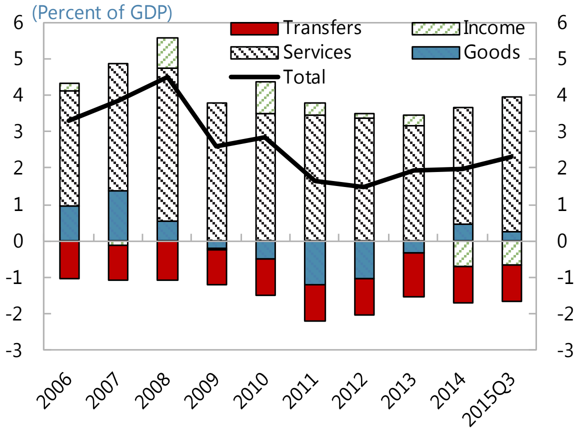


Sources: Bloomberg and Thomson Financial/DataStream.

Figure 3. External Sector

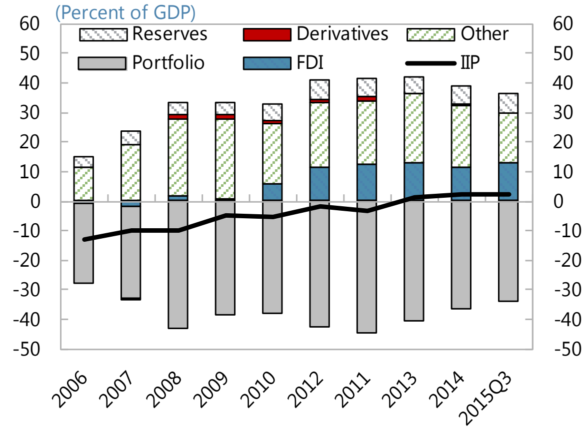
Austria has a moderate current account surplus which reflects strong revenue from tourism.

Current Account Balance
(Percent of GDP)



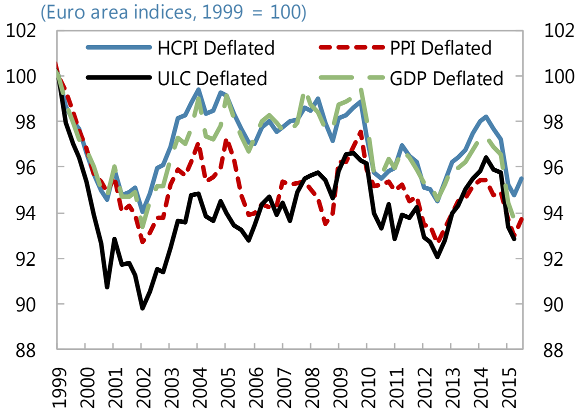
Its net international investment position is near zero.

International Investment Position
(Percent of GDP)



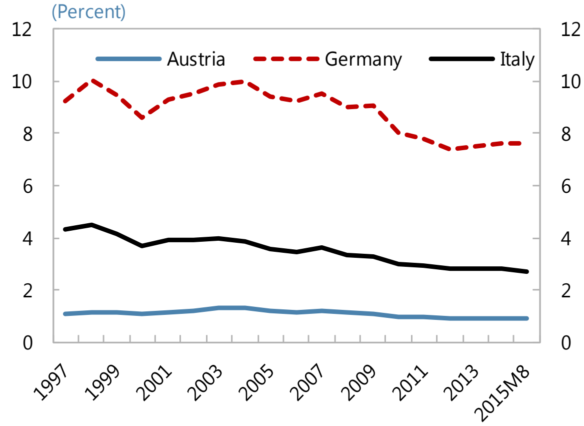
The REER has been broadly stable over the past decade...

Austria: Real Effective Exchange Rates
(Euro area indices, 1999 = 100)



...and so has Austria's share of world exports.

Share of World Exports
(Percent)

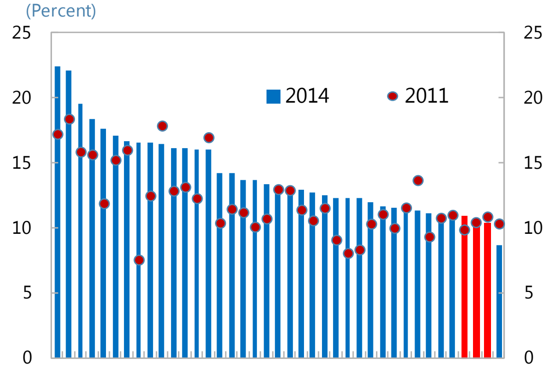


Sources: Direction of Trade Statistics, EU Cost Price Indicators for Euro area, Haver Analytics, OeNB.

Figure 4. Banking Sector

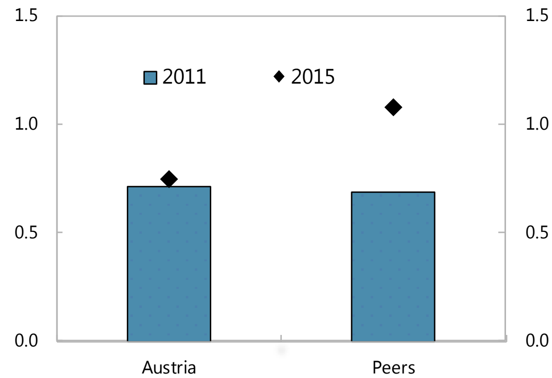
Bank capitalization remains low relative to peers...

Selected Large European Banks: Tier I Ratio 2011-2014 1/
(Percent)



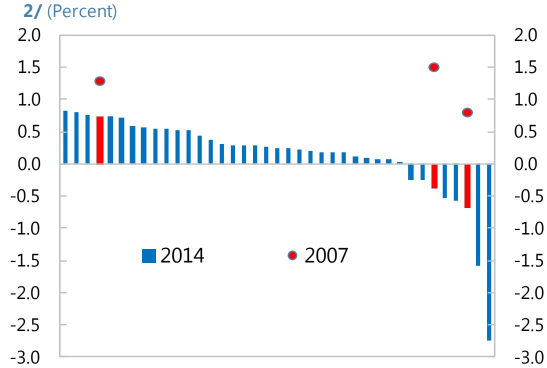
... and so are market valuations.

Price to Book Ratio of Austrian Banks



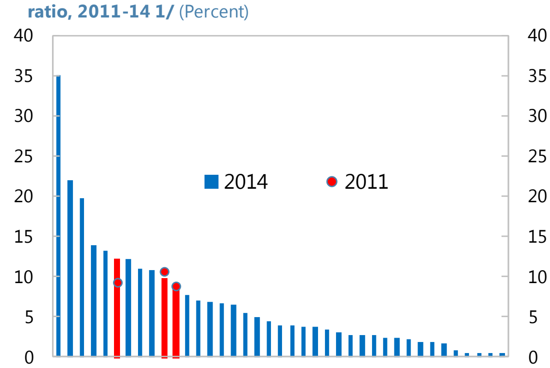
Returns have come down...

Selected Large European Banks: Return on Assets 2007-14 2/ (Percent)



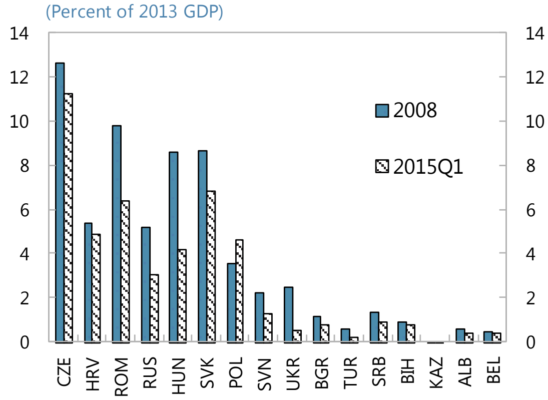
...and NPLs remain high...

Selected Large European Banks: Nonperforming loans ratio, 2011-14 1/ (Percent)



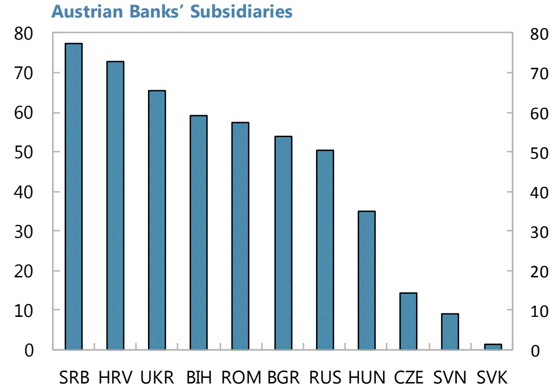
...with high CESEE exposure...

CESEE Exposures
(Percent of 2013 GDP)



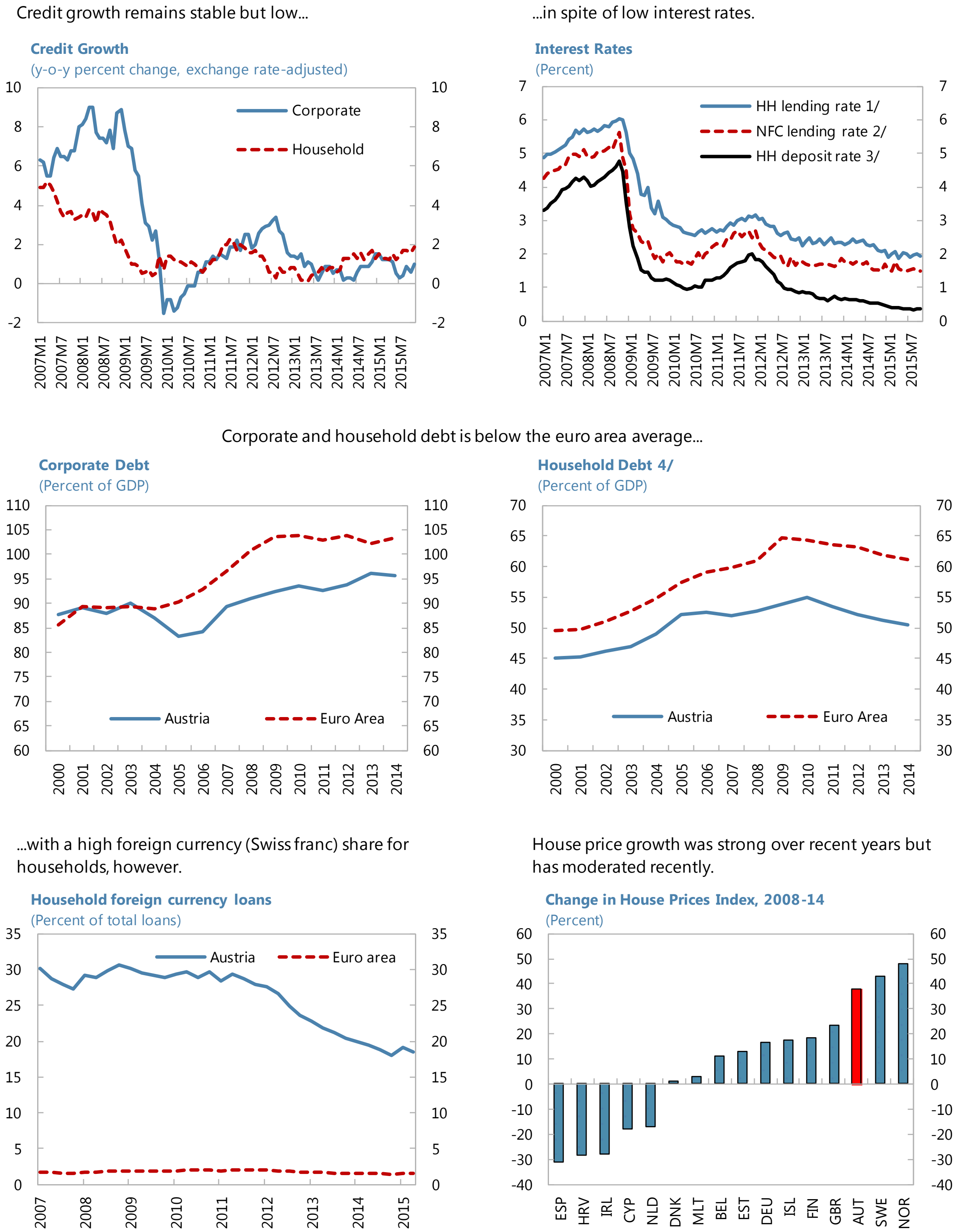
...and legacy foreign currency lending.

Share of Foreign Currency Loans in the Lending of Austrian Banks' Subsidiaries



Sources: OeNB; Bloomberg; SNL Financial; BIS consolidated banking statistics; and IMF staff calculations.
1/ Austrian banks are shown in red and non-Austrian banks are shown in blue. The set of "large European banks" includes 2 Belgian banks, 1 Danish bank, 4 French banks, 3 German banks, 2 Irish banks, 5 Italian banks, 1 Dutch bank, 1 Norwegian bank, 5 Spanish banks, 4 Swedish banks, 1 Swiss bank, and 6 British banks.
2/ Series includes foreign-owned banks and is adjusted for currency movements and provisions.

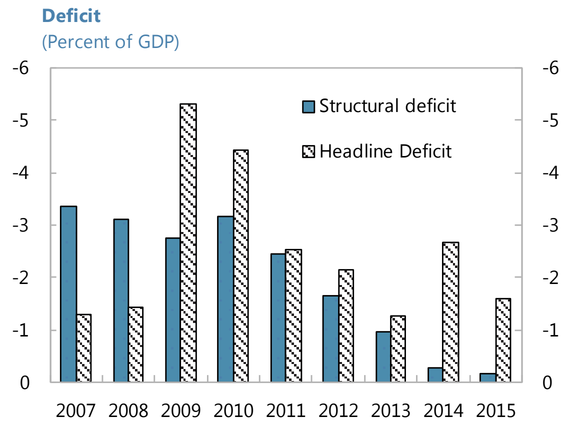
Figure 5. Corporate and Household Indebtedness and House Prices



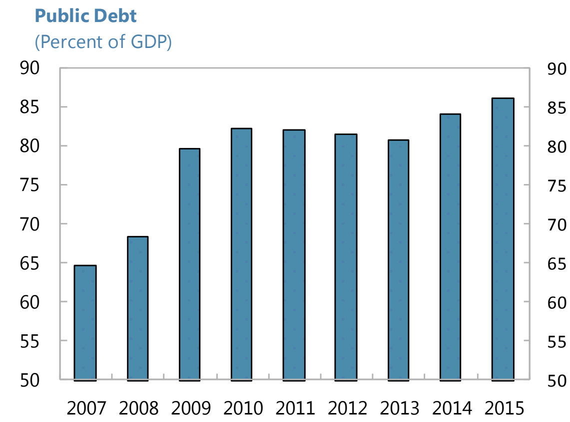
Sources: ECB, Eurostat, Haver Analytics, OeNB, and Statistics Austria.
1/ Up-to-one-year fixed rate for house purchases loans to household.
2/ Up-to-one-year fixed rate for new loans over 1 million euros to non-financial corporations.
3/ For household time deposits with maturity up to one year.
4/ Includes total of short-term and long-term loans.

Figure 6. Fiscal Developments and Outlook

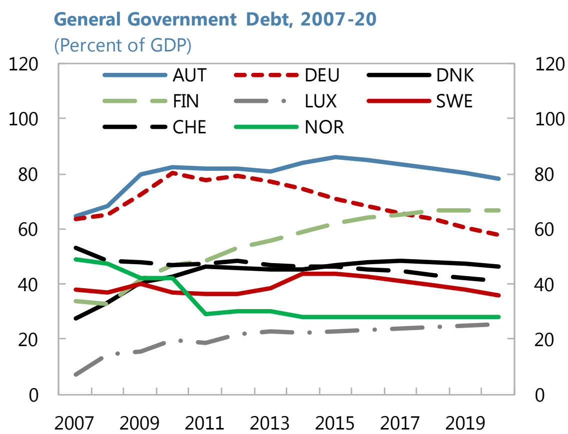
The structural deficit has narrowed...



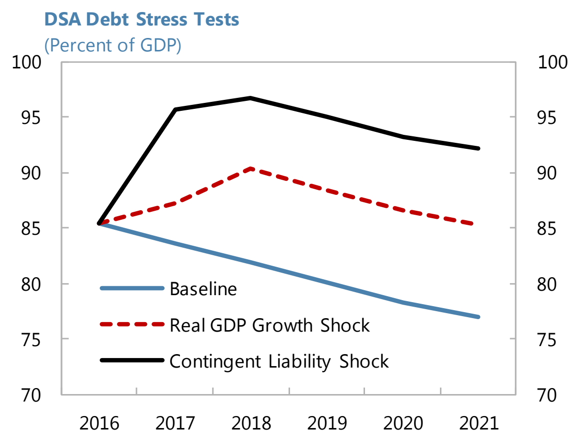
...but debt has increased substantially, driven by bank restructuring expenses.



Current fiscal plans leave Austria's debt above peers...



...and standard DSA growth and contingent liability shocks would increase debt significantly.

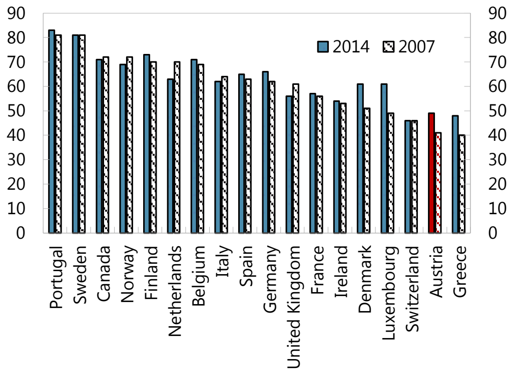


Sources: Austrian authorities; EC; IMF WEO; and IMF staff calculations and projections.

Figure 7. Migrants Integration Policies and Economic Impact of Immigrants

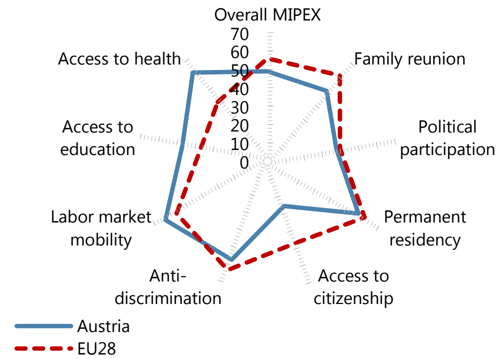
Austria's position on the MIPEX index has improved since 2007...

MIPEX Index 1/



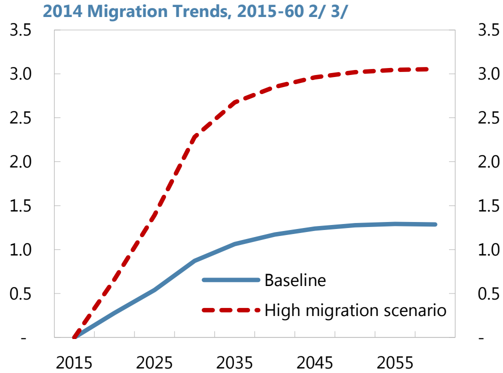
...however, Austria is still modestly lagging the EU average on some policies to integrate the migrants.

MIPEX index 1/



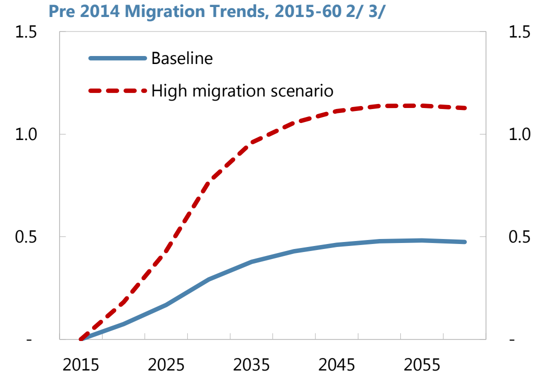
Successful integration of immigrants in the economy could reduce notably net pension cost relative to GDP...

Reduction in Net Pension Spending Relative to Pre 2014 Migration Trends, 2015-60 2/ 3/



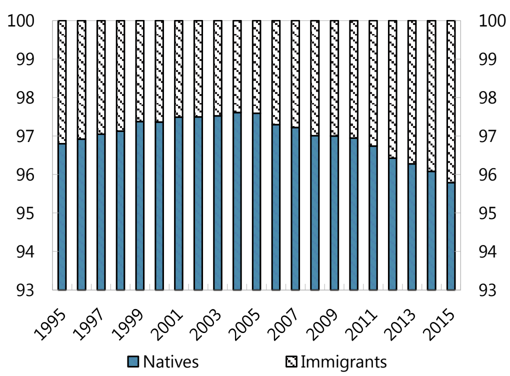
... and to a lesser extent net health care cost.

Reduction in Net Health Care Spending Relative to Pre 2014 Migration Trends, 2015-60 2/ 3/



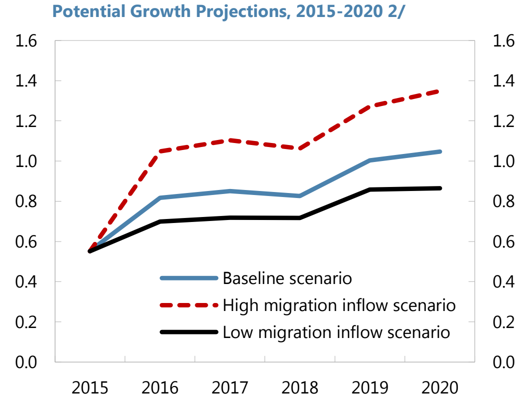
The share of potential output generated by immigarnts has been increasing.

Distribution of Potential Output, 1995-2015



Successful integration of migrants can raise Austria's potential growth.

Potential Growth Projections, 2015-2020 2/



Sources: Eurostat, MIPEX index database, and IMF staff calculations.

1/ Migrant Integration Policy Index (MIPEX) benchmarks current laws and policies of individual countries against the highest relevant standards through consultations with top scholars and institutions.

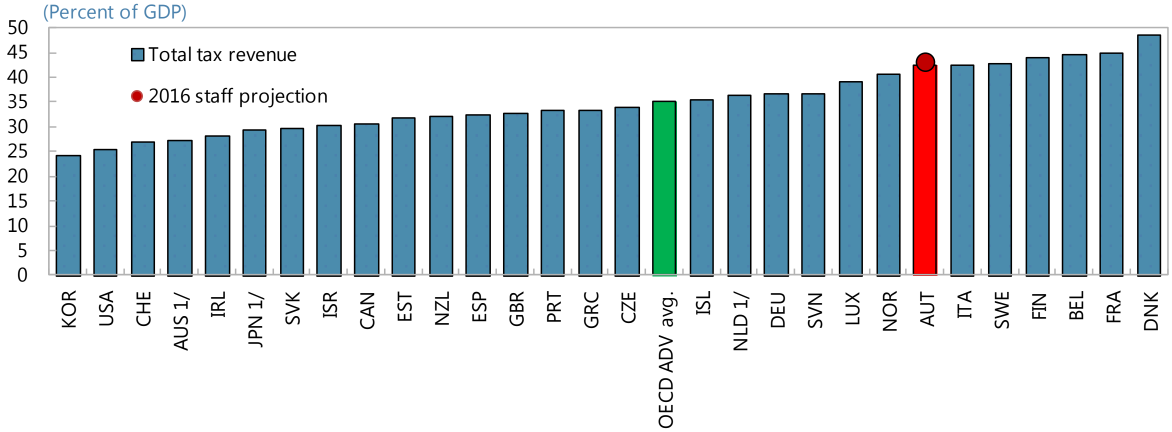
2/The baseline scenario reflects migrant inflows of 1 percent of the working-age population (WAP) a year, the higher inflow scenario assumes 1.7 percent of the WAP, while the low inflow scenario corresponds to pre 2014 migration trends.

3/ Net pension and health care spending are net of the respective social security contributions generated by employed immigrants.

Figure 8. Tax Revenue, PIT and Social Security Contributions — Advanced OECD Countries

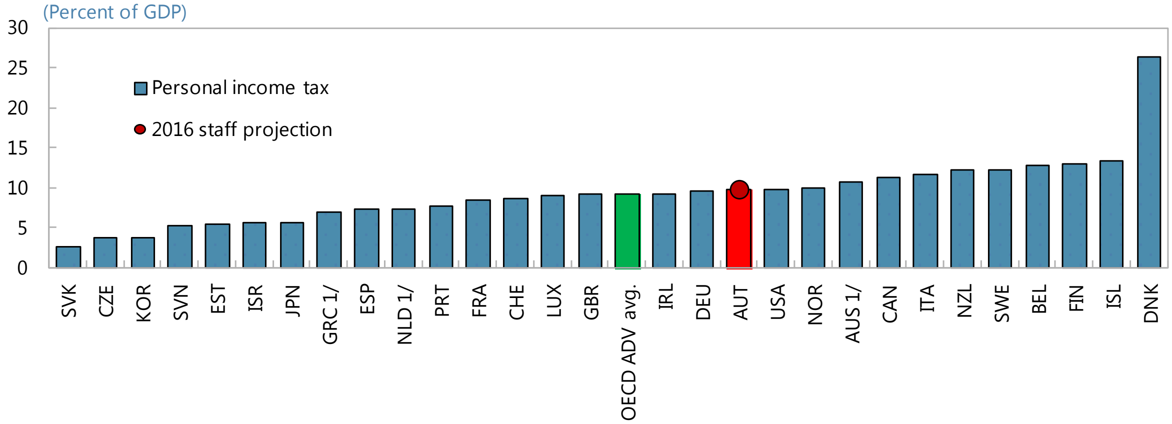
Austria's tax intake remains high...

Total Tax Revenue, 2013
(Percent of GDP)



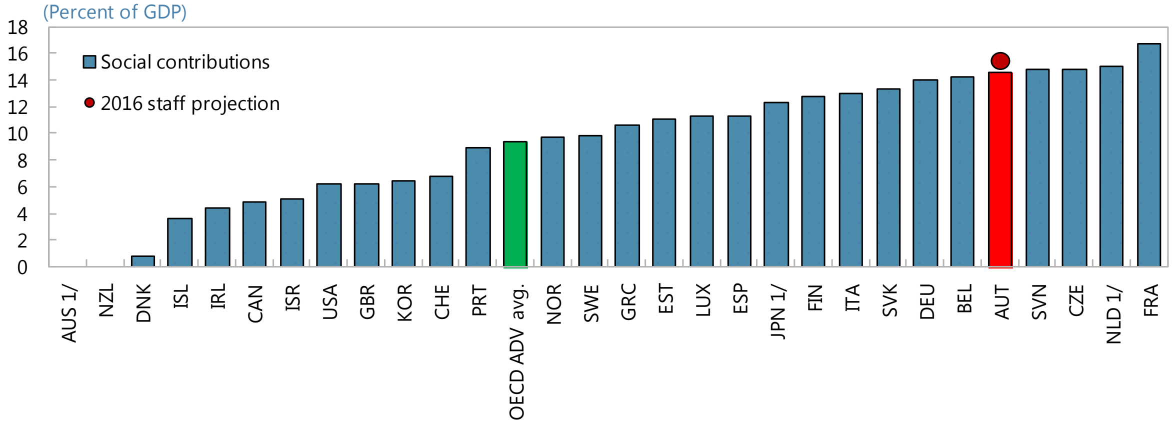
...even after the personal income tax cut in 2016...

Personal Income Tax, 2013
(Percent of GDP)



...and large social security contributions weigh on demand for labor.

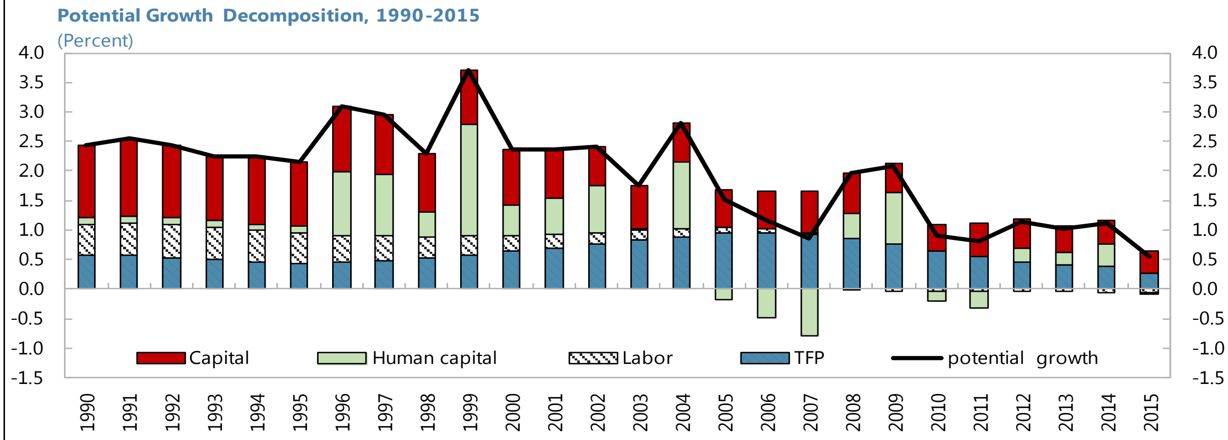
Social Security Contributions, 2013
(Percent of GDP)



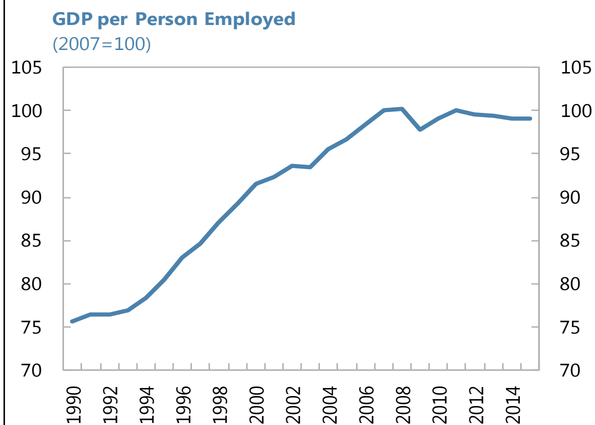
Sources: OECD and Fund staff estimates.
1/ 2012 values.

Figure 9. Potential Growth and Productivity

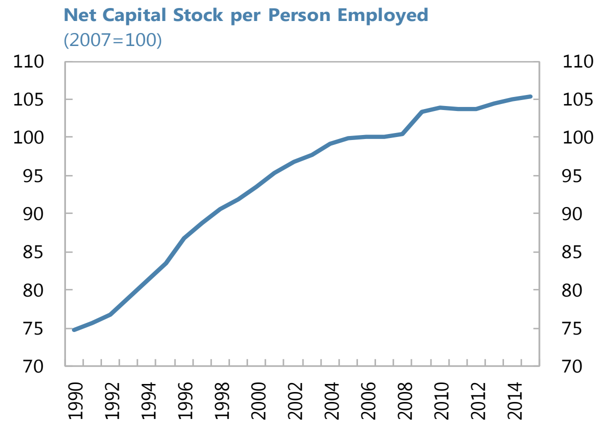
Potential growth decelerated driven by slower accumulation of physical and human capital, negative contribution from the labor force, and lackluster productivity growth.



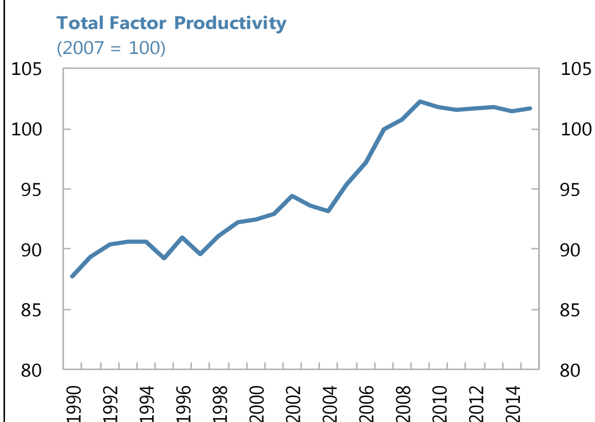
GDP per person employed has stagnated since 2007...



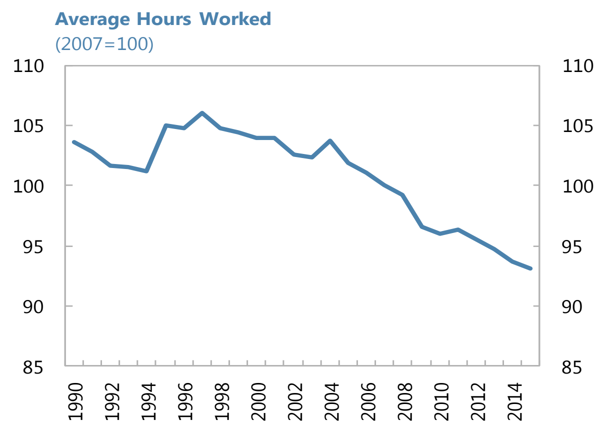
...despite the steady increase in the stock of capital...



...reflecting sluggish growth in total factor productivity...



...and declining average hours worked...

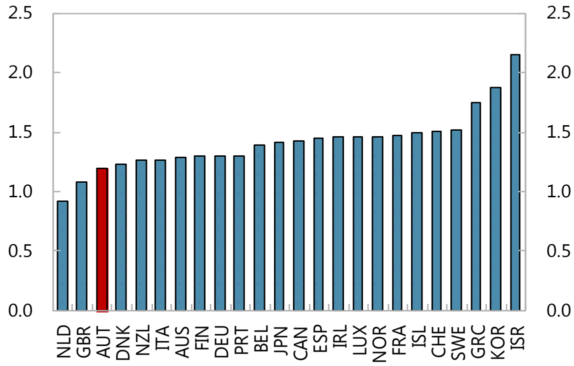


Sources: Eurostat, Haver Analytics, and IMF staff calculations.

Figure 10. Structural Indicators

Austria's product market regulations are not restrictive.

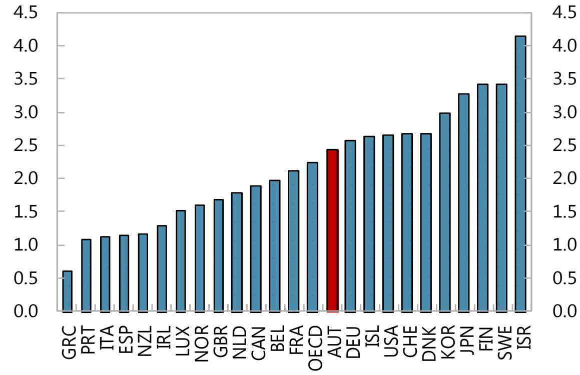
Product Market Regulations, 2013



Austria spends more on R&D than the OECD average, although still less than the frontrunners in this area.

Spending on R&D, 2000-13 Average

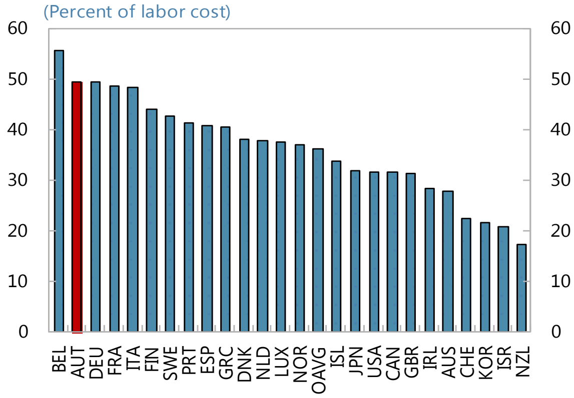
(Percent of GDP)



However, Austria has one of the highest labor taxation compared with peers...

Tax Wedge, 2014

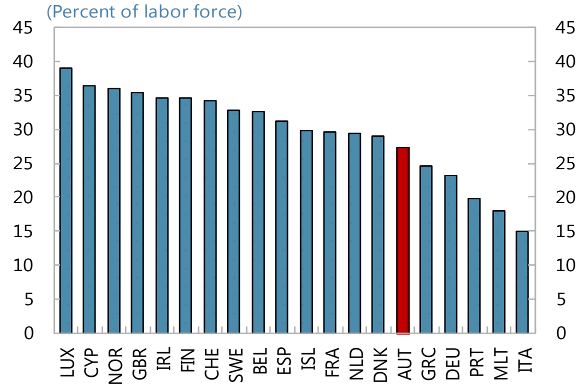
(Percent of labor cost)



... and is among the countries with relatively low share of labor force with tertiary education.

Labor Force with Tertiary Education, 2014

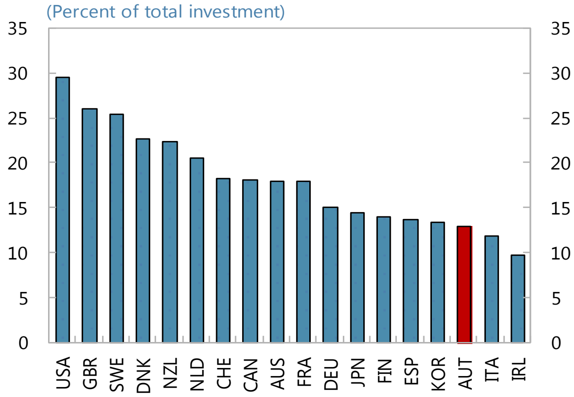
(Percent of labor force)



Moreover, Austria invests less in ICT than its peers...

ICT Investment, 2000-2010 Average

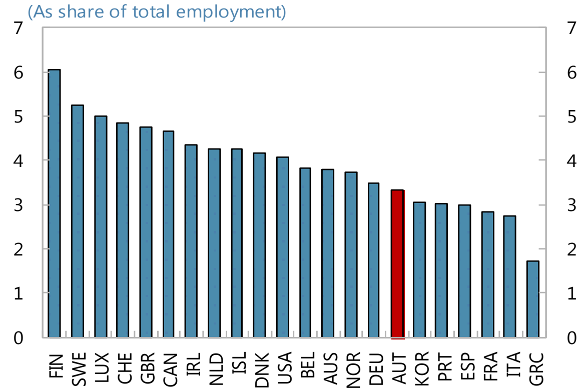
(Percent of total investment)



...and employs fewer ICT specialists.

Employment of ICT Specialists Across the Economy, 2014

(As share of total employment)



Sources: OECD database, Eurostat, and IMF staff calculations.

Table 1. Selected Economic Indicators, 2011–16

Total area	83,850 square kilometers
Total population (2013)	8.5 million
GDP per capita (2013)	US$ 48,957 (36,851 Euro)

	2011	2012	2013	2014	2015	2016
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	2.8	0.8	0.3	0.4	0.7	1.4
Total domestic demand	2.9	0.3	-0.4	-0.2	0.5	1.1
Consumption	0.9	0.5	0.2	0.3	0.5	1.1
Gross fixed capital formation	6.7	1.3	-0.3	-0.2	-0.5	1.4
Net exports (growth contribution in pp)	0.1	0.3	0.4	0.5	0.3	0.3
Exports of goods and nonfactor services	6.0	1.7	0.8	2.1	1.1	3.2
Imports of goods and nonfactor services	6.2	1.1	0.0	1.3	0.6	3.0
Output gap (percent of potential GDP)	0.2	-0.1	-0.8	-1.6	-1.4	-0.9
Unemployment (in percent; Eurostat definition)	4.6	4.9	5.3	5.6	5.8	6.2
Prices						
Consumer price index (period average)	3.6	2.6	2.1	1.5	0.8	1.4
General government finances (percent of GDP)						
Revenue	48.3	48.9	49.7	50.0	50.3	49.4
Expenditure	50.8	51.1	50.9	52.7	51.9	51.2
Balance (EDP-definition)	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8
Structural Balance 1/	-2.5	-1.7	-1.0	-0.3	-0.2	-1.0
Gross debt (end of period)	82.1	81.6	80.8	84.2	86.2	85.4
Balance of payments						
Current account (percent of GDP)	1.6	1.5	2.0	1.9	2.6	2.6

Sources: Austrian authorities; and IMF staff estimates and projections.

1/ The structural balance excludes the following one-offs (as percent of GDP): (a) capital transfers to banks: 0.2 in 2011; 0.5 in 2012; 0.5 in 2013; 1.6 in 2014; 0.6 in 2015; 0.2 in 2016; (b) flood related expenditure: 0.1 in 2013; (c) revenues from the sale of mobile telecommunication licenses: 0.6 in 2013; (d) tax revenues from treaties with Switzerland and Luxembourg: 0.1 in 2012; 0.2 in 2013; 0.1 in 2014; (e) revenue from the adjustment in EU contributions: 0.1 in 2014.

Table 2. Medium-Term Macroeconomic Framework, 2011–21

(in percent of GDP unless indicated otherwise)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections						
National accounts											
GDP (growth in percent)	2.8	0.8	0.3	0.4	0.7	1.4	1.4	1.3	1.1	1.1	1.1
Total domestic demand	2.9	0.3	-0.4	-0.2	0.5	1.1	1.2	1.1	1.0	1.0	1.0
Consumption	0.9	0.5	0.2	0.3	0.5	1.1	1.2	1.0	0.9	0.9	1.0
of which: Private consumption	1.3	0.6	0.1	0.0	0.4	1.2	1.2	1.1	1.0	1.0	1.0
Gross fixed capital formation	6.7	1.3	-0.3	-0.2	-0.5	1.4	1.4	1.3	1.1	1.1	0.9
Exports of goods and nonfactor services	6.0	1.7	0.8	2.1	1.1	3.2	3.8	3.8	4.0	4.0	4.0
Imports of goods and nonfactor services	6.2	1.1	0.0	1.3	0.6	3.0	3.7	3.8	3.9	4.1	4.1
Growth contributions (percentage points)											
Final domestic demand	2.2	0.6	0.1	0.1	0.3	1.1	1.1	1.0	0.9	0.9	0.9
Net exports	0.1	0.3	0.4	0.5	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Inventories and statistical discrepancies	0.6	-0.2	-0.2	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Prices and unemployment											
CPI inflation (pa; annual percent change)	3.6	2.6	2.1	1.5	0.8	1.4	1.8	1.9	2.0	2.0	2.0
Unemployment rate (percent)	4.6	4.9	5.3	5.6	5.8	6.2	6.4	6.3	6.2	6.2	6.2
Current account balance	1.6	1.5	2.0	1.9	2.6	2.6	2.7	2.6	2.5	2.4	2.4
Goods and services balance	2.2	2.4	2.8	3.7	3.4	3.5	3.6	3.5	3.5	3.4	3.3
General government accounts											
Revenue	48.3	48.9	49.7	50.0	50.3	49.4	49.2	49.1	49.1	49.2	49.3
Expenditure	50.8	51.1	50.9	52.7	51.9	51.2	50.6	50.3	50.1	50.2	50.4
Balance	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8	-1.4	-1.3	-1.0	-1.0	-1.1
Gross debt	82.1	81.6	80.8	84.2	86.2	85.4	83.7	81.9	80.1	78.3	77.0
Structural balance 1/	-2.5	-1.7	-1.0	-0.3	-0.2	-1.0	-1.0	-1.1	-1.0	-1.0	-1.1
Memorandum items:											
Overall balance (EDP-definition)	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8	-1.4	-1.3	-1.0	-1.0	-1.1
Gross national saving	25.5	25.4	25.1	23.5	24.8	24.9	24.9	24.9	24.9	24.7	24.7
Gross domestic investment	24.2	24.0	23.3	22.8	22.3	22.3	22.2	22.3	22.3	22.3	22.3
Real effective exchange rate (percentage change)	1.8	-1.6	2.2	1.5	...	...	...	...	...	...	...
International investment position	-1.8	-3.2	0.7	2.0	4.8	7.3	9.7	12.0	14.2	16.4	18.8
Potential output (growth in percent)	0.8	1.1	1.0	1.1	0.6	0.8	0.9	0.9	1.1	1.1	1.1
Output gap (in percent of potential output)	0.2	-0.1	-0.8	-1.6	-1.4	-0.9	-0.4	0.0	0.0	0.0	0.0
GDP (current prices, in billion euro)	308.6	317.1	322.9	329.3	337.2	346.9	357.6	368.2	378.9	389.8	401.0

Sources: Austrian authorities; and IMF staff estimates and projections.

1/ The structural balance excludes the following one-offs (as percent of GDP): (a) capital transfers to banks: 0.2 in 2011; 0.5 in 2012; 0.5 in 2013; 1.6 in 2014; 0.6 in 2015; 0.2 in 2016; and 0.1 in the years 2017-19; (b) flood related expenditure: 0.1 in 2013; (c) revenues from the sale of mobile telecommunication licenses: 0.6 in 2013; (d) tax revenues from treaties with Switzerland and Luxembourg: 0.1 in 2012; 0.2 in 2013; 0.1 in 2014; (e) revenue from the adjustment in EU contributions: 0.1 in 2014.

Table 3. Balance of Payments, 2011–21

(In percent of GDP)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections						
Balance on current account	1.6	1.5	2.0	1.9	2.6	2.6	2.7	2.6	2.5	2.4	2.4
Balance on goods and services	2.2	2.4	2.8	3.7	3.4	3.5	3.6	3.5	3.5	3.4	3.3
Exports of goods and services	53.4	53.5	53.4	53.3	53.0	53.4	54.1	54.8	55.8	56.8	57.8
Imports of goods and services	51.2	51.1	50.5	49.7	49.5	49.9	50.5	51.4	52.3	53.4	54.5
Balance on goods	-1.2	-1.0	-0.3	0.5	0.0	0.1	0.2	0.2	0.2	0.0	-0.2
Exports of goods	39.6	39.3	38.3	37.9	37.2	37.3	37.6	38.0	38.5	39.0	39.6
Imports of goods	40.8	40.3	38.6	37.5	37.2	37.2	37.4	37.8	38.3	39.0	39.8
Balance on services	3.4	3.4	3.2	3.2	3.4	3.4	3.4	3.3	3.2	3.3	3.4
Exports of services	13.8	14.2	15.1	15.4	15.7	16.1	16.5	16.8	17.3	17.8	18.2
Imports of services	10.4	10.8	11.9	12.2	12.3	12.7	13.1	13.6	14.1	14.5	14.8
Income, net	-0.7	-0.9	-0.9	-1.7	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Balance on capital account	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Balance on financial account	1.4	1.6	3.4	1.1	2.5	2.5	2.6	2.6	2.6	2.7	3.0
Direct Investment, net	3.5	3.2	2.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Portfolio investment, net	-5.2	-1.8	-0.6	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Financial derivatives, net	-0.2	-0.3	-1.2	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Other investment, net	3.1	0.3	2.6	-2.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.3
Reserve assets	0.2	0.3	0.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.1	0.2	1.6	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Austrian National Bank; WIFO; and IMF staff projections.

Table 4. General Government Operations, 2011–21

(In percent of GDP, unless indicated otherwise)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections						
Revenue	48.3	48.9	49.7	50.0	50.3	49.4	49.2	49.1	49.1	49.2	49.3
Taxes	26.9	27.4	27.7	28.1	28.6	27.6	27.8	27.9	28.0	28.1	28.2
Indirect taxes	14.3	14.5	14.4	14.4	14.5	14.6	14.7	14.7	14.7	14.7	14.7
o/w VAT	7.6	7.7	7.7	7.8	7.8	7.9	8.1	8.1	8.1	8.1	8.1
Excises	3.4	3.4	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Direct taxes	12.6	12.9	13.3	13.7	14.1	13.1	13.1	13.2	13.3	13.4	13.5
o/w Personal income tax	9.7	10.0	10.2	10.6	10.9	9.9	10.0	10.1	10.2	10.3	10.4
Corporate income tax	2.1	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Property taxes	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Social contributions	14.9	14.9	15.2	15.4	15.5	15.5	15.3	15.1	15.1	15.1	15.1
Other current revenue	6.5	6.6	6.7	6.5	6.3	6.3	6.1	6.0	6.0	6.0	6.0
Expense	47.8	48.2	48.6	49.8	49.0	48.3	47.7	47.6	47.3	47.4	47.6
Compensation of employees	10.7	10.7	10.6	10.6	10.6	10.5	10.4	10.4	10.4	10.4	10.4
Goods and services	6.4	6.3	6.4	6.4	6.3	6.2	6.3	6.3	6.3	6.3	6.3
Interest	2.8	2.7	2.6	2.5	2.4	2.2	2.0	1.9	1.9	1.9	2.1
Subsidies	1.5	1.5	1.4	1.4	1.5	1.4	1.3	1.3	1.3	1.3	1.3
Social benefits	22.3	22.6	23.0	23.3	23.4	23.6	23.7	23.8	23.8	23.8	23.8
Other current transfers	2.5	2.6	2.8	2.8	2.9	2.9	2.7	2.6	2.5	2.5	2.5
Capital transfers	1.1	1.4	1.3	2.4	1.4	1.0	0.8	0.9	0.8	0.8	0.8
Other expense	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Gross operating balance	0.4	0.7	1.1	0.2	1.4	1.1	1.5	1.5	1.7	1.8	1.7
Acquisition of non-financial assets	3.0	2.9	2.4	2.9	3.0	2.9	2.8	2.8	2.8	2.8	2.8
o/w Gross fixed capital formation	3.0	2.9	3.0	3.0	3.0	2.9	2.8	2.8	2.8	2.8	2.8
Net acquisition non-fin. non-prod. assets	0.0	0.0	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / Net borrowing	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8	-1.4	-1.3	-1.0	-1.0	-1.1
Net acquisition of financial assets	0.6	-0.5	-0.2	-0.3	...	...	...	...	...	...	...
Net incurrence of liabilities	3.4	1.9	1.0	2.3	...	...	...	...	...	...	...
Statistical Discrepancy	0.3	0.2	0.0	0.0	...	...	...	...	...	...	...
Memorandum item:											
Overall balance (EDP-definition)	-2.6	-2.2	-1.3	-2.7	-1.6	-1.8	-1.4	-1.3	-1.0	-1.0	-1.1
Primary balance	0.2	0.6	1.3	-0.2	0.8	0.5	0.6	0.6	0.8	0.9	1.1
Structural balance 1/	-2.5	-1.7	-1.0	-0.3	-0.2	-1.0	-1.0	-1.1	-1.0	-1.0	-1.1
Change in structural balance	0.7	0.8	0.7	0.7	0.1	-0.9	0.0	-0.1	0.1	0.0	-0.1
Structural primary balance 1/	0.3	1.1	1.6	2.2	2.2	1.2	1.0	0.8	0.9	1.0	1.1
Public debt	82.1	81.6	80.8	84.2	86.2	85.4	83.7	81.9	80.1	78.3	77.0
Net public debt		49.5	49.2	47.7	47.8	47.4	45.9	44.5	42.9	41.4	40.4

Sources: Authorities, Eurostat, and IMF staff projections.

1/ The structural balance excludes the following one-offs (as percent of GDP): (a) capital transfers to banks: 0.2 in 2011; 0.5 in 2012; 0.5 in 2013; 1.6 in 2014; 0.6 in 2015; 0.2 in 2016; and 0.1 in the years 2017-19; (b) flood related expenditure: 0.1 in 2013; (c) revenues from the sale of mobile telecommunication licenses: 0.6 in 2013; (d) tax revenues from treaties with Switzerland and Luxembourg: 0.1 in 2012; 0.2 in 2013; 0.1 in 2014; (e) revenue from the adjustment in EU contributions: 0.1 in 2014.

Table 5. General Government Balance Sheet, 2007–14

(In percent of GDP, unless indicated otherwise)

	2007	2008	2009	2010	2011	2012	2013	2014
Net worth	...	...	...	...	...	...	...	...
Nonfinancial assets	...	...	...	...	...	...	...	...
Net financial worth	-39.6	-43.7	-46.5	-49.1	-51.0	-58.6	-58.1	-61.6
Financial assets	35.1	36.1	42.3	44.7	43.7	49.8	47.4	52.5
Currency & deposits	4.4	7.5	5.4	5.9	6.9	6.1	6.2	8.2
Securities other than shares	1.0	1.3	5.4	4.9	4.3	3.7	2.9	2.6
Loans	10.3	10.2	10.7	10.9	10.6	11.0	11.0	13.7
Shares and other equity	15.6	14.0	17.2	18.9	18.1	17.7	15.8	16.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.9	0.2	0.5	0.5	0.4	0.5	0.2	0.3
Other accounts receivable	2.8	2.9	3.1	3.5	3.3	10.9	11.3	11.8
Liabilities 1/	74.7	79.9	88.8	93.8	94.7	108.4	105.5	114.1
Securities other than shares	54.4	60.5	68.2	72.7	73.3	78.2	75.2	82.2
Loans	11.5	10.5	11.7	12.5	13.3	13.3	13.2	14.7
Shares and other equity	4.9	4.7	4.9	4.8	4.6	4.5	4.4	4.3
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	1.0	1.2	1.2	0.9	0.8	0.5	0.4	0.2
Other accounts payable	2.8	3.1	2.7	2.8	2.8	12.0	12.3	12.6

Sources: Statistical Office of Austria and Eurostat.

1/ At market value

Table 6. Financial Soundness Indicators, 2010–15

(Percent)

	2010	2011	2012	2013	2014	2015Q3
Capital adequacy						
Regulatory capital to risk-weighted assets 1/	15.4	15.8	17.0	18.0	16.3	16.4
Regulatory Tier I capital to risk-weighted assets 1/	11.7	12.0	12.9	13.7	12.3	12.6
Capital to assets (percent) 2/	7.5	7.2	7.8	8.0	6.8	7.0
Large exposures to capital 2/	64.8	62.9	59.1	52.6	70.5	63.4
Nonperforming loans net of loan-loss provisions to capital 2/ 4/	8.2	8.0	6.9	5.8	13.8	14.3
Asset quality						
Nonperforming loans to total gross loans 2/ 4/	2.8	2.7	2.8	2.9	3.5	3.5
Sectoral distribution of loans to total loans 3/						
Residents	70.0	70.0	70.5	70.2	70.0	70.5
Deposit-takers	25.2	25.4	23.6	22.6	20.2	19.3
Central bank	1.4	2.0	2.6	1.7	1.6	2.1
Other financial corporations	3.2	2.9	2.8	2.7	3.0	2.9
General government	3.8	4.0	4.0	3.9	4.3	4.4
Nonfinancial corporations	18.4	18.1	18.9	19.8	20.0	20.2
Other domestic sectors	18.1	17.7	18.6	19.6	20.8	21.6
Nonresidents	30.0	30.0	29.5	29.8	30.0	29.5
Geographical distribution of loans to total loans 2,3/						
Domestic economy	70.0	70.0	70.5	70.2	70.0	70.5
Advanced economies, excluding China	13.7	14.5	14.6	14.6	16.4	15.9
Emerging market and developing countries, including China	16.3	15.6	14.9	15.2	13.7	13.6
Africa	0.1	0.1	0.1	0.1	0.1	0.1
of which: Sub-Sahara Africa	0.1	0.1	0.1	0.1	0.1	0.1
Central and Eastern Europe	13.2	12.6	12.2	12.3	10.7	10.8
Commonwealth of Independent States and Mongolia	2.1	2.0	1.9	2.1	2.0	1.7
Developing Asia, including China	0.4	0.4	0.5	0.5	0.5	0.5
Middle East	0.4	0.3	0.1	0.1	0.1	0.2
Western Hemisphere	0.1	0.1	0.1	0.1	0.2	0.2
Earnings and profitability 1/						
Return on assets	0.5	0.1	0.3	0.1	-0.2	0.4
Return on equity	7.9	1.4	5.5	1.2	-3.2	6.9
Net interest income to gross income	67.4	63.3	59.3	65.7	58.7	59.5
Noninterest expenses as a percentage of gross income	83.0	87.4	84.4	96.5	77.3	66.4
Liquidity 2/						
Liquid assets to total assets	23.5	25.4	24.8	24.5	22.8	24.9
Liquid assets to short-term liabilities	68.0	71.6	73.4	68.9	67.0	71.3
Net open position in foreign exchange to capital	0.3	0.1	0.4	0.2	0.7	0.2
Other FSIs 2/						
Trading income as a percentage of gross income	3.4	1.7	3.3	2.6	1.8	1.9
Personnel expenses as a percentage of noninterest expenses	50.2	51.2	51.2	50.7	53.1	47.6
Spread between reference lending and deposit rates (basis points)	197.0	208.0	180.0	181.0	196.0	191.0
Foreign currency-denominated loans to total loans	22.1	21.4	19.7	18.8	18.8	17.7
Foreign currency-denominated liabilities to total liabilities	11.3	12.0	10.6	10.0	9.9	10.5

Sources: IMF FSI.

1/ Domestically controlled, cross-border and cross sector consolidation basis.

2/ Domestic consolidation basis.

3/ Total loans include loans to financial institutions.

4/ Starting in 2014, NPLs are reported on a borrower rather than single loan basis, which results in a break in the series.

Table 7. Authorities' Response to Past IMF Policy Recommendations	
IMF 2014 Article IV Recommendations	**Authorities' Response**
Fiscal policy I Implement more decisive expenditure and fiscal federalism reforms in the following areas in order to create room for faster debt reduction and tax cuts: (i) increase statutory retirement ages; (ii) close the gap between statutory and effective retirement age; (iii) cut subsidies and target them better; (iv) make health care reforms more ambitious; (v) introduce meaningful tax autonomy at the subnational level.	The authorities continue to implement the health care and pension reforms designed in 2013–14. No additional reforms in these areas have been passed since the last Article IV consultation (September 2014).
Fiscal policy II Target a structural fiscal surplus of ½ percent of GDP by 2018.	The structural fiscal target remains a deficit of ½ percent of GDP.
Fiscal policy III Reduce labor taxation to support employment and potential growth.	A sizable personal income tax cut is effective in 2016. Modest cuts in social security contributions are envisaged for 2017–18.
Financial sector policy I Further strengthen the capital position of internationally active banks.	The authorities introduced a systemic risk buffer of up to 2 percentage points of the banks' capital-risk weighted asset ratio, to be phased in over 2016–19.
Financial sector policy II Implement the European Banking Union framework and strengthen the macroprudential framework.	While the implementation of the banking union framework has progressed, the macroprudential toolkit has yet to be expanded.
Financial sector policy III Progress further with the restructuring of fully or partly nationalized banks but avoid the retrospective effective voiding of the state of Carinthia's guarantees for the debt of Hypo Alpe Adria.	Volksbanken sector: the main institution has been transformed into a wind-down unit and the sector is being streamlined. Kommunalkredit/KA Finanz: Part of Kommunalkredit has been sold and the rest transferred to KA Finanz, which still maintains its banking license. Hypo Alpe Adria: A wind-down unit ("HETA") has been established and the SEE network has been sold. The authorities are seeking an agreement with two thirds of the HETA creditors on a voluntary debt buyback at a discount, with retroactive collective action clauses imposing this agreement on all creditors. This would still imply a retrospective voidance of part of the guarantees by the state of Carinthia.

Annex I. Macroprudential Policies

The Austrian authorities have been implementing the new EU-wide macro-prudential framework. Drawing from the lessons from the global financial crisis, their earlier focus was on strengthening the business model of CESEE-active banks and reducing foreign currency loans.

Institutional Setup

An Austrian Financial Market Stability Board (FMSB) was created in 2014 and has a consultative role. The Austrian authorities regard financial stability as a shared responsibility of the Financial Market Authority (FMA), the Austrian National Bank (OeNB), and the Federal Ministry of Finance (MoF). The FMSB serves as forum for exchanging views and encouraging cooperation among these actors. It can issue risk warnings and recommendations and eventually make them public. It also reports annually to parliament.

The Austrian Financial Market Authority remains the implementing authority for macro-prudential measures. The FMSB recommendations need to be legally implemented by the FMA under a "comply or explain" rule.

The Austrian National Bank is in charge of operational bank supervision in the Austrian supervisory setup and provides macro-prudential analysis for the FMSB such as the identification of systemic risks and the evaluation of the effectiveness of implemented measures. The OeNB can make proposals for risk warnings and recommendations to the FMSB.

The Ministry of Finance has two representatives at the FMSB and chairs it. In addition, two other representatives come from the Fiscal Council. OeNB and FMA have one representative each. The Board decisions are made with simple majority, with the chair deciding in case of a tied vote. Reports have to be agreed on unanimously.

Currently Available Tools

So far, the available macro-prudential toolkit remains limited to instruments as foreseen in the EU Capital Requirement Directive (CRDIV). The toolkit includes various capital buffers, such as the counter-cyclical and systemic risk buffer, and the possibility to change risk weights on exposures secured by mortgages on immovable property.

Additional sector-specific macro-prudential tools would be beneficial. In particular, caps on the loan-to-value (LTV) ratios, debt-to-income (DTI), or debt service-to-income (DSTI) ratios specifically targeted to the housing market and possibly regionally differentiated could help moderate periodically occurring strong house price hikes. Legally, this would be possible on the basis of national legislation as in several other EU countries.

Forthcoming Activation of the Systemic Risk Buffer

The FMSB issued a recommendation to the FMA to activate the systemic risk buffer in September 2015. The measure targets structural systemic risks that arise from the size of banks and the banking sector as a whole, banks' ownership structure, interconnectedness, and the concentrated foreign risk exposure to CESEE. The buffer, to be phased in over 2016–19, applies to twelve large and medium-size banks, consists of CET-1 capital, and ranges from 1 to 2 percent of risk-weighted assets. The three major CESEE-active banks will face the maximum requirement of 2 percent of RWA additional capital.

2012 "Sustainability Package"

In March 2012, the Austrian supervisory authorities issued macro-prudential guidance to strengthen the resilience of their large internationally active banks ("sustainability package"). The objective was to strengthen the sustainability of these banks' business models and foreign operations in particular in CESEE. The guidance applies to the three large CESEE-active Austria-based banks, and its most important component relates to the promotion of a more stable local funding base for their foreign operations. As another component of the package, Basel III CET-1 capital rules were already introduced as of 2013 without transitional provisions.[1] Furthermore, the surcharge for large internationally active banks that was also envisaged in the "sustainability package" is now being implemented via the introduction of a systemic risk buffer over 2016–19 (as explained above).

The key component of the "sustainability package" is the promotion of a more stable local funding base for subsidiaries abroad. Specifically, supervisors have established a benchmark "Loan-to-Local-Stable-Funding-Ratio (LLSFR)".[2] Subsidiaries with a stock-LLSFR higher than 110 percent have been encouraged to achieve a sustainable flow-LLSFR to bring their stock-LLSFR to below 110 percent over time. Exceptions apply if there is agreement between home and host supervisors that (i) there are no impediments to liquidity transfers between parent bank and subsidiaries, including in stress situations; and (ii) a burden sharing agreement is in place.

The guidance has largely been effective. According to the authorities, only 4 out of 35 subsidiaries still have a stock LLSFR higher than 110 percent, and three of them have a flow LLSFR that is correcting the situation. The adjustment in most subsidiaries was facilitated by steady deposit growth in host countries.

Initiatives to Reduce Foreign Currency Lending

The authorities have taken various initiatives to rein in the extension and reduce the stock of foreign-currency loans domestically and in host countries of their banks' subsidiaries. Domestically, the extension of new foreign-currency loans to households has become increasingly restrictive since 2008. Only naturally hedged or high-wealth households remain eligible. As for the still existing stock of Swiss franc loans to households, banks are encouraged to offer conversion options to their customers. As regards CESEE, Austrian banks committed themselves to refrain from the most risky forms of foreign currency lending in 2010 in line with guiding principles issued by the authorities. Respective ESRB recommendations were implemented in 2013.

---

[1] Except for private and state participation capital under the Austrian bank support package, which had not yet been repaid at that time.

[2] The exact definition of the LLSFR is loans to nonbanks divided by the sum of deposits from non-banks, supranational funding, capital from third parties, and outstanding debt securities with an original maturity of at least one year issued by the subsidiary to investors outside the consolidation perimeter of the group.

Annex II. Public Debt Sustainability Analysis (DSA)

Debt is sustainable within the DSA medium-term projection horizon, but ageing cost pressures are looming in the longer term. Under the baseline, debt will gradually fall from around 86 percent of GDP at end-2015 to 77 percent of GDP by end-2021. A relatively high share of public debt held by non-residents could increase volatility in times of adverse external developments. Lower growth and a contingent liability shock could shift up debt significantly but would still leave it on a downward trajectory. However, in the longer term (starting in the mid-2020s) and barring additional policy measures, ageing cost pressures and higher interest rates would reverse the debt path as explained in the staff report.

Baseline

With growth still subpar, fiscal consolidation has slowed. Although Austria's structural budget deficit is projected to have remained below ½ percent of GDP in 2015, the debt-to-GDP ratio would peak slightly above 86 percent of GDP in 2015, propped up by the creation of a defeasance structure for the former Hypo Alpe Adria Bank and the addition of further assets to the "bad bank" KA Finanz, both within the general government. Under the baseline reflecting staff's assessment of the authorities' current policy plans, the structural fiscal balance would widen to about 1 percent of GDP in 2016–21.[1] Debt would then gradually fall to about 77 percent of GDP by 2021. Gross financing needs are moderate in the period 2016–21.

While debt remains sustainable in the medium term, the standard DSA heat map indicates several vulnerabilities. The main ones are associated with the already elevated debt level (above 85 percent of GDP, which is responsible for the red-colored top cells of the heat map) as well as the potential impact of shocks to growth and contingent liabilities on the debt dynamics. The high share of public debt held by non-residents is a potential vulnerability, although this should not be a source of concern as long as Austria is perceived as a safe-haven euro area core country. However, it could lead to higher volatility in spreads, especially once the ECB's QE is over, depending on interest rate dynamics outside Austria and residual risks from commercial banks' CESEE exposure.

[1] The structural balance excludes various one-offs, in particular bank restructuring cost (see Table 1 of the main document). The cyclically-adjusted primary balance confirms that the baseline scenario is realistic (see panel "Austria Public DSA – Realism of Baseline Assumptions" (continued), bottom LHS chart).

Stress Tests

Standardized macro-fiscal stress tests reveal lower growth and the realization of contingent liabilities as main factors that could shift the debt-to-GDP ratio upwards, even though debt remains on a downward trajectory.

The standardized low-growth scenario assumes that growth is reduced by one standard deviation of the historical growth outturn and amounts to a negative ¾ of a percent in 2017–18.[2] In this case, the debt-to-GDP ratio would increase by 6 percentage points to a peak of 91 percentage points in 2018 and follow a downward trend to 87 percentage points in 2021. A purely illustrative contingent liability shock of 10 percentage points of GDP, about 40 percent of the overall government-guaranteed debt, would prop up the debt-to-GDP to some 97 percent before a very gradual reduction to some 93 percent towards the end of the decade.

The other standardized macro shocks will not lead to significant deviations from the baseline debt path. These shocks are the primary balance shock, the real exchange rate shock, and the real interest rate shock.[3] A "combined shock" for all variables is driven by assumed lower growth and leads to a similar debt path as in the low-growth scenario.

[2] The scenario also assumes that lower growth induces a reduction in the inflation rate by some ½ percentage points, while interest rates are assumed to fall by 1/3 percentage point.

[3] Compared to baseline, the primary balance shock assumes a deterioration of the balance in 2017 and 2018 by half of the 10-year historical standard deviation; the real exchange rate shock assumes a depreciation of 13.1 percent in 2017 (largest historical depreciation over the last ten years); and the real interest rate shock assumes a spread increase of 200 bps.

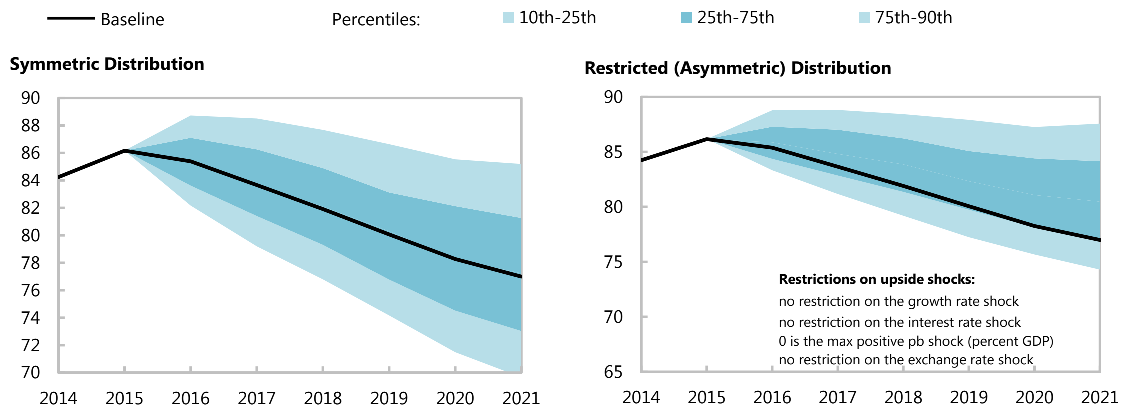
Austria Public DSA—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

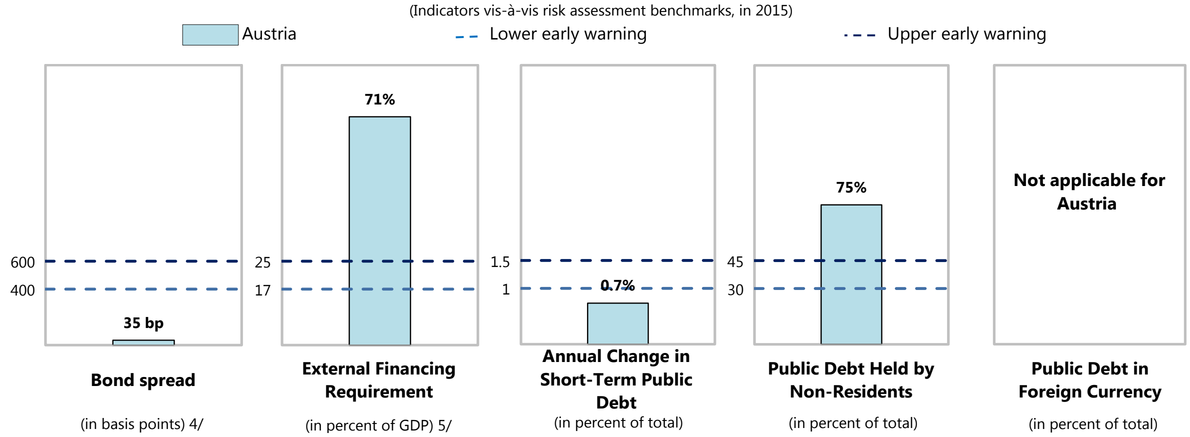
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

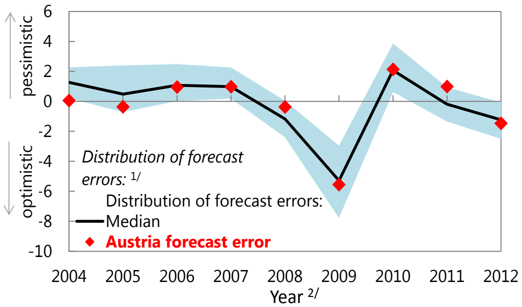
4/ Long-term bond spread over German bonds, an average over the last 3 months, 06-Oct-15 through 04-Jan-16.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

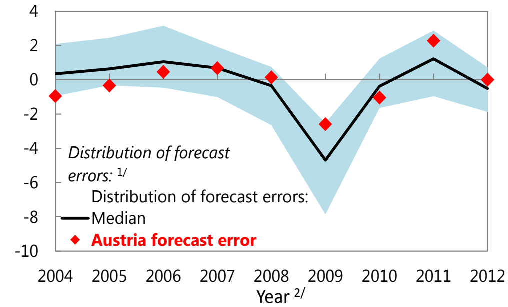
Austria Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

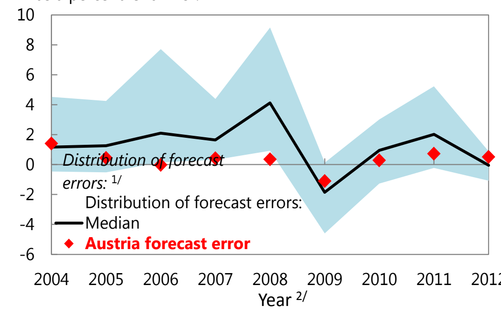
Real GDP Growth
(in percent, actual-projection)
Austria median forecast error, 2004-2012: 0.06
Has a percentile rank of: 45%



Primary Balance
(in percent of GDP, actual-projection)
Austria median forecast error, 2004-2012: 0.00
Has a percentile rank of: 52%

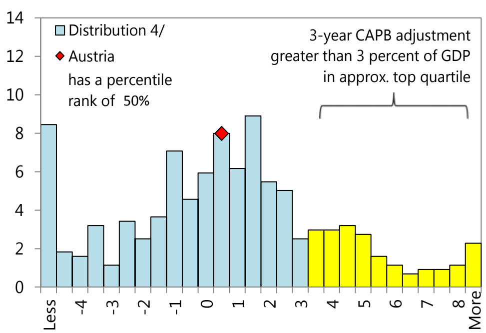


Inflation (Deflator)
(in percent, actual-projection)
Austria median forecast error, 2004-2012: 0.42
Has a percentile rank of: 33%

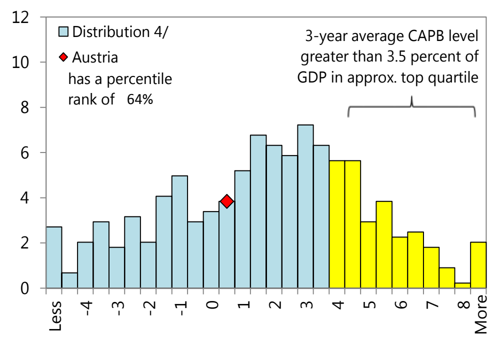


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

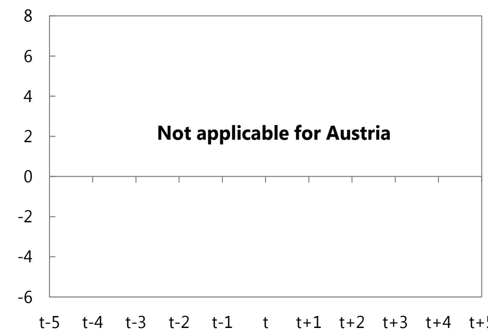


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Austria, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Austria Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

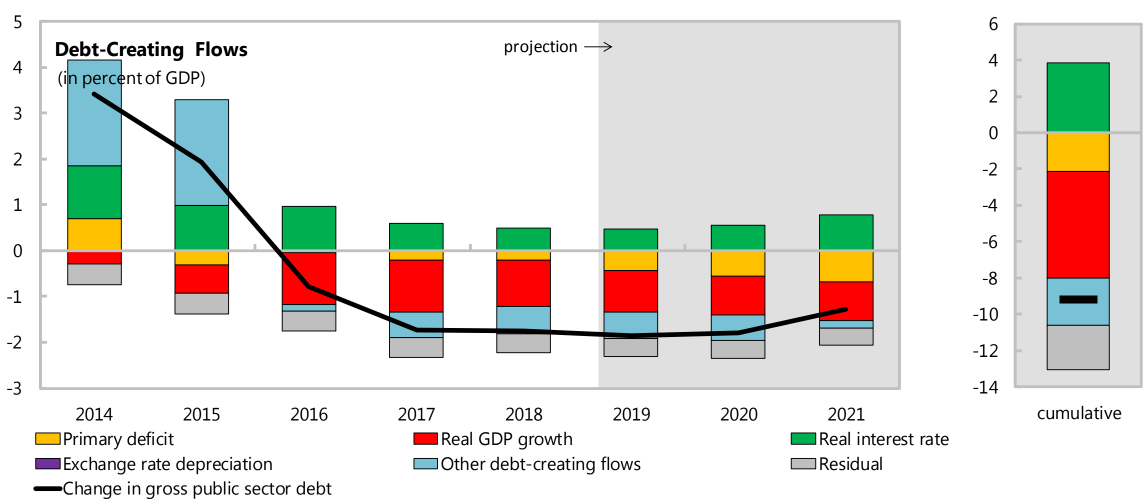
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	75.0	84.2	86.2	85.4	83.7	81.9	80.1	78.3	77.0
Public gross financing needs	...	14.2	9.7	9.7	8.8	9.6	9.8	11.2	10.1
Real GDP growth (in percent)	1.4	0.4	0.7	1.4	1.4	1.3	1.1	1.1	1.1
Inflation (GDP deflator, in percent)	1.9	1.6	1.6	1.5	1.7	1.7	1.7	1.8	1.7
Nominal GDP growth (in percent)	3.3	2.0	2.4	2.9	3.1	3.0	2.9	2.9	2.9
Effective interest rate (in percent) [4/]	4.3	3.1	2.9	2.7	2.4	2.3	2.4	2.5	2.8

As of January 04, 2016		
Sovereign Spreads		
EMBIG (bp) 3/	28	
5Y CDS (bp)	22	
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AA+	AA+
Fitch	AA+	AA+

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.8	3.4	1.9	-0.8	-1.7	-1.7	-1.8	-1.8	-1.3	-9.2	
Identified debt-creating flows	2.4	3.9	2.4	-0.3	-1.3	-1.3	-1.4	-1.4	-0.9	-6.7	
Primary deficit	0.4	0.7	-0.3	0.0	-0.2	-0.2	-0.4	-0.6	-0.7	-2.1	-0.2
Primary (noninterest) revenue and gran	47.7	49.6	49.9	49.0	48.8	48.7	48.7	48.8	48.9	292.8	
Primary (noninterest) expenditure	48.1	50.3	49.6	48.9	48.6	48.5	48.2	48.2	48.2	290.7	
Automatic debt dynamics [5/]	0.8	0.9	0.4	-0.2	-0.6	-0.5	-0.4	-0.3	-0.1	-2.0	
Interest rate/growth differential [6/]	0.7	0.9	0.4	-0.2	-0.6	-0.5	-0.4	-0.3	-0.1	-2.0	
Of which: real interest rate	1.7	1.2	1.0	1.0	0.6	0.5	0.5	0.6	0.8	3.9	
Of which: real GDP growth	-1.0	-0.3	-0.6	-1.1	-1.1	-1.0	-0.9	-0.8	-0.9	-5.9	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.2	2.3	2.3	-0.1	-0.6	-0.6	-0.6	-0.6	-0.1	-2.6	
SFA (incl. bank defeasance structure)	1.2	2.3	2.3	-0.1	-0.6	-0.6	-0.6	-0.6	-0.1	-2.6	
Residual, including asset changes [8/]	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-2.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

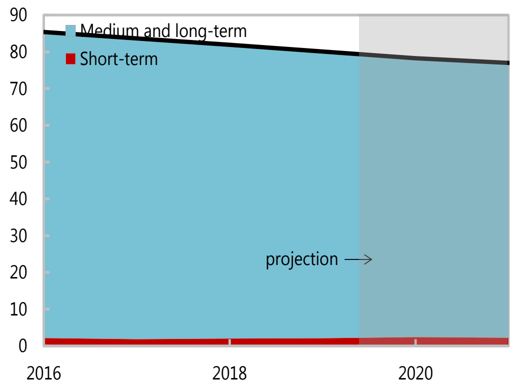
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Austria Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

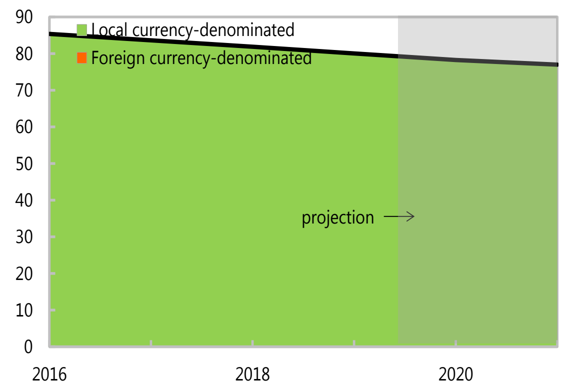
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

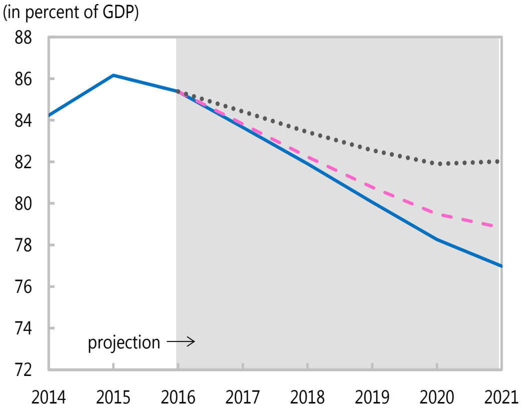


Alternative Scenarios

Baseline · Historical · Constant Primary Balance

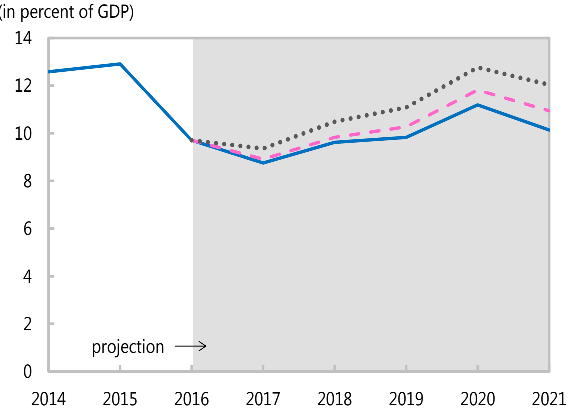
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

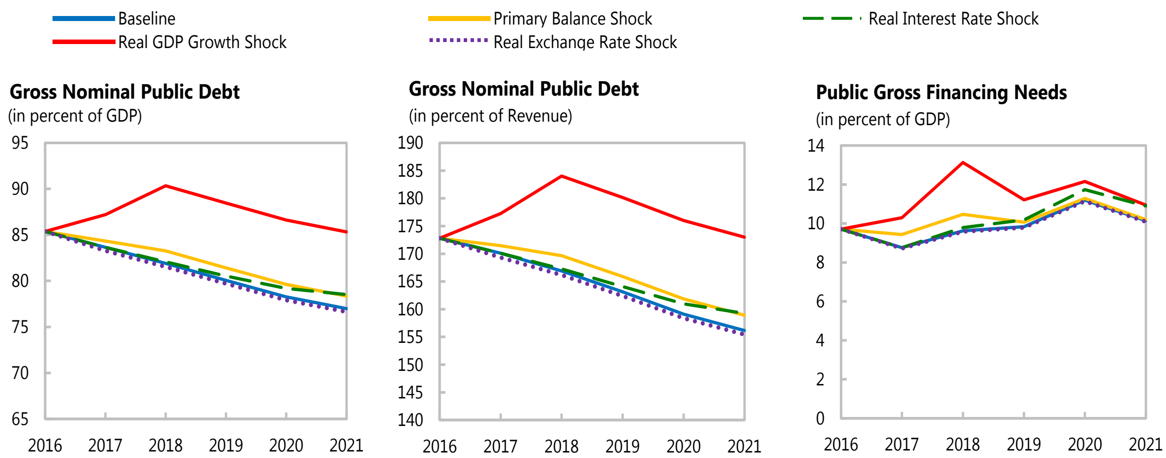
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.4	1.4	1.3	1.1	1.1	1.1
Inflation	1.5	1.7	1.7	1.7	1.8	1.7
Primary Balance	0.0	0.2	0.2	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.3	2.4	2.5	2.8
Constant Primary Balance Scenario						
Real GDP growth	1.4	1.4	1.3	1.1	1.1	1.1
Inflation	1.5	1.7	1.7	1.7	1.8	1.7
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	2.7	2.4	2.3	2.3	2.5	2.8

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.4	1.2	1.2	1.2	1.2	1.2
Inflation	1.5	1.7	1.7	1.7	1.8	1.7
Primary Balance	0.0	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	2.7	2.4	2.5	2.6	2.9	3.3

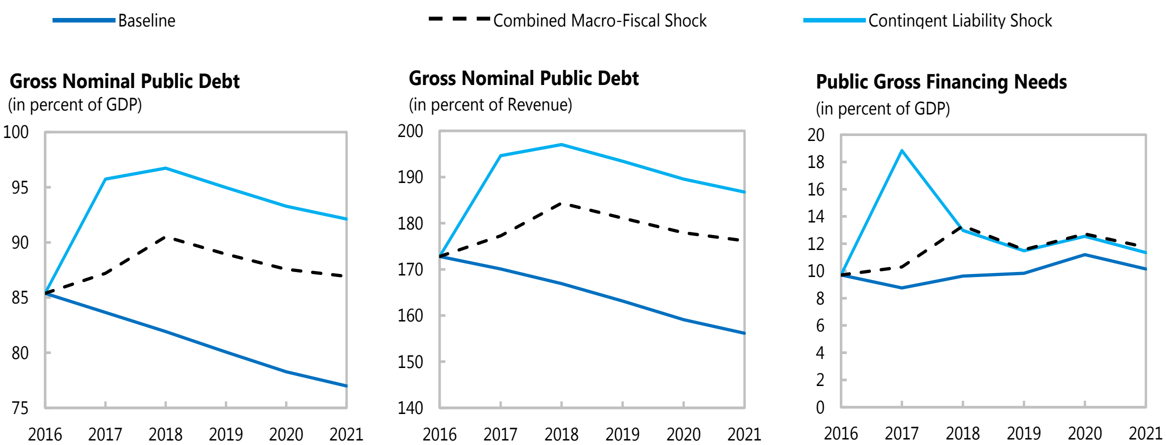
Source: IMF staff.

Austria Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	1.4	1.4	1.3	1.1	1.1	1.1
Inflation	1.5	1.7	1.7	1.7	1.8	1.7
Primary balance	0.0	-0.5	-0.5	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.3	2.4	2.5	2.8
Real Interest Rate Shock						
Real GDP growth	1.4	1.4	1.3	1.1	1.1	1.1
Inflation	1.5	1.7	1.7	1.7	1.8	1.7
Primary balance	0.0	0.2	0.2	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.5	2.7	3.1	3.6
Combined Shock						
Real GDP growth	1.4	-0.7	-0.9	1.1	1.1	1.1
Inflation	1.5	1.1	1.2	1.7	1.8	1.7
Primary balance	0.0	-1.1	-2.4	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.5	2.8	3.1	3.6

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	1.4	-0.7	-0.9	1.1	1.1	1.1
Inflation	1.5	1.1	1.2	1.7	1.8	1.7
Primary balance	0.0	-1.1	-2.4	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.4	2.4	2.5	2.8
Real Exchange Rate Shock						
Real GDP growth	1.4	1.4	1.3	1.1	1.1	1.1
Inflation	1.5	2.1	1.7	1.7	1.8	1.7
Primary balance	0.0	0.2	0.2	0.4	0.6	0.7
Effective interest rate	2.7	2.4	2.3	2.4	2.5	2.8
Contingent Liability Shock						
Real GDP growth	1.4	-0.7	-0.9	1.1	1.1	1.1
Inflation	1.5	1.1	1.2	1.7	1.8	1.7
Primary balance	0.0	-9.6	0.2	0.4	0.6	0.7
Effective interest rate	2.7	2.5	2.7	2.6	2.7	3.0

Source: IMF staff.

INTERNATIONAL MONETARY FUND

AUSTRIA

February 10, 2016

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of November 30, 2015)

Mission: Consultation discussions were held in Vienna from December 3-14, 2015. The authorities released the mission's concluding statement, which is available at: http://www.imf.org/external/np/ms/2015/121415.htm

Staff team: Mr. Gueorguiev (head), Ms. Batini, and Messrs. Steinlein and Stepanyan (all EUR). Mr. Just (OED) participated in the discussions.

Country interlocutors: Minister of Finance Schelling, OeNB Governor Nowotny, Labor and Social Affairs Minister Hundstorfer, Minister of Arts, Culture, Constitution, and Media Ostermayer, other senior officials, parliamentarians, and representatives of the social partners, the banking sector, and think tanks.

Fund relations: Austria is on a 12-month consultation cycle. The last consultations were held June 20-July 1, 2014, and the staff report is available at: http://www.imf.org/external/pubs/cat/longres.aspx?sk=41904.0

Membership Status: Joined: August 27, 1948; Article VIII, as of August 1, 1962

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	2,113.90	100.00
Fund holdings of currency	1,865.11	88.23
Reserve position in Fund	248.79	11.77
Lending to the Fund:		
New Arrangements to Borrow	345.26	

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	1,736.31	100.00
Holdings	1,624.31	93.55

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund:

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	--	--	--	--	--
Charges/Interest	--	0.09	0.09	0.09	0.09
Total	--	0.09	0.09	0.09	0.09

Implementation of HIPC Initiative: Not Applicable

Exchange System:

As of January 1, 1999, the currency of Austria is the euro, which floats freely and independently against other currencies. Austria's exchange system is free of restrictions on the making of payments and transfers for current international transactions, with the exception of restrictions notified to the Fund in accordance with decision No.144-(52/51) resulting from UN Security Council Resolutions and EU Council Regulations.

STATISTICAL ISSUES

1. Macroeconomic statistics are adequate for surveillance. Austria subscribed to the Fund's Special Data Dissemination Standard (SDDS) in 1996, and its metadata are available on the Fund's electronic Dissemination Standards Bulletin Board. Austria is availing itself of the SDDS flexibility option on the timeliness of the industrial production index and the merchandise trade data. Austria is currently preparing for SDDS Plus adherence.

2. The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB. The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the IFS and IFS Supplement.

Austria: Table of Common Indicators
(as of December 31, 2015)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	12/31/15	12/31/15	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov. 2015	12/20/15	Monthly	Monthly	Monthly
Reserve/Base Money	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
Broad Money	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
Central Bank Balance Sheet	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
Interest Rates[2]	12/31/15	12/31/15	Daily	Daily	Daily
Consumer Price Index	Nov 2015	12/14/15	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	Nov. 2015	12/30/15	Monthly	Monthly	Monthly
External Current Account Balance	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly
GDP/GNP	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly
Gross External Debt[5]	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly
International Investment Position	2015:Q3	12/30/15	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments).
[5] Including currency and maturity composition.

Statement by the IMF Staff Representative on Austria
February 10, 2016

1. **This statement provides information that has become available since the Staff Report was circulated to the Executive Board on January 20, 2016**. The information does not alter the thrust of the staff appraisal.

2. **The authorities intend to restrict the number of asylum applications.** After receiving about 90,000 asylum seekers in 2015, the authorities intend to cap applications at 37,500 in 2016 and a cumulative 1.5 percent of the population (about 128,000) in 2016-19. They are in the process of ascertaining whether such limits are in line with Austria's constitution and EU laws. In addition, a draft law envisages that asylum cases will be reviewed after three years to determine whether the reason for granting asylum still exists, while providing incentives for the applicants to actively participate in integrating measures meanwhile. The new policy, if implemented, implies significantly less applicants for 2016 than envisaged in the staff report and Selected Issues paper, with smaller differences in future years. However, as the reduced number of pre-screened applicants should normally lead to a higher acceptance rate, the economic effects of migration may differ only moderately from the estimates in the staff report. Specifically, based on the acceptance rates for high-risk countries (Syria and Afghanistan) in 2015, staff estimates that under the new policy, cumulative fiscal costs would be lower by up to 1/3 and potential GDP growth estimates - by about 1/7 relative to the figures in the staff report and Selected Issues paper.

3. **The province of Carinthia has published an offer to buy back HETA debt covered by provincial guarantees.** The offer affects senior bonds of € 10.1 billion with a haircut of 25 percent and a much smaller amount of subordinated debt (€ 900 million) with a haircut of 70 percent. These debt instruments are covered by a guarantee of the province of Carinthia, which would become effectively void in the amount of the haircut. Carinthia would receive liquidity support from the federal level for making the buyback. Initial creditor reactions to the offer are negative. However, while insisting on full repayment, some creditors indicate willingness to negotiate and hint specifically at a possible prolongation of the repayment schedule. The deadline for creditor decisions is March 11, 2016.

4. **The regular update of the IMF's External Balance Assessment (EBA) confirms that Austria's external position is broadly in line with fundamentals and desirable policies.** The current account gap for 2015 has narrowed from 2 to 1.4 percentage points of GDP, still indicating a norm somewhat higher than the expected surplus, with the high health expenditure now explaining almost the whole gap. The estimated overvaluation gap in the REER (levels) remains at about 9 percent.

5. The flash GDP growth estimate for 2015 came at 0.9 percent, slightly above staff's projection of 0.7 percent.

Statement by Mr. Christian Just, Alternate Executive Director for Austria
February 10, 2016

The Austrian authorities welcome the consultations with the Fund staff and appreciate the insightful report, which is exemplary in clearly presenting the staff's position. The authorities broadly agree with the assessment of Austria's economic and financial situation and the recommendations on economic and financial policies.

The authorities concur that economic growth in Austria is set to pick up after a period of rather sluggish economic activity with an average growth rate of approximately 0.6 percent between 2012 and 2015. According to the European Commission's Winter 2016 forecast, the economy appears to have passed its cyclical trough in 2015 with the output gap expected to close by around 2019, so that, in the current cycle, the Austrian economy would have seen its trough later than almost all other economies in the EU. Despite this relatively long span of moderate growth in conjunction with fiscal consolidation, no major domestic imbalances have emerged. Credit growth and private consumption have remained low, investment activity cautious and public consumption conservative with the external sector contributing to a persistent increase in the positive international investment position.

The authorities also concur on the importance of a further strengthening of balance sheets and profitability in the financial sector, including the ability to cater for potential effects of asset revaluations of Austrian bank subsidiaries in CEEC, such that domestic banks continue providing funding for the real sector as demanded. Indeed it will be key for the Austrian economy to secure the long-term sustainability of public finances and safeguard a solid growth potential of the economy.

Macroeconomic outlook

Having passed the low of the business cycle in 2015, the Austrian economy is expected to enter a moderate recovery path, helped by the recent landmark tax reform and the impact of the refugee crisis. Like staff, the Austrian authorities do not see any sign of discernible lack of access of the real economy to bank finance. Due to the continued inflow of, in particular, foreign labour supply the unemployment rate will rise slightly despite relatively robust employment growth. The Austrian authorities agree that a swift integration of asylum seekers, once their status is cleared, into the labour market will be crucial for maximising their input to the economy. In addition, the Austrian authorities deem it important to further analyse and understand the underlying reason for the persistent positive inflation differential vis-à-vis the rest of its peers in the euro area, in particular with regard to the services sector, albeit so far this gap has not translated into a loss of external price competitiveness.

Productivity growth

Total factor productivity growth in Austria had been on a secular downward trend in the past and has flattened after the crisis. as is the case for most peer economies inside and outside the EU. Apart from (shared) uncertainties surrounding data on the real capital stock and total annual hours worked in the aftermath of the crisis, a number of policy actions may reverse the weaker than pre-crisis productivity growth in Austria. The IMF staff mentions enhanced IT penetration, improved access to risk financing for start-ups or an increase of efficiency in certain areas of the public sector. Indeed there is still some room to raise potential output via a further increase of the input of labour supply by improving the incentives to participate in the labour market as well as to work longer. The government has started an initiative to foster broadband connections and earmarked significant amounts to this end. Part-time work for the elderly, enhanced crowd-funding possibilities and some tax relief are other measures to this end.

Fiscal Policy

Despite a series of lower than forecast growth outcomes in a low growth environment in general, government revenues remained relatively stable and the structural balance has been improving continuously since 2011 according to IMF calculations. The Austrian authorities intend to act in line with the staff's recommendation to strike a balance between supporting activity and rebuilding buffers, in particular after the public debt level has shifted upwards following a series of bank rescue measures.

The authorities agree that public spending on health care and education provides room for efficiency improvements. However, they are more cautious about putting too much emphasis on a narrow set of studies due to their methodological limitations. The authorities acknowledge the high level of subsidies but caution about labeling them *per se* as inefficient since their objectives as well as the spill-overs they are intended to achieve will have to be first weighed against prospective revenue savings. Spending reviews are currently under consideration.

Financial Sector

Austrian banks have stepped up their efforts to address structural weaknesses in the "new normal". Several banks have announced, or already have started to implement, consolidation plans in order to improve the efficiency of their activities. These adjustments include a stronger focus on markets with a higher potential for generating sustainable returns and a reduction of risk-weighted assets to increase capital.

Overall, the profitability of Austrian banks has already improved considerably in the first half of 2015 compared to the previous year, supported by lower credit risk provisioning and reduced write-offs and impairments. However, the low interest rate and low growth environment will make the longer-term sustainability of this recovery more challenging.

Rising emerging market risks might also affect Austrian banks if growth slows down in core markets. This development could put a further drag on asset quality as well as on the profitability of Austrian banks. The Austrian supervisors therefore continuously advise banks to adequately provision for risks and have policies in place to deal with credit quality issues.

The Austrian authorities concur with the staff that the loss absorbing capacity of Austrian banks has to be further strengthened with the continuous build-up of additional capital. Banks have strengthened their capital positions in recent years through a combination of higher capital and reduced risk-weighted assets; micro- and macroprudential measures will also contribute to improving Austrian banks' capitalization. However, compared to their peers, larger Austrian banks still have a relatively low capitalization and therefore will need to build up capital further.

One building block in strengthening Austrian banks' capitalization will come from macroprudential oversight. In 2015, the Financial Market Stability Board (FMSB) decided to activate a systemic risk buffer (SRB) of up to 2 percent to address the specific combination of systemic risks in the Austrian banking sector. These risks arise from the relatively large size of the Austrian banking sector as compared to the domestic economy, its high exposure to emerging markets, its below-average capitalization in relation to its European peers and its high share of non-listed banks and leveraged owners. The SRB will therefore contribute to alleviating those risks.

Staff rightly points out that systemic risks arising from foreign currency lending to domestic borrowers have declined over the last years but are still significant. The outstanding volumes as well as the number of foreign currency (FX) borrowers have declined substantially. However, 75 percent of foreign currency loans are designed as repayment vehicle loans (i.e. bullet loans that are redeemed only at maturity by life insurance policies and/or other capital market products; until then, regular financial contributions are only made towards the repayment vehicle) and exhibit a non-negligible aggregate borrowers' funding gap. Consequently, the Austrian National Bank (OeNB) and Financial Market Authority have stepped up their efforts to encourage banks and debtors to timely engage in bilateral negotiations aimed at sustainable tailor-made solutions.

The Austrian authorities concur with the staff that the macroprudential toolkit needs expansion with respect to real estate-specific instruments. As real estate price increases have not been accompanied by excessive mortgage lending growth so far, the FMSB concluded, that there is no immediate reason to activate macroprudential instruments regarding real estate funding. However, the FMSB considers it necessary to extend its macroprudential toolkit with a view to aligning it with international best practice.