

INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Austria

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Executive Summary

Focus. The report is focused on the impact of the financial crisis on the Austrian economy and financial sector, the authorities' policy responses, and macro-financial linkages and spillovers.

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

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

Key policy issues. The two main challenges for the authorities looking forward are:

- *To ensure financial stability during a period of shocks to the financial sector.* Based on recent stress tests—which showed that systemic banks would not breach minimum capital requirements under shocks—the authorities do not see a need for further capital injections at this stage. They are, however, closely monitoring conditions in the financial sector. The staff report emphasizes that ratios well above regulatory minima are needed to support the markets' confidence in the banks. It recommends that the authorities use the tests as input for discussions with the banks about strengthening capital buffers, when needed. The banks' strategy of maintaining their presence in CESE will have positive spillovers for regional economic activity and stability, provided the risks are well-managed. This will require close collaboration between home and host authorities and adequate contingency planning. The authorities are committed to this.
- *To support the economy through responsible fiscal policy.* The approved stimulus, while supporting the economy in the short run, is neither targeted nor temporary, and may therefore become a threat to fiscal sustainability. The report recommends the development of a credible exit plan, aimed at structural fiscal consolidation over the medium term, to be prepared this year and implemented once the economy stabilizes. The focus should be on identifying expenditure saving measures. The authorities agreed with the need for consolidation, but warned against a premature exit from the stimulus.

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I. CONTEXT¹

1. **The Austrian economy performed well in past years.** This was the result of a combination of solid economic policies, structural reforms, wage moderation, and an early orientation towards rapidly growing Central, Eastern, and Southeastern Europe (CESE). Since the introduction of the euro, Austria has shown better economic outcomes than the euro area average in terms of growth and unemployment. Economic growth over the past five years has been almost $\frac{3}{4}$ of a percentage point higher than in the euro area.

Austria: Growth and Unemployment

	Average over	
	last 10 years	last 5 years
Real GDP Growth		
Austria	2.4	2.8
Euro area average	2.1	2.1
Unemployment rate		
Austria	4.3	4.6
Euro area average	8.4	8.3

Sources: Haver; and WEO.

2. **However, the economy is now feeling the full impact of the global crisis.** The economy's openness, both in trade and financial relations, means that it cannot be insulated from foreign shocks. The transmission runs through two main channels: trade—in particular the negative impact on exports of the worsened outlook for the European region—and financial flows—including the impact of the slowdown in CESE on the returns on foreign investments of the Austrian banks and corporates. These real and financial shocks associated with the crisis have a major adverse impact on the outlook for the Austrian economy.

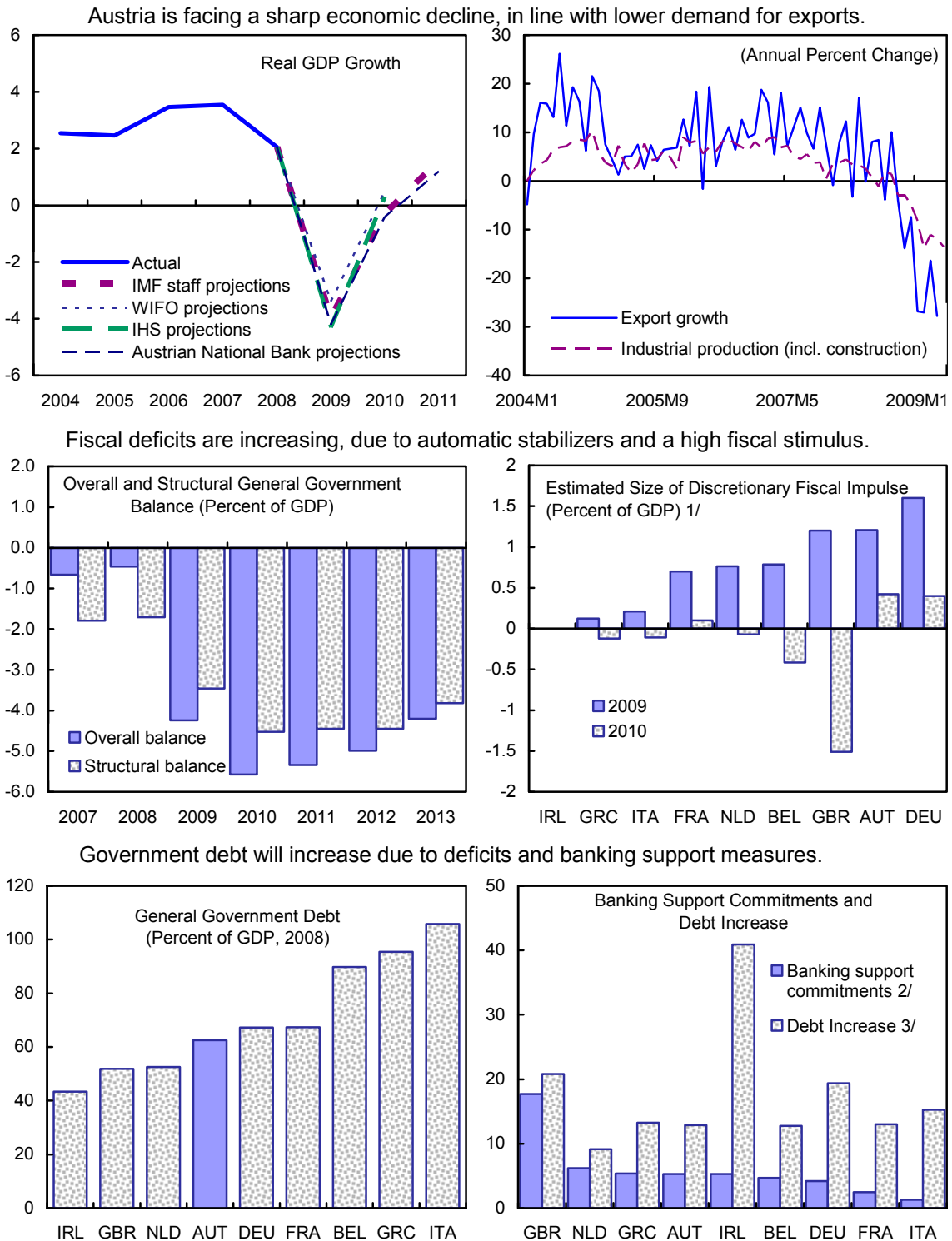
3. **Maintaining financial stability will be key to Austria's economic future.** The financial sector has been expanding rapidly, mostly outside Austria. This has brought substantial benefits, but also increased risks and vulnerabilities. The latter have now become apparent as large exposures to countries in CESE have become a source of concern. Maintaining financial stability will be essential for ensuring macroeconomic stability, fiscal sustainability, and a return to growth, while also having important spillovers to regional financial stability.

II. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

4. **The current downturn is expected to be the deepest in its postwar history** (Table 1, Figure 1). The economy started shrinking in the fourth quarter of 2008 as the global financial crisis intensified and world trade fell sharply. This process accelerated in the first quarter of 2009, with exports of goods declining by roughly a quarter compared with 2008. Consumption also declined slightly, but has held up relatively well so far (Figure 2)—due to substantial wage increases agreed to last year when inflation was high, and tax cuts—but as unemployment rises, household spending will lose momentum. Staff expects GDP to decline by 4 percent in 2009 and to recover in the course of 2010—depending on global

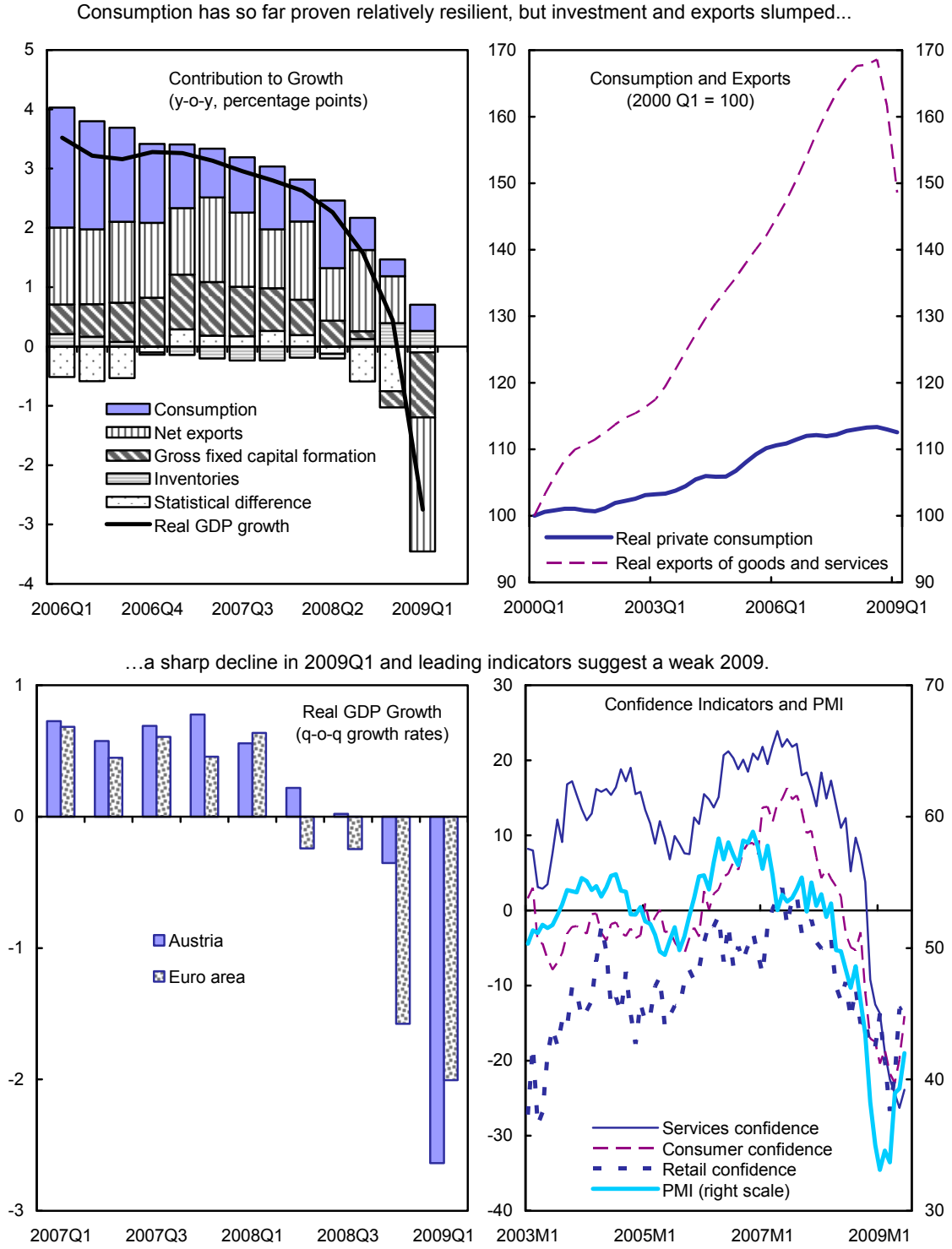
¹ A staff team comprising Mr. Hilbers (head), Ms. Ohnsorge, Mr. Clausen (all EUR), Ms. Zanforlin and Mr. Tower (both MCM), and Ms. Ilyina (SPR) visited Vienna during June 19–30, 2009.

Figure 1. Austria: Economic and Fiscal Developments



Sources: Austrian authorities; IHS; WIFO; Haver; WEO; REO; and other IMF staff estimates.
 1/ Calculated as the y-o-y change in discretionary measures (source: REO Europe, May 2009).
 2/ Capital injections plus asset purchases and lending; in percent of 2008 GDP (source: REO).
 3/ Increase in government debt as a percent of GDP from 2008 to 2010 (percentage points).

Figure 2. Austria: GDP Growth and Leading Indicators



developments. The authorities broadly agreed with this outlook and noted that the sharp downward revision of earlier projections reflects an unprecedented collapse in demand for exports and investment.

5. **Inflation is expected to remain subdued.** As elsewhere in the euro area, inflation is projected to decline further in 2009, to about ½ percent for the year. However, it is expected to pick up again in 2010, and deflationary risks are considered limited. Core inflation has been more stable than headline (Figure 3) and is expected to remain above 1 percent in the period ahead. The authorities noted that Austria could temporarily experience some negative inflation during the second half of 2009, depending on developments in energy and commodity prices.

6. **The brunt of the crisis on unemployment is still to be felt.** Austria traditionally benefits from a low unemployment rate compared with the euro area. However, the absolute increase in registered unemployment (especially in manufacturing) is the largest in decades, due to the severity of the economic decline and the relatively flexible labor market. Unemployment is widely expected to increase to above 5 percent in 2009 and to continue rising into 2011 (Table 2). The authorities and social partners emphasized that subsidized short-term work schemes were an important instrument to preserve human capital during an economic downturn.

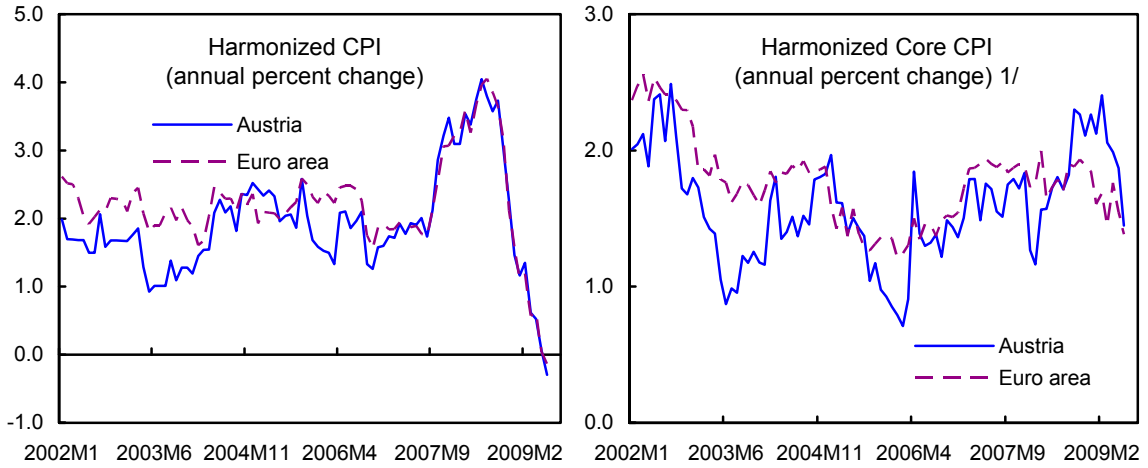
7. **The external position is expected to weaken somewhat, but to remain sound** (Table 3). Market shares and the real effective exchange rate have been relatively stable over the past few years (Figure 4). Applying the CGER methodology to Austria also suggests that there are no major competitiveness issues.² In 2009, imports—driven by private consumption—are expected to shrink by less than exports. This will have a negative impact on the current account surplus, which is nevertheless expected to remain positive. It was expected that unit labor costs will increase in 2009, due to relatively high wage increases and the use of short-term work schemes. However, there was no indication that these would have a permanent impact on Austria's competitiveness and authorities and social partners were expecting moderate wage increases in the future.

8. **The uncertainties surrounding the outlook are considerable.** The extent of economic decline hinges critically on developments in trading partner countries. An additional uncertainty is the impact of the crisis on Austria's financial sector. Due to its large exposure to Eastern Europe, it would be hit hard by a further economic decline in the region, which could translate into deteriorating credit quality, declining profitability, and the possibility of a credit crunch. The authorities acknowledged these factors, but saw the risks as overall balanced, including in Eastern Europe.

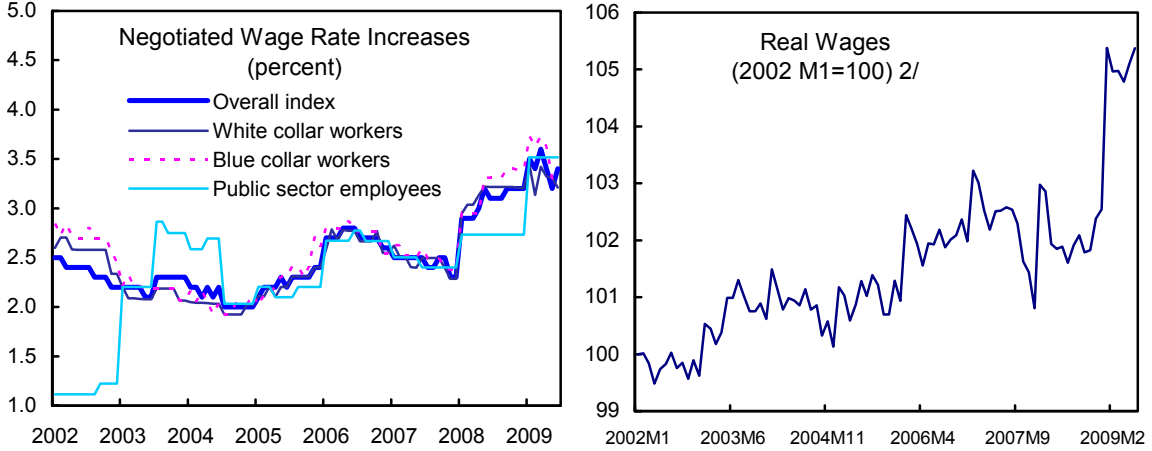
² The macro balance and the equilibrium real exchange rate approach indicate an overvaluation of 1 and 7 percent, respectively, while the external sustainability approach suggests a 4 percent undervaluation.

Figure 3. Austria: Inflation and Labor Market

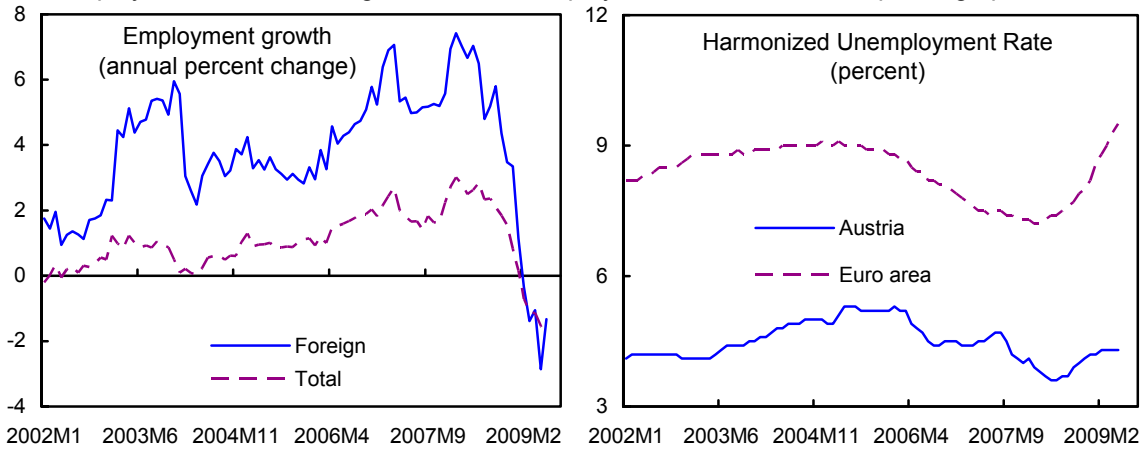
Headline CPI dropped below zero, due to a fall in energy prices.



Nominal wage increases did not anticipate the drop in inflation, raising real wages.



Employment is now coming down and unemployment, while still low, is pointing upwards.

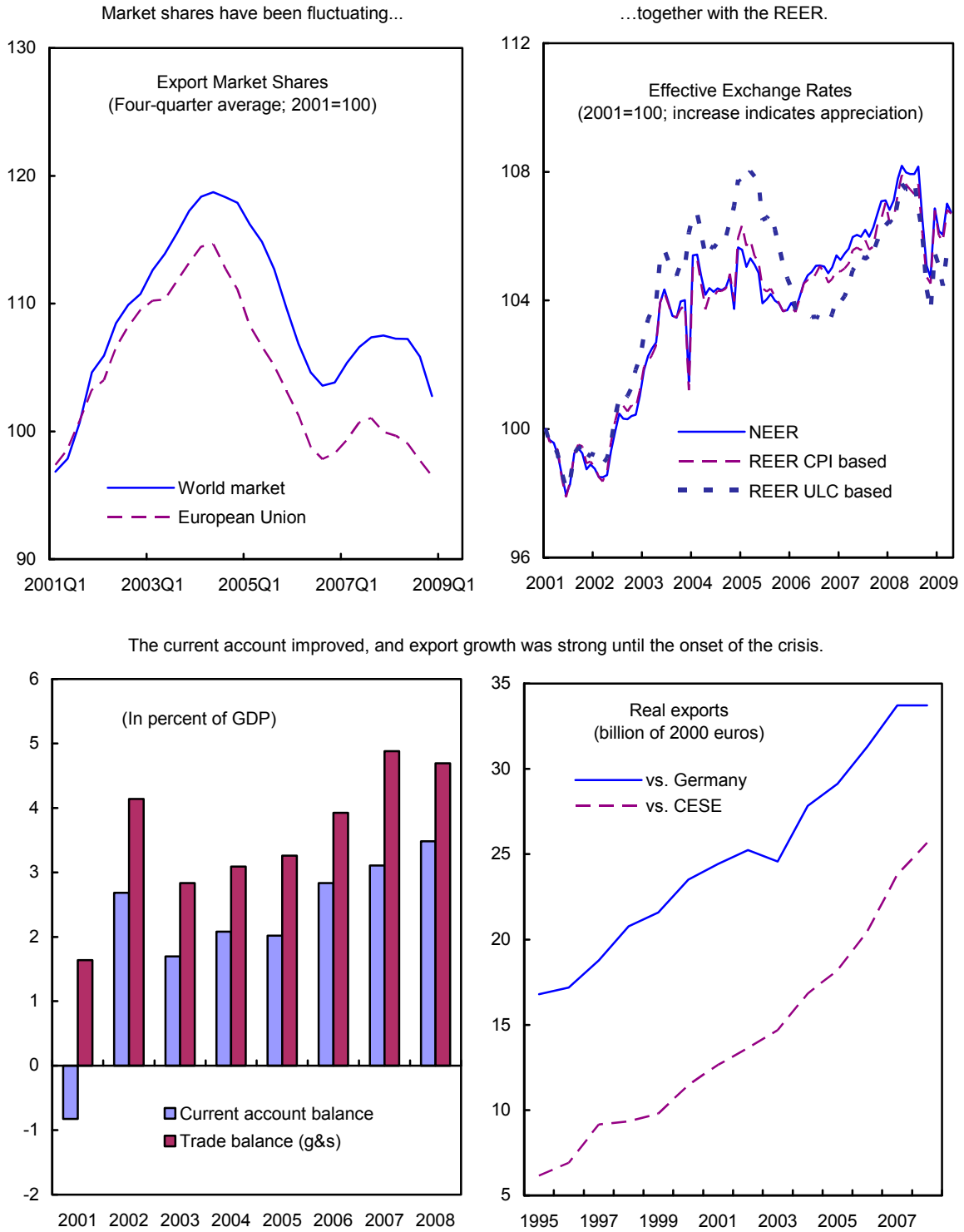


Sources: Austrian National Bank; Eurostat; Haver; WiFo; and Fund staff calculations.

1/ Excluding energy, food, alcohol, and tobacco.

2/ Overall wage index deflated with CPI.

Figure 4. Austria: Competitiveness



Sources: Austrian National Bank; Eurostat; World Integrated Trade System; WEO; and IMF staff calculations.

III. MACRO-FINANCIAL LINKAGES

9. The financial sector's contribution to Austrian growth has been sizeable.

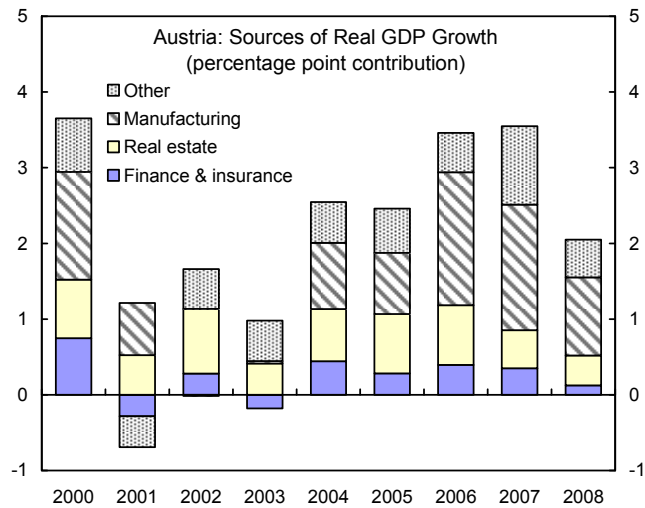
Between 2004-2007, the banking and insurance sector contributed on average about 0.4 percentage points to real GDP growth (annually). The sector has been growing rapidly and financial intermediation represented about 6 percent of GDP in 2008 (Figure 5). Its share in recent growth was considerably higher than a decade ago (Figure 6), but dropped significantly in 2008.

10. The Austrian banking system is not overly large relative to the economy. Austria's banking sector

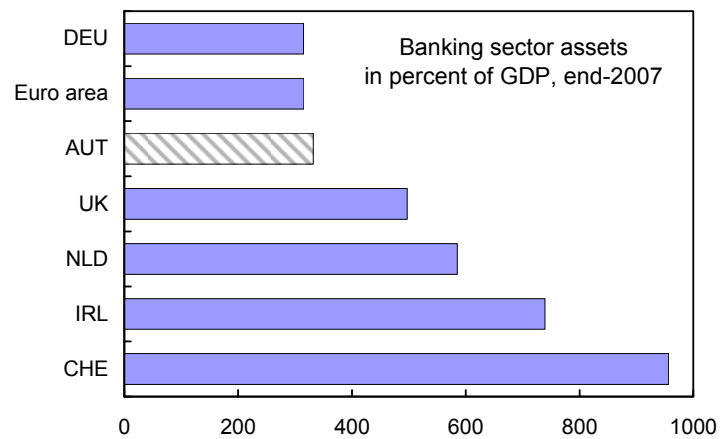
assets accounted for about 330 percent of GDP at end-2007. This is close to the euro area average and considerably less than the size of the banking sectors in some other countries with internationally active banking systems.

11. However, the banking system's exposure to CESE is large, which makes the system vulnerable to regional shocks.³

The financial system's rapid expansion into European emerging markets has brought significant benefits but also increased vulnerabilities (see also section V). The CESE exposures of Austrian banks are large relative to the domestic economy (roughly 70 percent of GDP) and bank capital (350 percent), with profits from the CESE operations accounting for 30-40 percent of total profits in 2005-07. These exposures are also large in relation to the size of the economies of the host countries. About half of lending is denominated in foreign exchange. The authorities emphasized that for the Austrian banking system as a whole, the portfolios are relatively well-diversified, and that three-quarters of all assets in CESE represent claims on EU member countries.

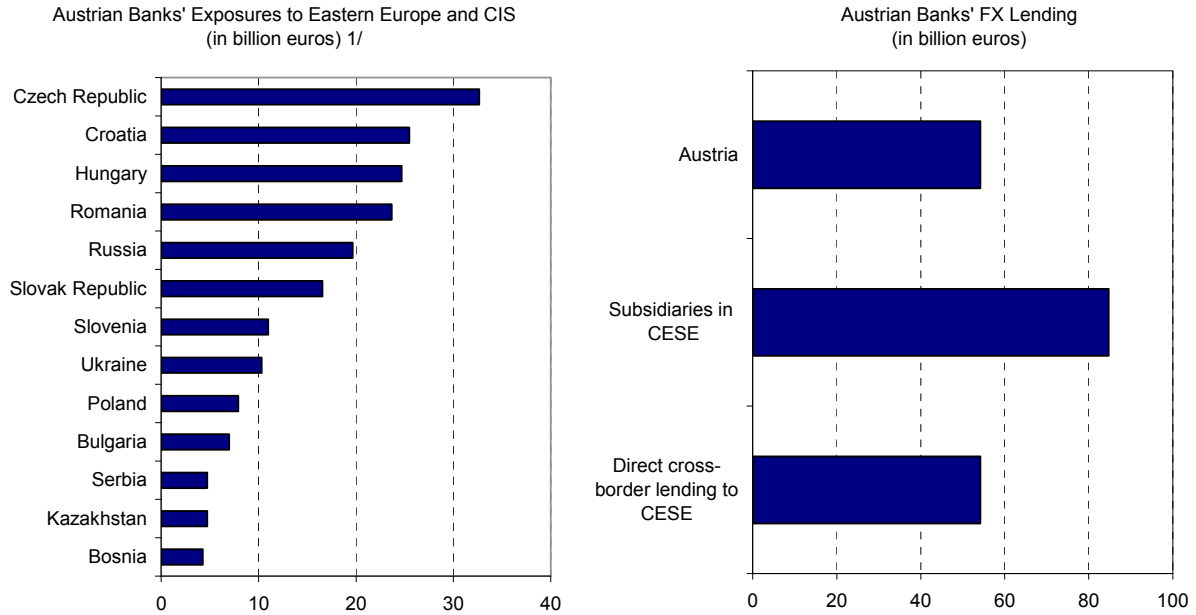


Source: WiFo, IMF staff calculations.



Source: ECB, Haver, IFS, and country authorities.

³ See Annex 1 on *Western Banks' Exposures to Eastern Europe* for more details.



Source: Austrian National Bank.

1/ Figures refer to exposure through cross-border lending and via subsidiaries, but exclude interbank loans or lending to sovereigns. Figures include the exposure of foreign owned banks that are licensed in Austria.

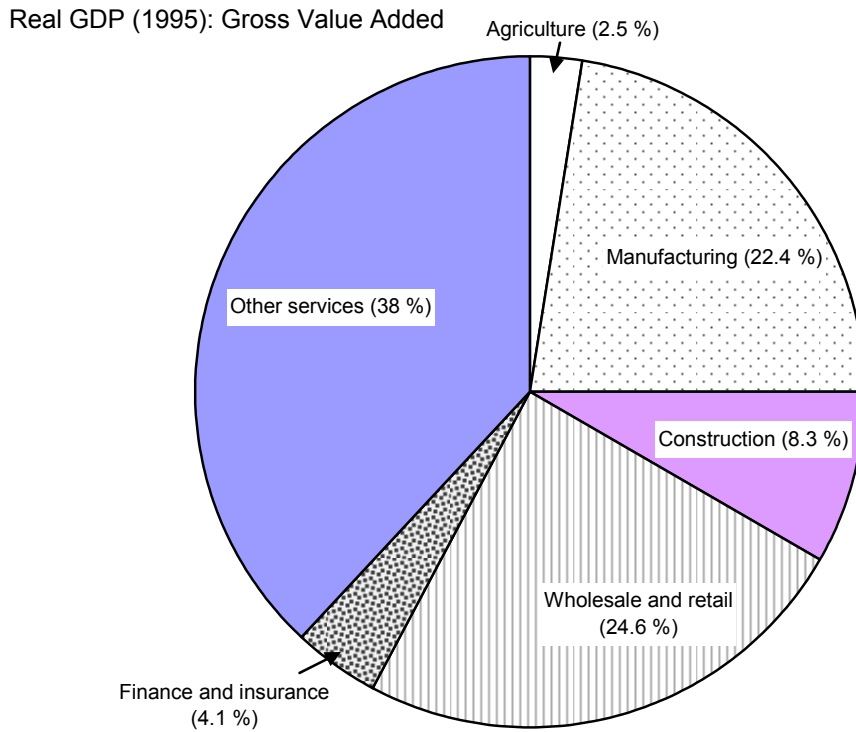
12. **Household balance sheets are in a relatively good shape** (Figure 7). The lack of a housing boom-bust cycle contributed to lower cumulative credit growth in recent years than in some other European countries. This helped prevent an unsustainable rise in debt-financed private consumption. Household debt stood at 90 percent of disposable income at end-2008, compared with 100 percent in the euro area. There was agreement that relatively low levels of debt are enabling Austria to avoid the sharp household deleveraging that has occurred elsewhere with its negative impact on consumption and growth.

13. **The drop in stock markets will have an impact on savings.** The erosion of wealth in financial assets as well as precautionary motives are expected to induce an increase in the savings rate.⁴ To some extent this impact is cushioned by the guarantees that insurance companies offer, including on retirement savings. However, a sizeable share of savings is held in mutual funds, where investment losses are passed on to investors. Private pension funds have been hit hard by the crisis and further reductions in benefits or increased contributions will be hard to avoid, although this sector is relatively small.

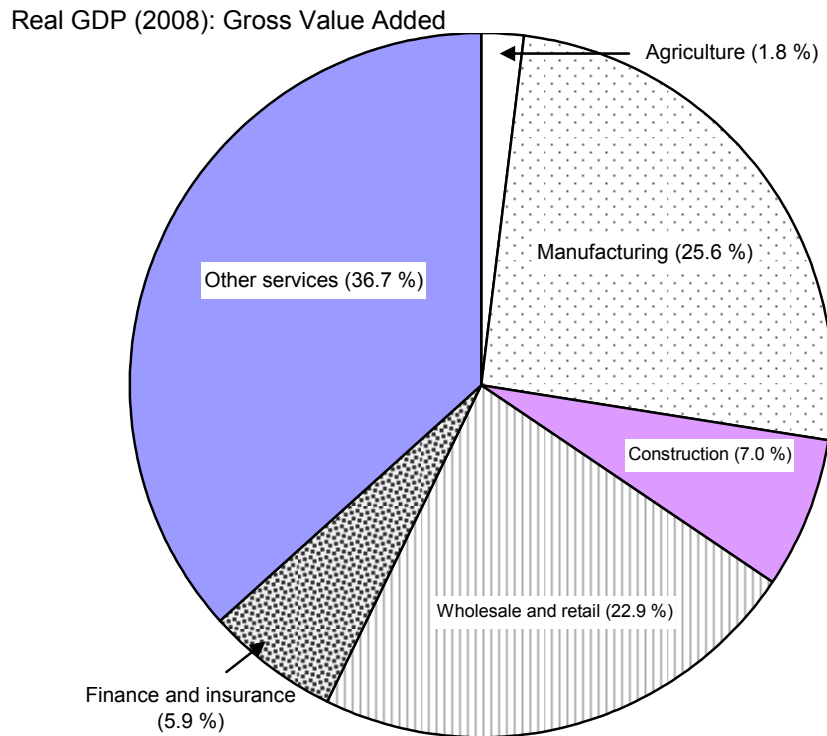
⁴ Fenz and Fessler (2008) find that simulations based on macro data indicate that a decrease in wealth has a relatively minor effect on private consumption and economic growth in Austria. However, the authors note that in this crisis confidence effects could be stronger than estimated in their study (*“Wealth Effects on Consumption in Austria,” Monetary Policy & The Economy Q4/08, Österreichische Nationalbank*).

Figure 5. Austria: The Role of the Financial Sector in the Economy

The finance and insurance sector generated 4 percent of GDP in 1995...



...this contribution increased to 6 percent of GDP in 2008...

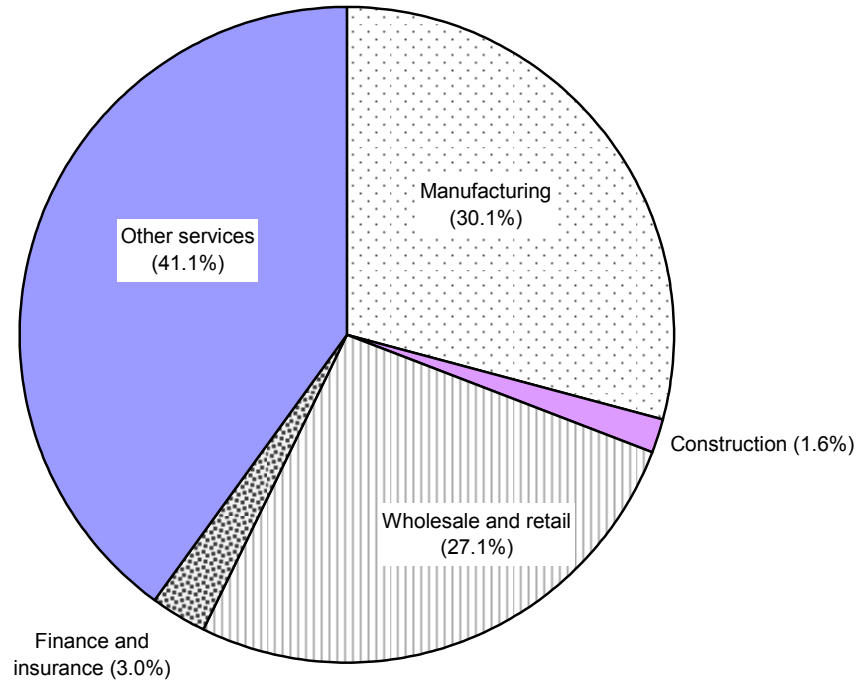


Sources: WIFO; and IMF staff estimates.

Figure 6. Austria: The Financial Sector's Contribution to Growth

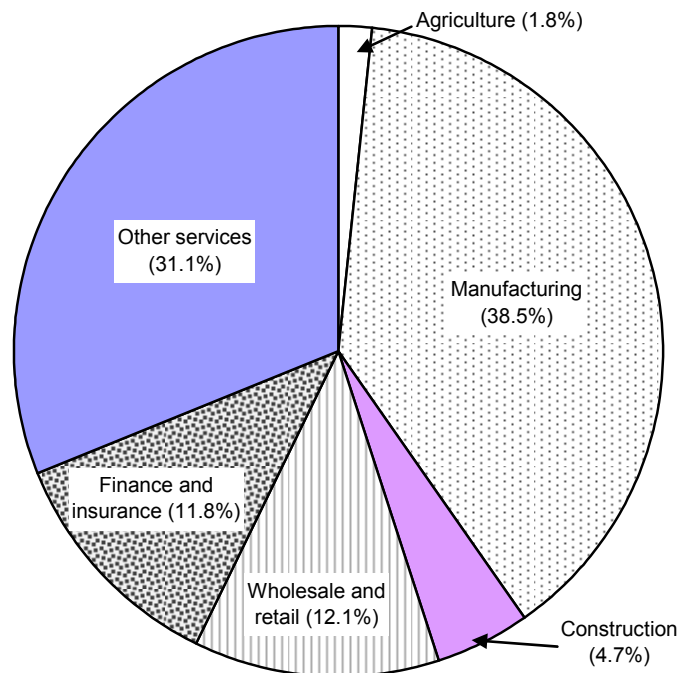
Finance and insurance contributed on average 3 percent of real GDP growth between 1995-2003...

Real GDP (1995-2003): Composition of growth 1/



...and 12 percent of GDP growth on average between 2004-2007.

Real GDP (2004-07): Composition of growth

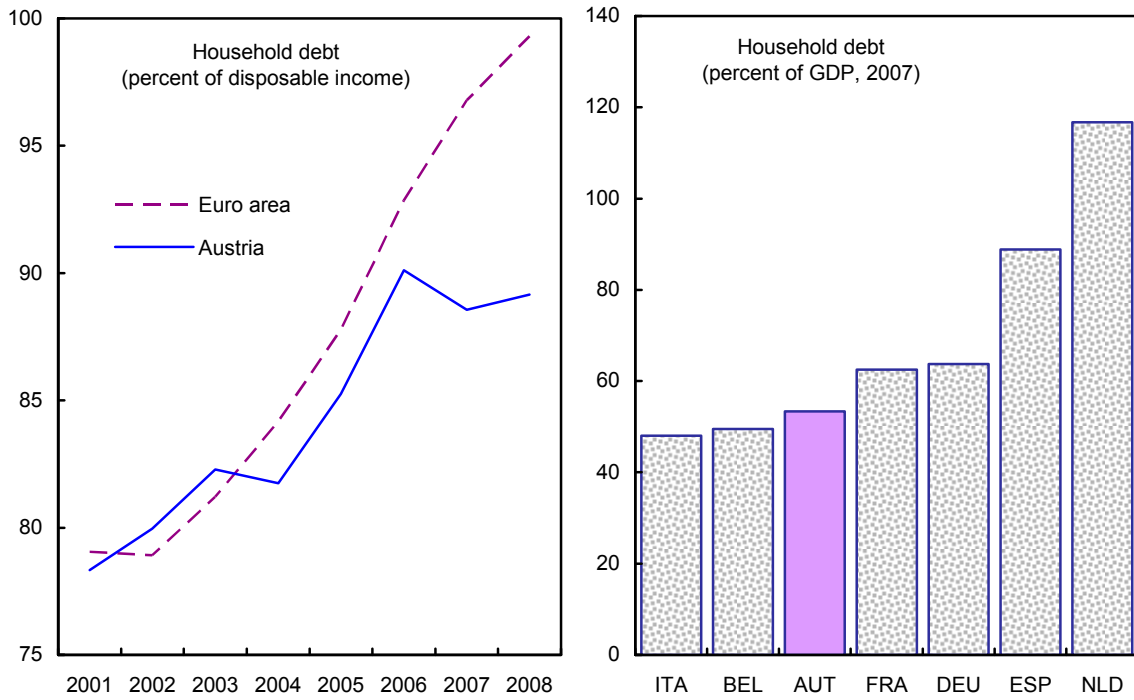


Sources: WIFO; and IMF staff estimates.

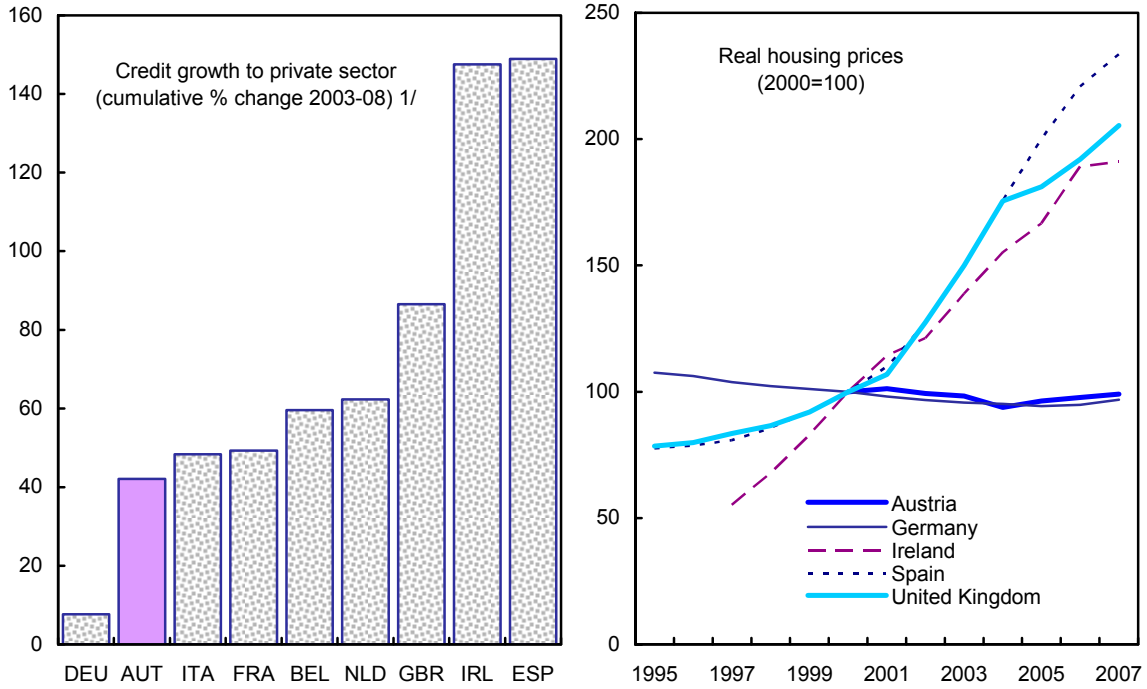
1/ On average, agriculture subtracted 3 percent from growth between 1995 to 2003.

Figure 7. Austria: Household Balance Sheets

Household debt increased, but by less than in most other European countries.



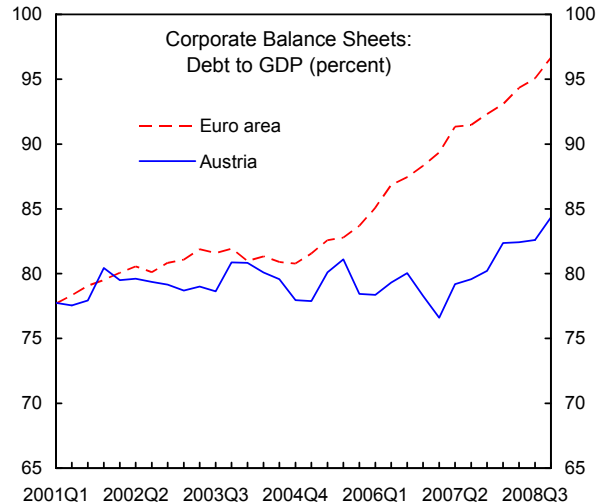
Low credit growth went hand in hand with stable housing prices.



Sources: Austrian authorities; Global Insight/Datinsight; OECD; IMF, IFS; and WEO.

1/ Refers to claims on other resident sectors in country; for GBR, series refers to claims on private sector.

14. **The corporate sector did not enter the crisis highly indebted.** While corporate debt to GDP increased by 8 percentage points between 2007Q1 and 2008Q4, the level is much lower than the euro area average. Since the onset of the crisis, Austrian enterprises have found it more difficult to finance themselves through profits or new equity and have resorted to loans. Insolvencies increased in 2008, but surveys show that this reflects a drop in demand for output more than a lack of financing.

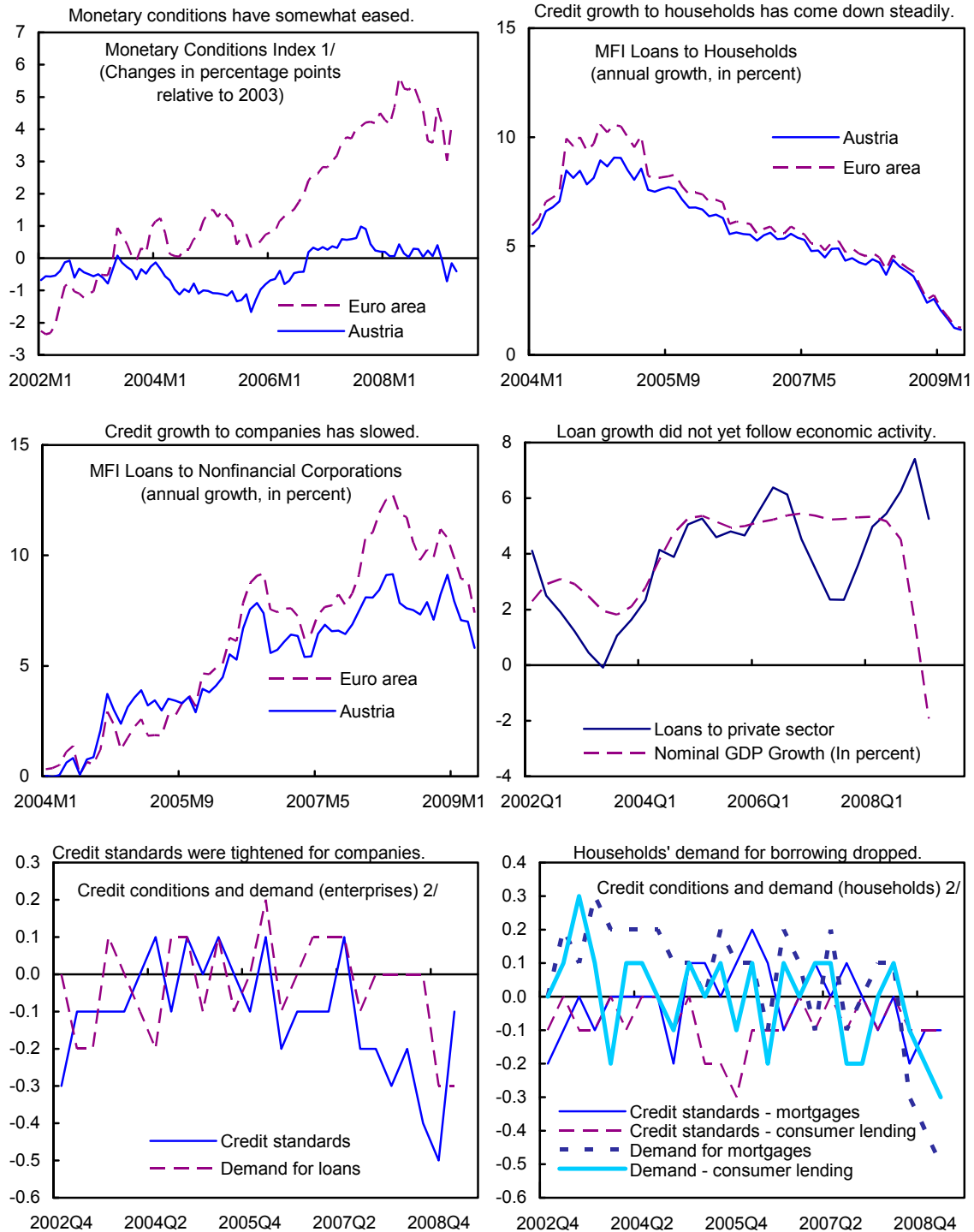


Source: Austrian National Bank and ECB.

15. **Although credit conditions are tightening, there is little evidence of a credit crunch so far** (Figure 8). Credit growth to households has fallen substantially (to 1 percent in April 2009), but bank lending surveys indicate that this trend is mostly associated with demand factors. In particular, demand for consumer loans has dropped sharply. For the corporate sector, credit standards have been tightened since the third quarter of 2007. While the year-on-year growth rate of loans to nonfinancial enterprises slowed somewhat to 6 percent in April 2009, it is not far from earlier averages. The authorities are closely monitoring credit conditions.

16. **Financial sector developments also have a bearing on fiscal outcomes, through direct and indirect channels.** The direct contribution of the financial sector to tax revenues has been limited, as financial institutions have benefited from relatively generous carry-forward rules for past losses. Financial sector support, however, has substantially worsened public finances. Under current projections, capital injections under the financial sector support program may account for some 4½ percent of GDP in general government debt by 2010. In addition, concerns about the Austrian financial sector have spilled into sovereign bond and CDS markets.

Figure 8. Austria: Monetary Conditions



Sources: Austrian National Bank; Haver; IMF; IFS; ECB; and Eurostat.

1/ Weighted average of changes in interest and exchange rates relative to their average values in a base period. An increase (decrease) indicates a monetary tightening (loosening).

2/ Based on bank lending survey data. Minus means tightening/decreased.

IV. FISCAL POLICY

A. Fiscal Developments and Outlook

17. **The fiscal stance was broadly neutral in 2008 despite some stimulus measures.** In September 2008, the authorities passed a stimulus package that envisaged a fiscal impulse of 0.3 percent of GDP in 2008 and additional stimulus in 2009-10. For 2008, the package increased family and pension benefits and reduced unemployment insurance contributions. More than offsetting this, however, were earnings-related tax receipts that increased on the back of strong labor market performance. As a result, the general government balance improved by some 0.2 percentage points of GDP to -0.5 percent of GDP (Table 4, Figure 9). This deficit, combined with the issuance of bonds to pre-fund financial sector support of almost 3 percent of GDP, raised the stock of debt to 62.6 percent of GDP at end-2008.

18. **The 2009/10 budget includes a stimulus package of 1.5 percent of GDP in 2009 and an additional 0.4 percent of GDP in 2010.** In contrast to other packages, the Austrian package consists mostly of personal income tax (PIT) cuts (Box 1). Since only the top half of income earners is subject to PIT, the multipliers of the package will be relatively low. Public investment, which has the highest multipliers if rapidly implemented, represents less than 5 percent of the package. As part of the package, Parliament recently approved a specific stimulus (of 0.2 percent of GDP) aimed at supporting employment through the extension of short-term labor benefits and old-age part-time work benefits.

19. **The stimulus, the unrestricted operation of automatic stabilizers, and support to a distressed bank will widen the deficit to 4.2 percent of GDP in 2009 and 5.6 percent of GDP by 2010.** Overall, automatic stabilizers are similar to the euro area average. In particular, the strong progression in PIT rates by international comparison generates large stabilizers. Initial unemployment benefits are less generous than elsewhere in the OECD, but their

General Government Accounts (Percent of GDP)

	Overall balance (ESA'95)	Debt
2007	-0.7	59.5
2008	-0.5	62.6
2009	-4.2	70.2
2010	-5.6	75.5
2011	-5.3	79.0
2012	-5.0	81.6
2013	-4.2	82.9
2014	-3.4	82.9

Source: IMF staff projections.

Composition of Fiscal Stimulus Package (Percent of GDP)

	2009	2010
Total 1/	1.5	1.9
Public investment	0.1	0.1
Social benefits	0.2	0.2
Tax cuts	1.0	1.3
Investment incentives	0.0	0.1
Other	0.1	0.1

Memorandum items

Share of stimulus, 2009-10	Tax cuts	Public inv.
Austria 2/	72	3
Switzerland	28	65
Germany	38	24
France	53	23
UK	84	2

Source: Austrian Stability Program 2008-13; IMF staff calculations.

1/ Figures reflect the budgetary cost of the stimulus packages in each year compared with baseline of 2007.

2/ Excludes accelerated investment by state-owned companies.

Automatic Stabilizers: Elasticity of Budget Items to Output Gap

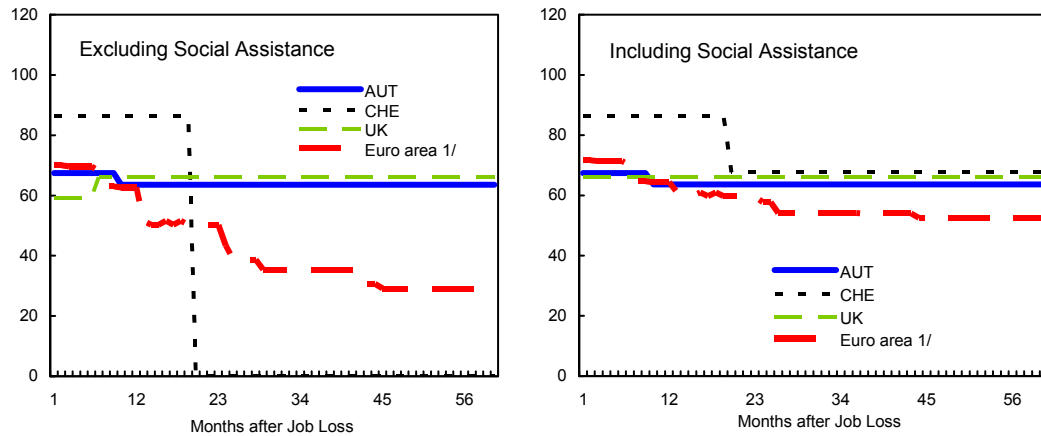
	Overall balance	PIT rev. 1/ expenditures	Current
Austria	0.47	2.2	-0.08
Germany	0.51	2.3	-0.18
Netherlands	0.53	2.4	-0.23
Switzerland	0.37	1.8	-0.19
Sweden	0.55	1.3	-0.15
Euro area average	0.48	2.0	-0.11
OECD average	0.44	1.8	-0.10

Source: OECD (2005).

1/ Elasticity of PIT revenues to tax base, as a measure of the progressivity of the tax code.

entitlement period is longer. Whereas unemployment benefits in OECD countries typically fall steeply after 12-24 months and are replaced by lower social assistance, the Austrian net replacement rate remains virtually constant for the five years following employment loss.

Net Replacement Rates Five Years Following Job Loss, 2007
(Percent of average wage)



Sources: OECD Benefits and Wages; and IMF staff estimates.
1/ Unweighted average.

Box 1. Austrian Fiscal Stimulus Measures in 2008-09

Austria passed a series of fiscal stimulus packages:

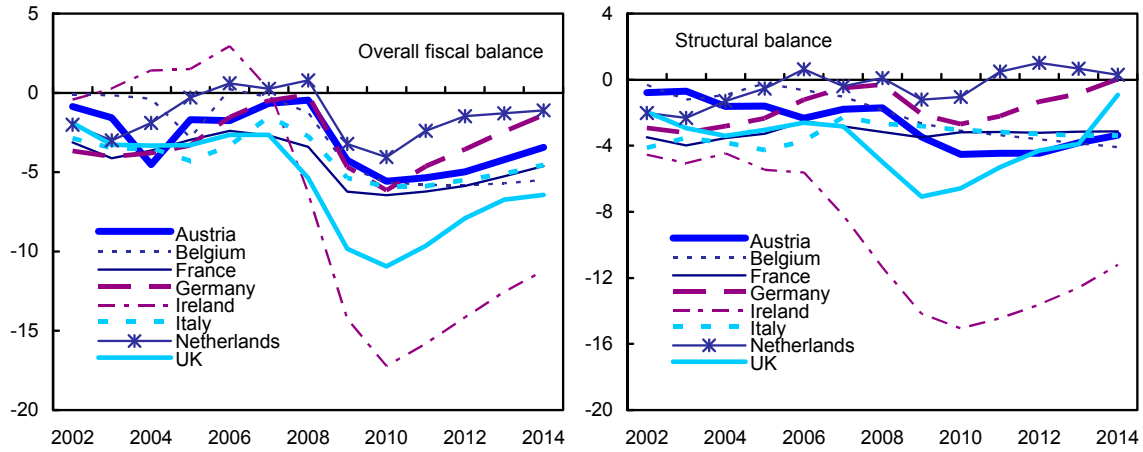
- September 2008: increase in pension and family benefits, removal of university fees, and a cut in VAT on pharmaceuticals.
- Stimulus package for 2008: support for SMEs, investment in broadband access, and increase in housing subsidies.
- Stimulus package for 2009: tax cuts and investment incentives for 2009, the latter mainly through advantageous depreciation rules.

More than half of the total stimulus for 2009 is accounted for by the tax reform that had originally been planned for 2010 and was brought forward. The tax reform reduces the personal income tax (PIT) in the two middle tax brackets by 0.3 and 1.8 percentage points, and raises the tax-exempt minimum by 10 percent and the income threshold for the highest income bracket by 15 percent. In addition, a tax exemption per child was introduced and the exemption for profits was raised. Tax deductibility of church and charitable contributions was increased and a deduction for child care expenditures introduced.

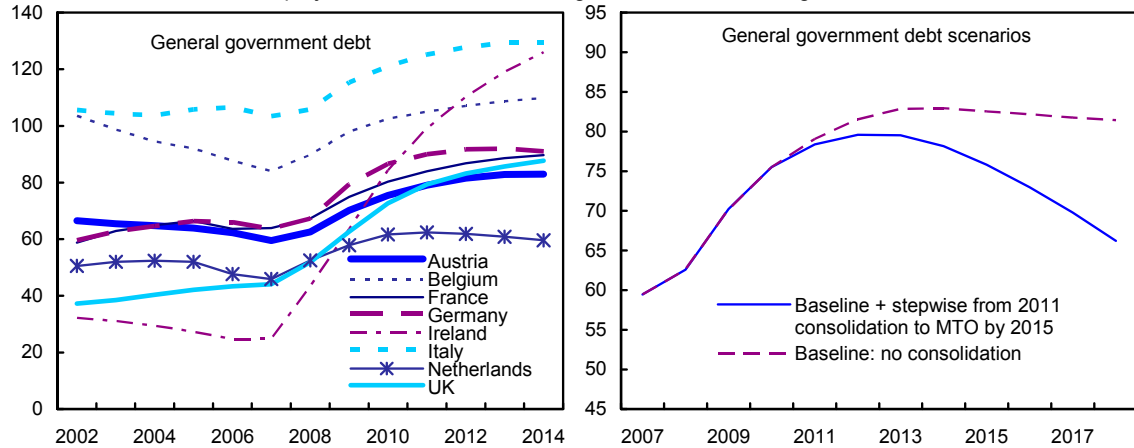
Additional stimulus will be provided by the decision of state-owned railway and highway companies to bring forward infrastructure investment. These plans amount to about 0.3 percent of GDP.

Figure 9. Austria: Fiscal Trends 1/
(In percent of GDP)

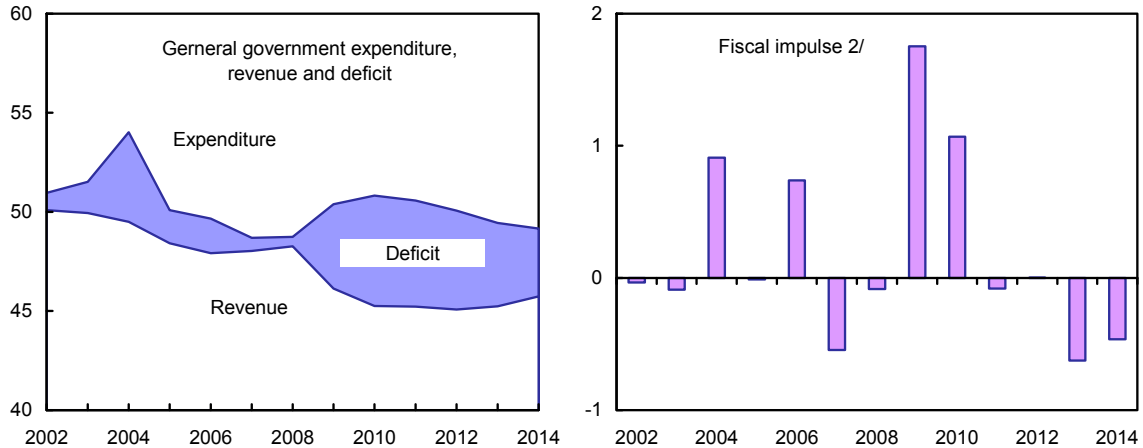
Austria has had persistent fiscal deficits, which are projected to stay.



Austria's debt ratio is projected to increase, adhering to its MTO would bring the debt ratio down.



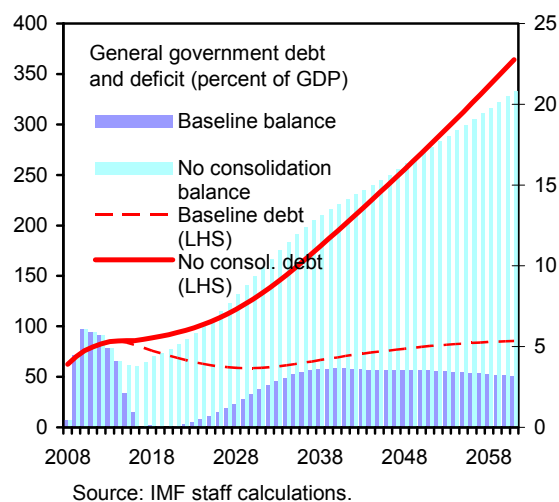
A decline in revenues is driven by high fiscal impulses in 2009-10.



Sources: IMF, WEO (April 2009); and staff calculations.
1/ WEO (April 2009) forecast from 2009 onwards.
2/ Negative of the change in the structural balance.

B. Fiscal Sustainability

20. **The underlying fiscal position has deteriorated significantly as a result of recent policy measures.** Absent consolidation measures, current policies put fiscal sustainability at risk. Under current policies, deficits are projected to be above the Maastricht reference value of 3 percent of GDP throughout the forecast horizon; this compares with medium-term deficit projections of 1 percent of GDP that formed the basis for earlier long-term projections. Aging-related costs for social security pensions, health, and long-term care will add to these deficits about 4-5 percent of GDP annually in the medium and long term. Without a consolidation to deficits below 1 percent of GDP by the middle of the next decade, the stock of debt could rise above 300 percent of GDP by 2050.⁵



21. **With debt projected to rise above 80 percent of GDP by 2012, the authorities and the mission agreed that fiscal consolidation was the key challenge once the economy recovers.** The mission recommended that—to put debt again on a downward path—specific consolidation measures be agreed later this year, to be implemented when the economic recovery begins. While the authorities agreed with the need for consolidation, they warned against a premature exit from the stimulus. They noted that consolidation measures should be expenditure based. In the administration of lower-level governments and in the health and education sectors, there remains substantial potential for efficiency gains without curtailing service quality. A Working Group on Fiscal Consolidation has been created to identify specific measures for expenditure consolidation. Members of the working group described 10 areas chosen for further study, including education, health, pensions, subsidies, the revenue sharing arrangement, and improvements in administrative efficiency. In education, the working group has completed its recommendations and submitted them to the government. With regard to improvements in administrative efficiency, recommendations were expected to be finalized soon.

⁵ The methodology is described in Kanda, Daniel (2007): “Long-Run Fiscal Challenges in Austria,” *IMF Country Report* 07/143.

22. **There is room to raise certain nondistortionary taxes, but these are unlikely to generate significant revenue increases.** Most taxes are above or at OECD and EU averages. The authorities noted that a further increase in labor taxation would run counter to the long-term need to reduce the tax burden on labor. Fuel taxes, in contrast, are low in comparison with neighboring countries, encouraging cross-border arbitrage. However, even assuming no behavioral response, the mission estimates that additional revenues from raising taxes to comparable levels are likely to be less than ¼ percent of GDP. Increased property taxes could provide an additional source of income for municipalities and, hence, encourage more accountability compared with the current system of fiscal federalism. Additional revenues may amount to some ½ percent of GDP.

Tax Revenues, 2007 (Percent of GDP)		
	Fuel tax	Property tax
Austria	1.4	0.2
Germany	1.5	0.7
France	1.3	2.6
Italy	1.5	0.8
Switzerland	...	0.2
UK	1.7	3.2

Sources: EC; and IMF *GFS*.

	Average Excise Duty Rates on Petrol, 2009		
	Leaded per 1000 l	Unleaded	VAT percent
Austria	531	459	20.0
Germany	721	662	19.0
France	640	623	19.6
Italy	564	564	20.0

Source: EC, Excise Duty Tables, 2009.

C. Structural Fiscal Issues

23. **The mission welcomed the long-awaited introduction of a medium-term budgeting framework (MTBF), but noted that the expenditure ceilings could have been more ambitious.** The budget for 2009/10 includes binding rolling four-year expenditure ceilings—currently to 2013—for five broad categories of expenditure.⁶ Within each broad category, indicative ceilings are set but expenditures are fungible. To allow full operation of automatic stabilizers, the nondiscretionary element of the expenditure ceilings, including pension and unemployment benefits, is automatically modified according to objective criteria. The discretionary element of the expenditure ceilings can only be modified by parliament. The authorities highlighted the removal of disincentives for cost savings by allowing budget entities to save unused funds at the end of the year. The mission cautioned, however, that the medium-term expenditure ceilings have to be sufficiently ambitious for them to be an effective tool for ensuring fiscal sustainability. The authorities agreed that the currently envisaged expenditure path does not accomplish this goal and will be revised once the economic recovery is underway. To ensure that expenditure ceilings are consistent with long-term sustainability, the mission suggested that the authorities explicitly take into account long-term aging cost estimates.

⁶ Law and order; labor and social affairs; education and research; economy, infrastructure and environment; and treasury.

24. **Important supporting elements of the medium-term budgeting framework have been postponed until 2013.** In 2006, the authorities embarked on an administrative reform that encompasses a wide range of structural reforms, many of them reaching into the responsibilities of subnational governments. The authorities confirmed their commitment to implementing these reforms. In both the education and health system, Austria ranks below average in efficiency. At the level of the federal government, loopholes remain in the disability insurance system that de facto assumes some of the functions of the pension and unemployment insurance systems. An expenditure review in these areas could benefit from benchmarking against comparator countries, along the lines of the indicators published in the European Commission's *Catalogue of Quality of Public Finance Indicators (2008)*. Similar benchmarking will also be helpful in preparation for the move to performance-based budgeting, which was postponed to 2013 as was the introduction of a more comprehensive accounting framework.

25. **A simplified federal equalization law for 2008-13 reduces some inefficiencies in the fiscal federalism system.** In particular, it converts some earmarked federal transfers into general transfers. The mission acknowledged that, to the extent that earlier earmarking had been enforced, this could enhance expenditure efficiency at the local and state government level. Room for additional efficiency gains remains, however, since take-up of incentives for municipalities to cooperate has been low. The federal equalization law is complemented by an internal stability pact that limits deficits for each level of government. Enforcement of these deficit limits, however, has not yet been tested because the trigger clause for sanctions was based on general government balances, which had outperformed expectations recently. In the authorities' views, the pact nevertheless provided a useful framework for discussion and a tool for raising awareness of the need for fiscal discipline.

V. FINANCIAL SECTOR

26. **The key challenges in the financial sector stem from risks related to the economic downturn—both in Austria and CESE—and the financial crisis.** While Austrian banks have access to a solid base of domestic deposits and have had relatively little exposure to U.S.-based structured securities, vulnerabilities arise from:

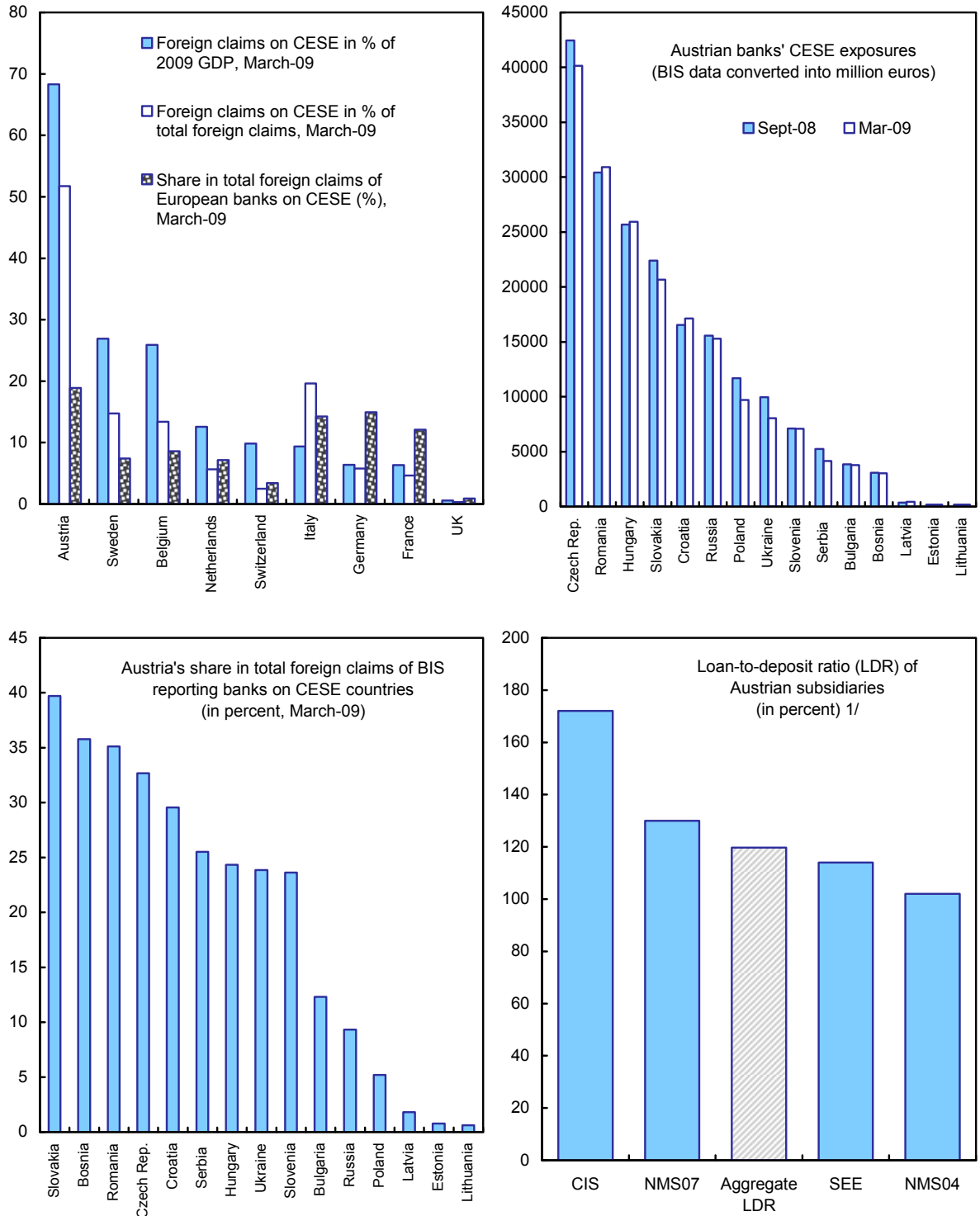
- Their significant involvement in CESE (Figure 10), which has exposed them to economic downturn in the region, directly through their subsidiaries and through the impact on major Austrian corporate customers who are exposed to the region. A particular risk arises from the extent of foreign currency loans made by their subsidiaries in CESE countries. This exposes them to indirect credit risk through the foreign exchange exposure taken on by unhedged borrowers.
- Credit risk on loan portfolios in Austria at a time of economic downturn, including rising unemployment. A particular risk arises from Austrian borrowers' extensive use of financial vehicles ("Tilgungsträger") for the repayment of bullet loans. As these relied on growth in underlying investments to provide the funds for repayment, funding gaps arose when markets fell and these could lead to impairments of the related loans. Foreign currency loans (in SFR) have also been made to Austrian customers, although their share of total loans is lower than in CESE countries (Figure 11).
- The need to secure medium-term funding in markets that remain challenging for banks. Government guarantees are currently facilitating the rollover of funding, but new guarantees are scheduled to be withdrawn by the end of the year.

A. The Authorities' Response to the Crisis

27. **The events of Fall 2008 had a large impact.** Against a background of rising concerns over exposure to CESE countries, the banks suffered sudden losses from significant exposures to Lehman and the Icelandic banks. Their participation in the European syndicated loan markets led to credit losses as well as funding challenges. The widespread lack of confidence that accompanied the market turmoil at that time caused interbank markets to dry up and liquidity positions to come under pressure. Share prices dropped and CDS spreads increased, while spreads on Austrian government paper were negatively affected as well (Figure 12).

28. **The authorities moved swiftly to deal with the crisis.** The Financial Market Authority (FMA) and the Austrian National Bank (ANB) worked together on a rapid response to the significant liquidity shortages facing banks. One small bank was subject to intervention and sold to its creditors, while another, of systemic importance in its market niche, was nationalized. Parliament enacted an extensive support package (Box 2) that included funding for state capital injections and a state guarantee scheme for new debt issues,

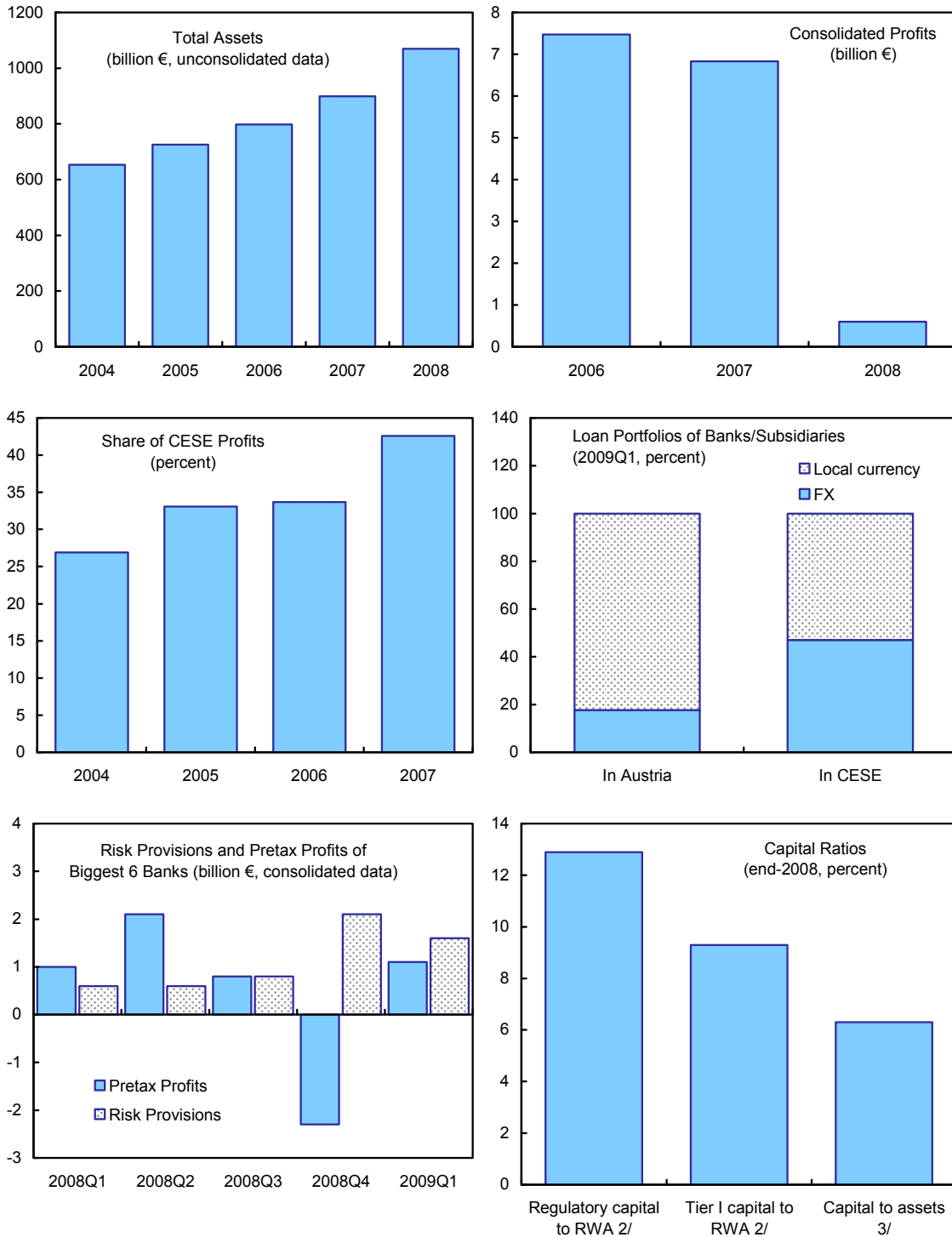
Figure 10. Austria: Banks' CESE Exposure



Sources: Austrian National Bank; BIS; and WEO.

1/ Based on unconsolidated figures, end 2008. NMS04 and 07 stand for the new member states that joined the EU in 2004 and 2007, respectively.

Figure 11. Austria: Banking System 1/



Source: Austrian National Bank.

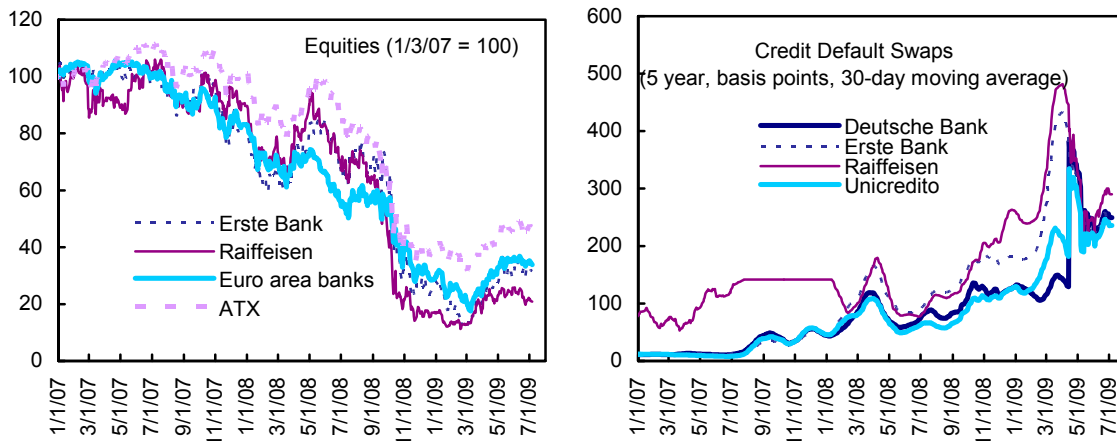
1/ If not specified otherwise, the data refers to the whole Austrian banking system, including foreign owned banks.

2/ Refers to Austrian owned banks (banks with domestic ownership of more than 50 percent). RWA stands for risk-weighted assets.

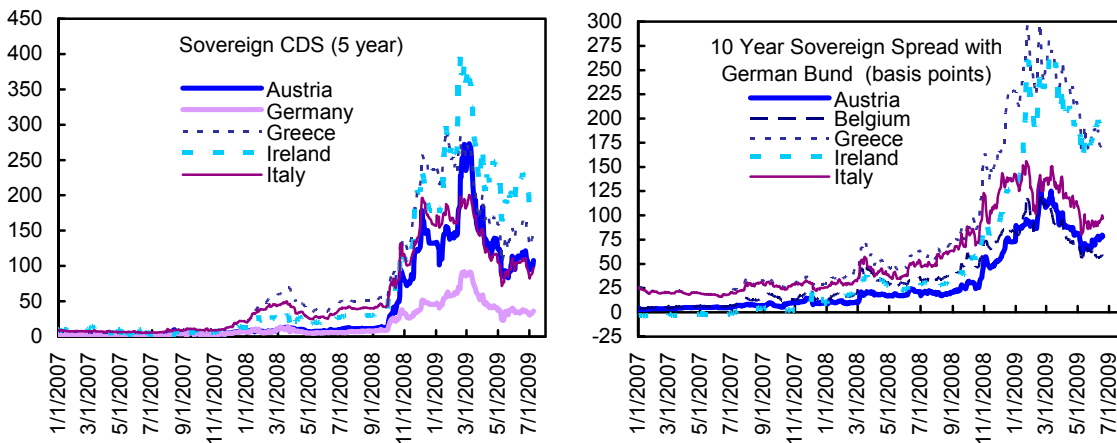
3/ Including foreign owned banks.

Figure 12. Austria: Selected Financial Market Indicators

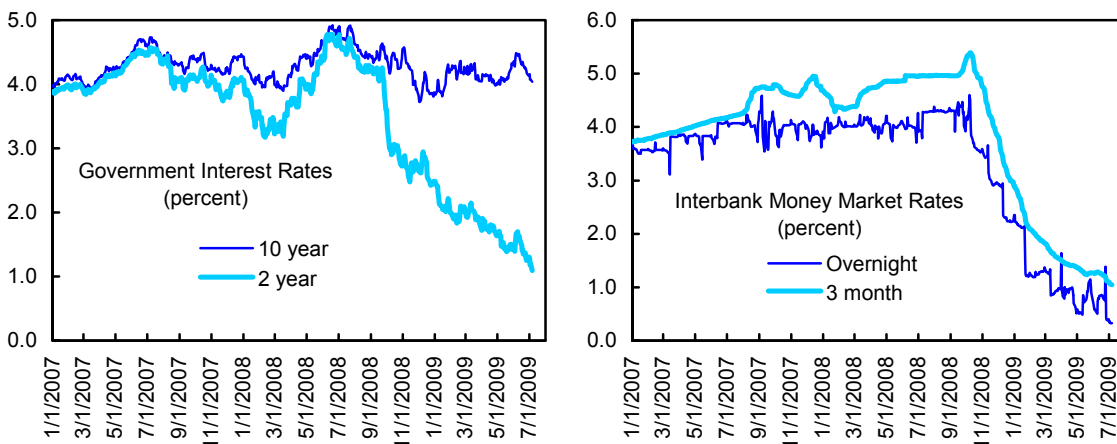
Banks have been under stress, with stocks declining and costs for CDS going up.



Concerns about banks' health reportedly pushed up sovereign CDS as well as bond spreads.



Long-term interest rates have not moved much, while short-term interest rates plummeted.



Sources: Thomson Financial/DataStream and Bloomberg.

available to both banks and insurance companies. A clearing bank supported by a public guarantee was set up to reduce liquidity pressures in the interbank markets. Finally, to address depositors' concerns, and in response to similar actions taken by other EU members, the authorities introduced a blanket deposit guarantee. The approach has been comprehensive, although implementation with regard to the capital injections has been drawn out.

Box 2. Financial Sector Support Measures

In October 2008, in response to tensions in financial markets, the authorities took several measures to support the banking sector. The package amounted to €100 billion in total or about 35 percent of GDP and contained the following support measures:

Capital injections, asset guarantees. The Financial Market Stability Act allows the Ministry of Finance to recapitalize banks and insurance companies. The measures taken under this law include government guarantees for assets and the acquisition of shares. As of mid-June, the government is guaranteeing assets of two banks worth €1.6 billion. The authorities have also purchased participation capital in four of the six biggest banks, worth €4.9 billion as of mid-June. Negotiations for capital injections into the other two big banks were ongoing as of that time. The conditions attached to these injections require viability reports of the corporate model, limits on staff remuneration and dividend payments, and a certain provision of credit. Public sector support for banks requires approval from the EU competition authorities and may be subject to conditions regarding the scope of activities conducted by the institutions receiving such support. If capital injections and asset guarantees in excess of the limit of €15 billion were needed, funds to support the interbank market (see below) could be used.

Austria: Banking Support Package		
Program	Amount (billion €)	Use as of mid-June 2009
Deposit insurance	10	0
Capital injections, asset guarantees	15	7
Guarantees	65	19
Guarantees for non-bank corporates	10	0
Total	100	26

Source: Austrian authorities.

Interbank market. Under the Interbank Market Support Act, the Ministry of Finance can provide guarantees for bonds issued by banks and for liabilities of and losses incurred by the *Oesterreichische Clearingbank AG* (OeCAG). Originally, €75 billion were pledged for this purpose of which €4 billion are reserved for the OeCAG. As of mid-June, €17 billion were outstanding in government guaranteed bank bond issues (used by four different banks) and €2.4 billion guarantees through the clearing bank. Out of this €75 billion, €10 billion have been redesignated to secure funding of nonbank corporations (see below).

Deposit insurance. Deposits of natural persons are guaranteed without limit until end-2009 and thereafter up to €100,000. The government pledged an amount of €10 billion to back this guarantee.

Funding of non-financial corporates. Parliament has recently passed a law that allows the government to guarantee debt of nonfinancial corporations up to a combined volume of €10 billion. Eligible companies had to be profitable before the summer of 2008, have more than 250 employees, and a turnover of more than €50 million.

29. **Despite the wide range of intervention measures, market sentiment has been volatile.** The government support package enabled the banks to maintain a relatively strong capitalization—with Tier 1 capital ratios averaging 9 percent for the system at end-December (Table 5)—while meeting refinancing needs. Such support also allowed issuer credit ratings to be maintained. In addition, their relatively strong position ahead of the crisis enabled the three biggest banks to remain profitable despite the market turmoil. However, in early Spring 2009, following the depreciation of some currencies in CESE, uncertainties about the economic outlook and the resilience of the Austrian banks increased, the profit outlook was downgraded by the rating agencies (Table 6), and CDS spreads rose to unprecedented levels.

30. **Banks are now strengthening their financial position in response to the deteriorating economic outlook.** While CDS spreads have recently subsided and liquidity has returned to interbank markets, banks are strengthening their capital and reducing credit risk. Internal lending policies have been tightened, foreign currency loans within Austria and non-euro foreign currency loans outside Austria curtailed and, where possible, the term of lending portfolios has been shortened. Banks are also seeking to broaden their deposit bases to reduce dependence on interbank funding. In addition, they are reviewing their asset portfolios to identify the collateral that would qualify in refinancing operations with the ECB.

31. **The authorities were clear that further resources will be committed if necessary.** Banks and authorities were reluctant to contemplate a further round of capital support from the government at this stage. However, if such support is required, and not (fully) available from private sources, it will be made available by the government, including if necessary from that part of the support package earmarked for guaranteed bank bond issuance.

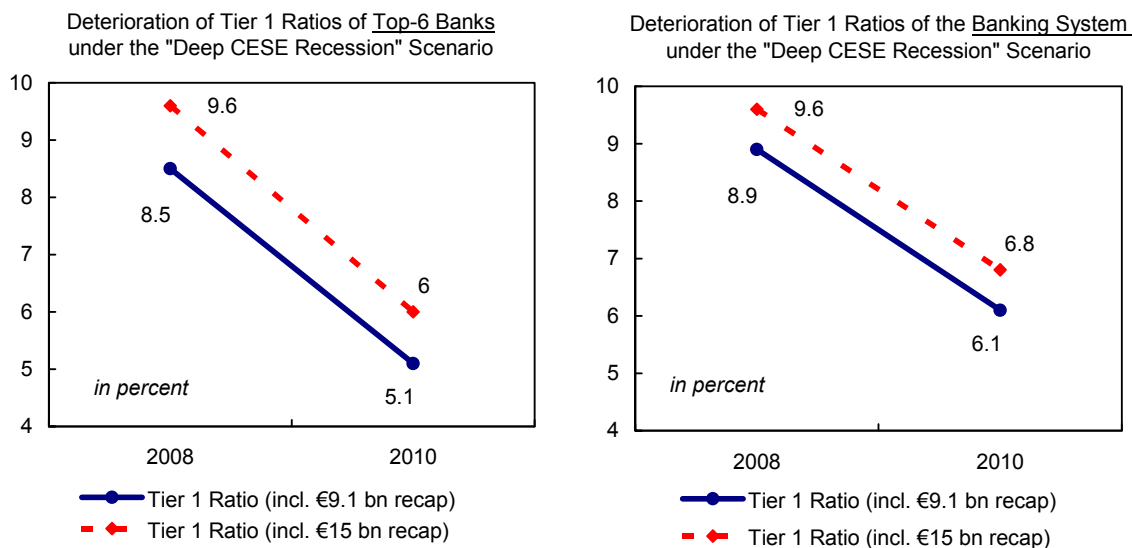
B. CESE Exposures—Risks and Strategy

32. **Stress tests carried out by the ANB suggest that major banks could withstand a relatively severe CESE recession without breaching minimum capital requirements.** Staff welcomed the ANB's use of stress tests to identify banks' CESE vulnerabilities and noted that the methodology is in line with international best practice. The tests suggest that the capital ratios of all systemic banks would remain above minimum regulatory requirements under a range of adverse shocks (Box 3). The authorities concluded that for now no further capital injections into the banking system were needed, although they are closely monitoring conditions in the banking sector. Staff noted that while the assumptions underlying the stress tests (the "Deep CESE Recession" scenario) appear to be broadly within the range of those used by analysts, more adverse outcomes cannot be ruled out. Moreover, because of uncertainty over the impact of the recession on future levels of banks' non-performing loans, Tier 1 ratios well above the regulatory minimum may still be needed to support private investors' confidence in banks. The possibility of tail risks materializing underlines the need for effective contingency planning, to which the authorities are committed.

Box 3. The ANB's Stress Tests

The stress tests recently conducted by the ANB included macro stress tests for credit risk, liquidity stress tests, and sensitivity analysis for market risk (interest rate, equity, foreign exchange, and volatility risk).

In view of the importance of the Austrian banks' exposures to Eastern Europe and the CIS, the macro stress tests for credit risk focused on the "Deep CESE Recession" scenario. The stress test results were published on the ANB's website (<http://www.oenb.at>) on July 6, 2009.



Source: Austrian National Bank.

The key features of the ANB's top-down "Deep CESE Recession" stress test are as follows:

- the Austrian banks' exposures include both direct cross-border lending and indirect exposures via foreign subsidiaries (on and off-balance sheet positions), but not interbank loans or lending to sovereigns;
- it covers the period from end-2008 to end-2010;
- for CESE countries, the April, 2009 WEO growth projections are taken as a baseline and further scaled down by 2 percentage points in 2009 and by 3.5 points in 2010;
- in addition, 20-30 percent depreciation is assumed for all countries with floating exchange rates and no change for countries with fixed exchange rate regimes;
- the impact on Austria is assessed using the ANB's Austrian Quarterly Model (AQM);
- further reduction of the banks' operating income before risk and an increase in risk-weighted assets due to deterioration of loan portfolios are taken into account as well.

Based on these assumptions, the NPL ratios reach close to 10 percent in the domestic market and almost 20 percent in the CESE region over the two year horizon.

The stress test results suggest that Austrian banks have sufficient buffers to withstand a fairly deep recession in the CESE region. If economic conditions in the region were to deteriorate along the lines of the "Deep CESE Recession" scenario, the top six banks' Tier 1 ratios would weaken substantially, but remain above the 4 percent regulatory minimum. It should be noted that the banks' starting Tier 1 ratios include €8.4 billion of preferred shares from the Austrian bank rescue package and €0.7 billion from third parties, although part of these capital infusions are still under negotiation. Further capital injections using the remainder of the €15 billion bank support package would help to keep the average Tier 1 ratio of the top six banks from falling below 6 percent in a stress scenario.

33. **Banks recognize the risks associated with foreign currency lending in CESE, but see limited scope for a significant reduction within a short time frame.** Most banks have stopped new lending in currencies other than the euro, and have begun to restructure outstanding non-euro currency loans by extending maturities and, in some cases, converting into local currencies. However, euro-denominated (or euro-linked) lending remains pervasive, not least because a large proportion of the banks' deposits in CESE are denominated in or indexed to euros. Banks believe that any reduction in the outstanding stock of euro loans can be made only gradually.

34. **While banks are committed to supporting their operations in Eastern Europe, changes in strategy are to be expected.** Banks are clearly concentrating more on risk management, and some have stated that they plan to focus on countries and products in which they have a sizeable market share. Major banks pointed to the good prospects for a resumption of growth in financial services in many CESE markets. Engagement in the region should continue to serve both the interests of the banks themselves and those of host economies. However, banks noted that this will need to be supported by a stronger control of risks, while the authorities are committed to further enhancement of the regulatory and supervisory approach, with a stronger macroprudential focus. This will result in lower credit growth rates than seen in the past.

35. **Banks and authorities are supporting international initiatives to address the impact of the crisis on CESE countries.** Banks' public statements of commitment to their subsidiaries through the downturn, and the endorsement of this approach by the authorities, have helped support confidence within Austria as well as in the region generally. The mission welcomed Austrian engagement in the European Bank Coordination Initiative ("Vienna Initiative"), which is helping to address cross-border banking issues in Eastern Europe (Box 4).

Box 4. European Bank Coordination Initiative ("Vienna Initiative")

Western European banks play a key role in CESE countries and have a long-term interest in the region. Continued private bank involvement is critical for balance of payments sustainability, which requires coordination to: (i) keep banks well capitalized and (ii) ensure rollover of loans.

The European Bank Coordination Initiative (EBCI) facilitates information exchange and coordination and includes home and host country authorities and banks. For program countries, the EBCI also involves country-related bank coordination under the leadership of the IMF and the EC—with support from other IFIs. Four country coordination rounds have taken place so far (Serbia, Romania, Hungary, and Bosnia and Herzegovina) with foreign banks involved signing commitment letters to support their subsidiaries in the individual countries, and also committing in some cases to forward looking recapitalization, as necessary, based on agreed stress tests.

In parallel, under a "Joint IFI action plan", the EBRD, EIB, and World Bank Group are directly lending to commercial banks, aimed at maintaining exposure in the CESE region.

Looking ahead, coordination efforts are scheduled to be extended to more countries, with a focus on specific commitments.

C. Insurance and Pensions

36. **The insurance sector has been affected by falling asset markets but has not experienced liquidity pressures or major adverse changes in policyholder behavior.** Some insurers were exposed to Icelandic banks and asset-backed securities. The failure of Lehman had an unexpected impact on guarantees attached to certain products. However, the main crisis impact has been falling asset values—especially corporate bonds, as equity investment is low (averaging 4.3 percent at the end of 2008). While many life policies have guarantees, the guaranteed return is relatively low. Because of the limited development to date of private pensions, annuities business is low. Insurers have not suffered liquidity pressures, and lapses (policyholders cashing in policies early) remain low, although new business has been falling in life insurance. Experience has been similar overall in CESE countries, where the larger insurers have been developing significant market presence.

37. **While government support is available to insurance, the focus now is on enhanced supervision.** The authorities noted that for precautionary reasons, they had made state support available to insurers as they had to banks, but neither capital nor guarantees had been needed. In addition, Insurance Supervision Act requirements related to the accounting recognition of investment losses were relaxed somewhat, mostly on a temporary basis. The authorities are now monitoring unrecognized losses in case of permanent impairment, as well as experience in CESE countries, where economic downturn may have increasingly varied impacts on asset values and policyholder behavior across markets. In common with the banks, Austrian insurers remain committed to a strategy of development in the CESE region. The supervisors are also stepping up their monitoring of complex new products.

38. **The authorities are addressing crisis lessons for the private pension system.** Falls in asset values have spurred interest in reform of pension funds (Pensionskassen) and the key Zukunftsvorsorge product (state-supported retirement provision). The authorities are now discussing these issues with the Pensionskassen, insurance companies and others. The mission noted that in the case of the Zukunftsvorsorge product, previous IMF reports, including the 2008 FSAP Update, had raised concerns over the high (40 percent) minimum equity investment requirement coupled with a generous guarantee. Total amounts invested are still relatively low. However, as these are longer-term (up to 40 year) policies and over one million have been sold since 2003, with total premiums now around €700 million per year, aggregate values are set to rise significantly over the medium term.

D. Regulatory Initiatives

39. **Regulatory reform will be taken forward mainly through the EU process, although other changes, many in response to the 2008 FSAP Update, are being made.** Most crisis lessons for regulation, including for bank capital and liquidity requirements, will be addressed through Austria's participation in EU reforms. But the authorities have also

responded to the particular crisis experience of Austria, including the prevalence of foreign currency lending.⁷ Many FSAP Update recommendations on regulatory reform and related issues have been addressed. Cooperation between the ANB and the FMA in banking supervision has been intensified—and worked well under pressure of the crisis. On-site inspection and off-site monitoring have been increased, staff resources augmented, and cooperation with foreign regulators stepped up, including through supervisory colleges.

VI. STAFF APPRAISAL

40. **The economic downturn in Austria will be severe.** The crisis came to Austria relatively late, but has now fully arrived. The economy is expected to shrink by 4 percent in 2009—the highest rate of decline in the post-war period—with a recovery starting in 2010. Exports and investment were affected first, in late 2008, and more recently private consumption has been impacted as well. Inflation is projected to remain low this year, with a slight increase in 2010. The risks to the outlook are balanced, but the uncertainties are large.

41. **The fiscal stimulus measures are welcome, but could have been better targeted.** The stimulus was timely, but neither temporary nor optimally targeted. The tax cuts for middle-income earners are likely to have lower multipliers than public investment or more targeted payments would have had. In addition, the measures included in the package—with the exception of those supporting short-term labor arrangements—are largely permanent.

42. **The stimulus, large automatic stabilizers, and financial sector support will weaken public finances significantly.** In the next few years, the deficit is projected to remain at 5-6 percent of GDP, and debt is expected to rise by about 20 percentage points to above 80 percent of GDP. In light of the rapid fiscal deterioration, and in particular the sharp rise in debt, further stimulus is not recommended at this stage.

43. **The authorities should prepare a credible fiscal consolidation plan to be implemented once the economy stabilizes.** This will strengthen the market's confidence in fiscal sustainability, and contribute to a lowering of borrowing costs. In particular, debt should be brought back to a downward path to accommodate the costs of aging and avoid crowding out the private sector. Plans for fiscal consolidation could be agreed upon later this year, so that implementation can start when the economy recovers.

44. **Expenditure measures are preferable to tax hikes.** Since taxation in the major categories remains relatively high, expenditure measures should have priority. Key areas for consolidation include administration at lower levels of government, pensions, and education and health. It is important that the Working Group on Fiscal Consolidation makes early

⁷ See Annex 2 on *Regulatory Reform Priorities in Austria* for further details.

progress in developing specific recommendations. Accompanying measures on the revenue side could include increases in the fuel tax and the real estate tax.

45. **Recent structural fiscal reforms are welcome, but need to be used more effectively to ensure long-term sustainability.** The federal equalization law for 2008-13 should be complemented by better-enforced limits on subnational deficits and by greater cooperation between municipalities to reap efficiency gains. The long-awaited medium-term budget establishes binding ceilings to 2013 for broad categories of federal government expenditures. The ceilings in this budget, however, are unambitious.

46. **The authorities' response to the financial crisis was timely and comprehensive.** The ANB and FMA cooperated to address liquidity shortages, while Parliament enacted a large banking support package, which included fresh capital and guarantees for new debt issues. A blanket deposit guarantee was introduced in response to similar measures by other EU members. Supervision has been stepped up, as has cooperation with foreign regulators. These measures have ensured that banks remain adequately capitalized with access to funding, although the slow pace of disbursements under the public support program has been a concern. Contingency planning should support quick and effective interventions, if needed.

47. **The banking system's exposure to CESE is large and we welcome the ANB's use of stress tests to identify banks' vulnerabilities.** The recent tests indicate that the capital ratios of all systemic banks would remain above minimum regulatory requirements under a range of shocks. Because of uncertainty over the impact of the recession on future levels of banks' non-performing loans, ratios well above the regulatory minimum will be needed to support private investors' confidence in banks. The authorities are advised to use the tests—to be repeated to reflect changes in the outlook—as input for discussions with the banks about the possible need for stronger capital buffers, if necessary through further public sector participation. Tail risks underline the importance of contingency planning.

48. **The banks are focused on risk management, while reiterating their commitment to Eastern European markets.** Many banks are reducing risk by tightening lending policies, curtailing foreign currency lending and, where possible, shortening the term of lending portfolios. They are also seeking to broaden their deposit base. At the same time, the major banks have stated the intention to support their subsidiaries in Eastern Europe. In this context, the active role of the Austrian banks and authorities in the European Bank Coordination Initiative (the "Vienna Initiative") is important and welcome.

49. **The insurance and pensions sectors also require attention.** The FMA should continue to monitor major insurers, particularly their vulnerability to asset falls that may accompany economic downturn in Austria and Eastern Europe. Further development of stress tests will be useful in this context. Government initiatives to consider possible reforms to the private pension system (including the "Zukunftvorsorge") are also worthwhile.

50. **The authorities should continue to strengthen the regulatory and supervisory framework in response to crisis lessons.** A further strengthening of regulatory capacity may be needed as EU and wider international initiatives, for example on bank capital and liquidity and the perimeter of regulation, are implemented. Gaps in the FMA's powers, for example its ability to levy significant fines, should be filled. Close cross-border supervisory cooperation will also be essential.

51. It is proposed that the next Article IV consultation be conducted on the standard 12-month cycle.

Table 1. Austria: Basic Data, 2005-10

Total area	83,850 square kilometers					
Total population (2008)	8.3 million					
GDP per capita (2008)	US\$ 44,600 (€ 33,800)					
	2005	2006	2007	2008	2009	2010
					Proj.	
	(Percentage changes at constant prices)					
Demand and supply						
GDP	2.5	3.5	3.5	2.0	-4.0	-0.3
Total domestic demand	1.9	2.3	1.7	1.1	-2.6	-0.1
Consumption	2.0	2.0	1.0	1.4	0.1	0.3
Gross investment	1.6	3.0	3.9	0.3	-10.8	-1.3
Foreign balance 1/	0.7	1.4	1.6	0.9	-1.6	-0.2
Exports of goods and nonfactor services	7.4	7.5	9.4	0.8	-10.3	0.5
Imports of goods and nonfactor services	6.4	5.3	7.3	-0.7	-8.8	1.0
Output gap (percent of potential GDP)	-0.4	1.2	3.0	3.4	-1.6	-2.7
	(Percentage changes; period averages)					
Employment and unemployment						
Employment	0.9	1.6	1.9	2.3	-1.4	-1.4
Unemployment rate (in percent)						
Registered (national definition)	7.3	6.8	6.2	5.8	7.2	8.3
Standardized (Eurostat)	5.2	4.8	4.4	3.9	5.3	6.4
	(Percentage changes; period averages)					
Prices						
Consumer price index	2.1	1.7	2.2	3.2	0.5	1.0
Unit labor costs (manufacturing)	-0.9	-4.4	-0.6	1.3	3.7	-1.3
	(Percent of GDP)					
General government finances 2/						
Revenue	48.4	47.9	48.0	48.3	46.1	45.3
Expenditure	50.1	49.7	48.7	48.7	50.4	50.8
Balance	-1.7	-1.7	-0.7	-0.5	-4.2	-5.6
Structural Balance	-1.6	-2.3	-1.8	-1.7	-3.5	-4.5
Gross debt (end of period)	63.9	62.3	59.5	62.6	70.2	75.5
	(Billions of euros)					
Balance of payments						
Trade balance (goods)	-1.4	0.3	1.3	-0.2	-3.0	-4.0
Current account	4.9	7.3	8.4	9.8	5.8	4.2
(In percent of GDP)	2.0	2.8	3.1	3.5	2.1	1.5
	(Percent; period average)					
Interest rates						
Three-month interbank rate	2.2	3.1	4.3	4.6	...	...
10-year government bond	3.4	3.8	4.3	4.3	...	...
	(Levels; period average)					
Exchange rates						
Euro per US \$	0.80	0.80	0.73	0.68	...	...
Nominal effective exchange rate (2000=100)	105.3	105.5	107.0	107.9	...	...
Real effective exchange rate (1990=100)						
ULC based	106.9	103.8	105.4	106.6	...	...
CPI based	105.8	105.6	106.9	107.8	...	...

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

1/ Contribution to GDP growth.

2/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps.

Table 2. Austria: Medium-Term Macroeconomic Framework, 2005-14

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Projections									
	(Percentage contribution at 2000 prices)									
National accounts										
GDP	2.5	3.5	3.5	2.0	-4.0	-0.3	1.6	2.0	2.1	2.4
Domestic demand	1.8	2.2	1.6	1.0	-2.4	-0.1	1.2	1.6	1.6	1.6
Final consumption	1.5	1.5	0.7	1.0	0.0	0.2	0.7	0.8	0.9	0.9
of which: Private consumption	1.2	1.0	0.4	0.4	-0.1	0.1	0.5	0.6	0.6	0.6
Gross investment	0.4	0.7	0.9	0.1	-2.4	-0.3	0.5	0.7	0.7	0.8
Exports of goods and nonfactor services	4.0	4.2	5.5	0.5	-6.3	0.3	1.5	3.3	3.5	3.8
Imports of goods and nonfactor services	-3.3	-2.8	-3.9	0.4	4.8	-0.5	-1.1	-2.9	-3.0	-3.1
Statistical difference	-0.1	-0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
	(Percentage change)									
Prices and unemployment										
CPI inflation	2.1	1.7	2.2	3.2	0.5	1.0	0.8	1.2	1.5	1.8
Unemployment	5.2	4.8	4.4	3.9	5.3	6.4	6.5	6.1	5.7	5.3
	(Percent of GDP)									
External accounts										
Current account balance	2.0	2.8	3.1	3.5	2.1	1.5	1.5	1.4	1.2	1.2
Goods and services balance	3.3	3.9	4.9	4.7	3.3	2.8	2.7	2.7	2.5	2.5
General government accounts 1/										
Revenue	48.4	47.9	48.0	48.3	46.1	45.3	45.2	45.1	45.2	45.7
Expenditure	50.1	49.7	48.7	48.7	50.4	50.8	50.6	50.1	49.4	49.2
Balance	-1.7	-1.7	-0.7	-0.5	-4.2	-5.6	-5.3	-5.0	-4.2	-3.4
Gross debt	63.9	62.3	59.5	62.6	70.2	75.5	79.0	81.6	82.9	82.9
Structural balance	-1.6	-2.3	-1.8	-1.7	-3.5	-4.5	-4.4	-4.4	-3.8	-3.4
Memorandum items:										
Gross national saving (percent of GDP)	24.6	25.4	26.0	26.2	23.2	22.4	22.5	22.8	22.8	23.1
Gross domestic investment (percent of GDP)	22.5	22.6	22.9	22.7	21.1	20.9	21.1	21.4	21.6	21.9
Potential output (growth in percent)	2.0	1.9	1.7	1.6	0.9	0.9	1.0	1.2	1.5	1.7
Output gap (in percent of potential output)	-0.4	1.2	3.0	3.4	-1.6	-2.7	-2.2	-1.4	-0.8	-0.2

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

1/ On ESA95 basis. The Maastricht Excessive Deficit Procedure (EDP) definition differs from this due to the inclusion of revenues from swaps.

Table 3. Austria: Balance of Payments, 2005-14
(In percent of GDP)

	2005	2006	2007 Rev.	2008 Est.	2009	2010	2011	2012	2013	2014
	Projections									
Current account	2.0	2.8	3.1	3.5	2.1	1.5	1.5	1.4	1.2	1.2
Trade	3.3	3.9	4.9	4.7	3.3	2.8	2.7	2.7	2.5	2.5
Exports	53.4	55.8	58.8	58.1	54.2	54.4	54.8	56.6	58.3	60.5
Imports	50.1	51.9	53.9	53.5	50.9	51.6	52.1	53.9	55.8	58.1
Goods	-0.6	0.1	0.5	-0.1	-1.1	-1.5	-1.5	-1.7	-2.1	-2.3
Exports	39.4	41.6	43.8	43.1	39.5	39.7	40.0	41.5	42.9	44.8
Imports	39.9	41.4	43.4	43.2	40.6	41.1	41.5	43.2	44.9	47.1
Nonfactor services	3.8	3.8	4.4	4.8	4.4	4.2	4.2	4.4	4.5	4.7
Exports	14.0	14.2	14.9	15.1	14.7	14.7	14.8	15.1	15.4	15.7
Imports	10.2	10.4	10.5	10.3	10.2	10.5	10.6	10.7	10.9	11.0
Balance on Factor Income	-0.7	-0.6	-1.4	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9
Credit	8.6	9.6	10.6	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Debit	9.2	10.2	12.0	11.8	11.8	11.8	11.8	11.8	11.8	11.8
Current transfers, net	-0.6	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Capital and financial accounts	-0.2	-3.4	-3.5	-4.2	-2.1	-1.5	-1.5	-1.4	-1.2	-1.2
Capital account, net	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FDI, net	-0.1	-1.4	-1.0	-3.6	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Portfolio investment, net	-4.5	4.5	8.5	9.1	6.5	4.5	4.0	2.5	2.0	2.0
Financial derivatives	0.1	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other	4.2	-6.0	-9.9	-9.7	-6.8	-4.2	-3.7	-2.1	-1.4	-1.4
Reserve assets	0.2	0.2	-0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-1.8	0.6	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. Austria: General Government Accounts, 2005-14

(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Projections									
Revenue	48.4	47.9	48.0	48.3	46.1	45.3	45.2	45.1	45.2	45.7
Taxes on production and imports	14.6	14.2	14.1	14.2	14.0	14.1	14.2	14.4	14.6	14.8
Property income	1.4	1.4	1.5	1.2	1.2	1.2	1.2	1.1	1.1	1.1
Current taxes on income, wealth, etc.	12.9	13.0	13.5	14.0	12.5	11.9	11.7	11.6	11.6	11.9
Social contributions	16.2	16.1	15.9	16.0	15.5	15.1	15.2	15.1	15.0	15.0
Other	3.3	3.3	3.1	2.9	3.0	3.0	2.9	2.9	2.9	2.9
Expenditure	50.1	49.7	48.7	48.7	50.4	50.8	50.6	50.1	49.4	49.2
Intermediate consumption	4.4	4.3	4.3	4.5	4.6	4.5	4.5	4.5	4.2	4.2
Compensation of employees	9.4	9.4	9.1	9.1	9.9	9.9	9.3	9.1	8.9	8.9
Subsidies, payable	3.4	3.4	3.3	3.5	3.6	3.5	3.4	3.4	3.4	3.4
Interest	3.0	2.9	2.9	2.6	1.7	2.0	2.6	2.6	2.6	2.6
Social benefits	18.8	18.5	18.0	18.1	18.7	19.2	19.1	18.9	18.6	18.4
Transfers	9.9	10.1	9.9	9.7	10.4	10.3	10.2	10.1	10.1	10.1
Gross capital formation	1.1	1.0	1.0	1.0	1.2	1.1	1.1	1.1	1.1	1.1
Other	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Overall balance (ESA 95 basis)	-1.7	-1.7	-0.7	-0.5	-4.2	-5.6	-5.3	-5.0	-4.2	-3.4
Federal government	-1.9	-1.7	-0.8	-0.7	-2.0	-2.8	-2.6	-2.3	-1.8	-1.1
Other levels	0.2	0.0	0.1	0.2	-2.3	-2.8	-2.8	-2.7	-2.4	-2.3
Structural balance (ESA 95 basis)	-1.6	-2.3	-1.8	-1.7	-3.5	-4.5	-4.4	-4.4	-3.8	-3.4
Fiscal impulse 1/	0.0	0.7	-0.5	-0.1	1.8	1.1	-0.1	0.0	-0.6	-0.5
Public debt	63.9	62.3	59.5	62.6	70.2	75.5	79.0	81.6	82.9	82.9
Memorandum item:										
Overall fiscal balance, EDP definition 2/	-1.6	-1.6	-0.5	-0.4	-4.2	-5.5	-5.3	-4.9	-4.1	-3.4

Sources: Federal Ministry of Finance; Austrian Stability Program; and IMF staff estimates and projections.

1/ Negative of the change in the structural balance.

2/ The Maastricht Excessive Deficit Procedure (EDP) definition is used by the Austrian authorities. The difference from ESA95 is due to the inclusion of revenues from swaps.

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2005-09 1/
(In percent)

	2005	2006	2007	2008	2009Q1
<i>Capital adequacy</i>					
Regulatory capital to risk-weighted assets 2/	11.8	11.8	12.7	12.9	...
Regulatory Tier I capital to risk-weighted assets 2/	8.2	8.0	8.8	9.3	...
Capital to assets	4.8	5.2	6.5	6.3	6.3
<i>Asset composition</i>					
<i>Sectoral distribution of bank credit to total gross bank credits</i>					
<i>(as percentage of total bank credits)</i>					
Nonbank financial institutions	3.6	3.7	3.3	3.2	3.2
Nonfinancial corporations	20.4	19.7	18.4	16.6	16.6
Households	20.1	18.9	17.7	15.4	15.3
Of which: housing loans	10.1	10.4	9.6	8.6	8.6
personal loans	10.0	8.5	8.1	6.8	6.8
Public Sector	5.4	4.9	4.0	3.1	3.2
Nonresidents	12.9	13.7	15.7	15.6	15.5
Domestic and non-domestic banks	37.6	39.1	40.9	46.1	46.1
<i>Geographical distribution of loans to total loans</i>					
Domestic	70.6	68.6	65.7	67.5	67.1
Cross-border	29.4	31.4	34.3	32.5	32.9
Of which: EMU	10.1	10.2	11.7	9.7	10.3
CEEC	9.4	9.6	11.6	12.9	13.2
Other	9.9	11.6	11.1	9.9	9.5
<i>Asset quality</i>					
Nonperforming loans to total gross loans 3/	2.6	2.1	2.2	2.0	2.2
Loan loss provisions (as % of loans to non-banks, domestic and non-domestic)	3.1	2.9	2.4	2.2	2.4
Loan-loss provisions to nonperforming loans 3/	71.5	75.3	76.4	64.0	63.0
Nonperforming loans net of loan-loss provisions to Tier 1 capital 3/	15.1	9.6	6.0	8.8	9.7
Total foreign currency-denominated loans to total loans	25.9	24.8	23.6	25.9	24.6
Foreign currency-denominated loans to residents to total claims on residents	20.1	18.7	16.2	18.0	17.7
Foreign currency-denominated loans to households to total claims on househ.	31.0	30.8	27.4	30.7	30.2
Foreign currency-denominated loans to corporations to total claims on corp.	13.4	10.8	8.1	9.1	9.0
Large exposures to capital	89.7	77.5	56.4	67.8	65.1
10-largest credit to net credits (loans to nonbanks) 3/	6.8	6.8	6.0	8.8	10.4
<i>Earnings and profitability</i>					
Return on assets 2/ 3/	0.6	0.7	0.8	0.1	...
Return on equity 2/ 3/	14.8	16.9	17.0	2.6	...
Net interest margin (net interest income as % of interest bearing assets)	1.1	1.0	1.0	0.9	0.9
Gross income as a percentage of average assets	2.3	2.2	2.1	2.0	1.6
Net interest income to gross income 2/ 3/	72.2	71.1	70.7	64.6	...
Noninterest income to gross income 2/ 3/	27.9	28.9	29.3	35.4	...
Trading income as a percentage of gross income	4.1	4.1	1.7	-4.0	5.2
Noninterest expenses as a percentage of gross income 2/	71.9	68.8	66.6	90.4	...
Personnel expenses as a percentage of noninterest expenses	50.1	50.5	50.4	50.6	52.8
Spread between domestic lending and deposit rates	1.2	0.9	0.8	1.3	1.3

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2005-09 1/ (concluded)
(In percent)

	2005	2006	2007	2008	2009Q1
<i>Liquidity</i>					
Liquid assets to total assets	27.4	27.6	26.8	26.8	26.3
Liquid assets to short-term liabilities	68.0	68.6	67.2	67.8	71.2
Foreign currency-denominated liabilities to total liabilities	20.5	20.0	17.2	19.4	18.4
Deposits as a percentage of assets	65.3	63.8	62.6	63.4	63.3
Loans as a percentage of deposits	112.9	115.8	116.3	117.7	117.5
<i>Sensitivity to market risk</i>					
Off-balance sheet operations as a percentage of assets	207.5	208.1	200.2	190.2	191.3
<i>Of which: interest rate contracts</i>	171.9	170.7	159.5	140.2	143.8
forex contracts	33.1	35.1	38.6	47.4	44.9
other derivatives	2.4	2.5	2.2	2.6	2.6
Duration of assets (in percent of total assets)					
Less than 3 months	61.1	59.3	62.4	67.3	69.2
Between 3 months and 1 year	13.7	12.2	13.4	13.7	14.5
Between 1 and 5 years	12.4	11.5	10.7	10.1	10.7
More than 5 years	8.3	8.1	7.6	7.1	7.6
Duration of liabilities (in percent of total liabilities)					
Less than 3 months	58.6	54.4	56.9	60.0	61.9
Between 3 months and 1 year	13.4	13.5	14.6	16.4	17.4
Between 1 and 5 years	14.8	14.0	12.4	12.3	13.9
More than 5 years	9.1	8.9	10.0	9.4	8.8
Net open position in foreign exchange to capital	3.3	3.8	2.5	1.6	1.2
<i>Memorandum Items (EUR billions)</i>					
Regulatory capital 3/	51.8	59.5	63.1	87.8	88.1
Regulatory Tier 1 capital 3/	35.0	41.8	47.1	66.9	67.6
Risk-weighted assets 3/	353.4	393.3	362.3	454.8	448.6
Total assets	725.8	797.8	899.5	1,069.1	1,069.5
Total loans	535.4	589.4	654.9	797.5	794.9
Total deposits	474.2	509.2	563.2	677.5	676.6
Net interest income	7.1	7.2	7.4	8.2	2.2
Noninterest income	8.6	9.4	10.1	12.3	2.2
<i>Of which: Income from securities and participating interests</i>	2.7	2.9	3.5	7.2	0.7
Net fee-based income	3.9	4.3	4.7	4.2	0.9
Net income from financial transactions	0.6	0.7	0.3	-0.8	0.2
Other operating income	1.3	1.6	1.6	1.7	0.4
Noninterest expenses	10.1	10.8	10.8	11.4	2.7
Total operating income	15.7	16.6	17.5	20.6	4.3
Total operating expenses	10.1	10.8	10.8	11.4	2.7
Pre-tax operating profit	5.6	5.8	6.7	9.1	1.7
Pre-tax total profit	4.0	4.5	5.2	2.1	3.0
After-tax profit	3.7	4.0	4.8	1.9	2.7
Profits accrued from subsidiaries abroad	2.7	3.1	5.0	7.2	n.a.
Net open foreign exchange position	1.7	1.5	2.0	1.4	1.1

Source: Austrian National Bank.

1/ Figures refer to the whole banking system, including foreign owned banks, unless noted otherwise.

2/ Figures refer to Austrian owned banks only.

3/ Comparability across years is limited due to changes in reporting requirements or introduction of new reporting schemes.

Table 6. Austria: Major Banks' Ratings Changes, 2008-09

Bank Name	Date	Rating Type	Agency	New Rating	Previous Rating	Action type
Erste	10/16/2008	Outlook	S&P	Negative	Stable	...
	12/11/2008	Bank Financial Strength	Moody's	...	C	review
	12/11/2008	Senior Unsecured Debt	Moody's	...	Aa3	review
	4/16/2009	Individual Rating	Fitch	C	B/C	downgrade
	4/1/2009	Bank Financial Strength	Moody's	C-	C	downgrade
Raiffeisen	11/25/2008	Outlook	S&P	Negative	Stable	...
	4/1/2009	Issuer Rating	Moody's	A1	Aa2	downgrade
	4/1/2009	Bank Financial Strength	Moody's	D+	C	downgrade
Volksbanken	11/17/2008	Bank Financial Strength	Moody's	C-	C	downgrade
UniCredit Bank Austria	3/18/2009	Outlook	S&P	Stable	Stable	...
	3/18/2009	LT Local and Foreign Issuer Credit	S&P	A	A+	downgrade
	4/16/2009	Individual Rating	Fitch	C/D	B/C	downgrade
	4/27/2009	Senior Unsecured Debt	Moody's	A1	Aa2	downgrade
	4/27/2009	Bank Financial Strength	Moody's	D+	C+	downgrade

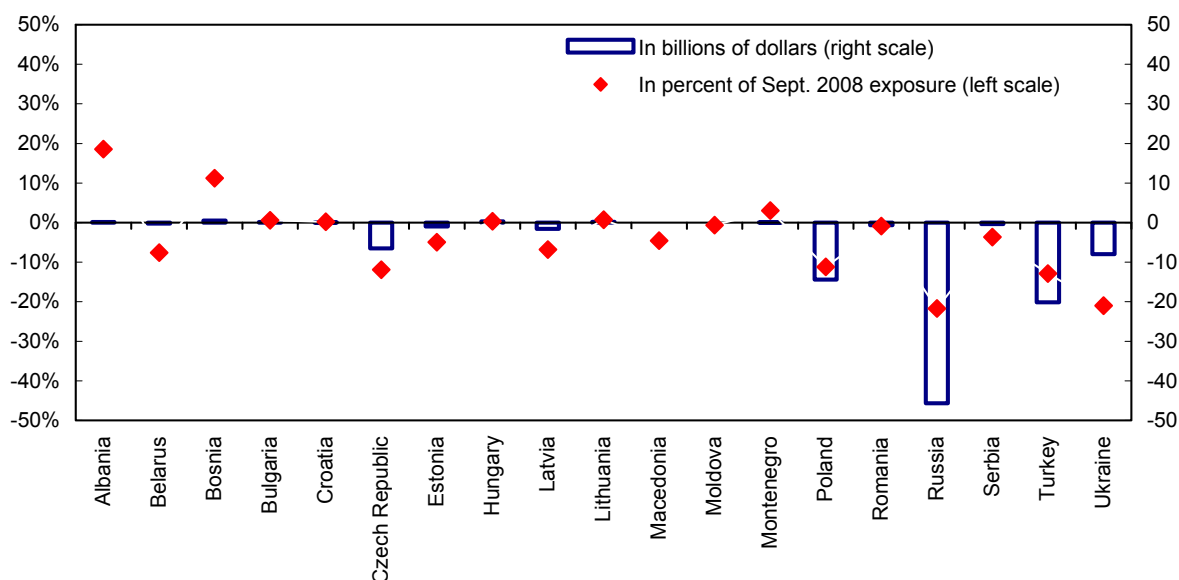
Source: Bloomberg.

Annex 1. Western Banks' Exposures to Eastern Europe: Interpreting the BIS Data

The BIS international banking data shows a significant decline in the Western banks' exposures to Eastern Europe in 2008Q4 and 2009Q1, with banks from most advanced European countries contributing to the decline.

Based on the BIS *locational banking statistics*, the exposure of Western banks to Eastern Europe declined by US\$57 billion in 2008Q4 and US\$40 billion in 2009Q1 (adjusted for exchange rate changes), after increasing by US\$25 billion in 2008Q3. The decline was concentrated in five emerging market countries—Russia, Turkey, Poland, Ukraine, and the Czech Republic (see Figure A1).

Figure A1: Exchange Rate Adjusted Changes in External Positions of Western Banks vis-à-vis Eastern European Countries during 2008Q4 and 2009Q1 (in billions of US dollar)



Source: BIS (July, 2009), Provisional data release, Table 6A: External positions of reporting banks vis-à-vis all sectors; vis-à-vis individual countries.

Because a breakdown of locational data by home/host country is not available, we take a closer look at *consolidated international banking statistics* to gauge the changes in bilateral exposures. Since the BIS does not publish the exchange rate adjusted changes in consolidated foreign claims of reporting banks, US dollar amounts outstanding are converted into euros at end-period exchange rates to control for US\$/euro exchange rate changes. Table A1 shows that the largest declines were observed in the Western banks' consolidated claims vis-à-vis, Poland, Russia, the Czech Republic, Ukraine, Latvia, and Turkey—consistent with the locational data. Only the Swedish, Spanish, and French banks seem to have maintained or increased their Eastern European exposures between end-September 2008 and end-March 2009.

Table A1: Changes in Foreign Claims of Western European Banks on Eastern European Countries during 2008Q4 and 2009Q1 (in billion euros) 1/

Country	Total foreign claims	Germany	Netherlands	Italy	Belgium	Austria	Switzerland	United Kingdom	Portugal	Spain	Sweden	France
Romania	1.8	0.0	-0.1	0.2	0.0	0.5	-0.5	-0.1	0.2	0.1	0.0	0.3
Bulgaria	0.8	-0.2	-0.1	0.4	-0.1	-0.1	0.1	0.1	0.0	0.0	0.0	0.4
Macedonia, FYR	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Bosnia and Herzegovina	0.0	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Albania	-0.1	0.0	0.0	-0.1	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Montenegro	-0.1	0.0	0.0	-0.3	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Moldova	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Belarus	-0.2	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1
Croatia	-0.3	0.1	0.0	-1.8	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.7
Lithuania	-0.8	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0	1.3	0.0
Serbia	-1.0	-0.3	0.0	0.2	0.0	-1.1	-0.1	0.0	0.0	0.0	0.0	0.5
Hungary	-1.4	-1.2	-0.9	-0.1	0.5	0.3	-0.2	-2.4	-0.1	0.2	0.0	0.4
Estonia	-2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	0.0
Turkey	-3.3	-0.4	-0.9	0.0	-1.3	-1.1	-1.0	0.0	-0.1	0.0	-0.1	1.3
Latvia	-4.1	-0.5	0.0	-0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.4	0.0
Ukraine	-5.7	-0.4	-0.6	0.3	-0.3	-1.9	-0.8	-0.1	0.0	0.0	-1.0	-0.4
Czech Republic	-10.6	-0.4	-1.4	-0.8	-3.7	-2.3	-0.2	-2.1	0.0	-0.1	0.0	0.0
Russia	-14.0	-7.4	-1.6	-0.7	-1.9	-0.3	-3.5	-2.3	-0.1	0.1	0.2	8.9
Poland	-24.1	-2.2	-5.2	-7.6	-2.0	-2.0	-0.6	0.0	-0.9	-0.1	-0.5	-0.8
All countries	-65.7	-12.9	-10.8	-10.5	-8.9	-7.2	-6.7	-6.9	-1.0	0.1	0.1	11.2

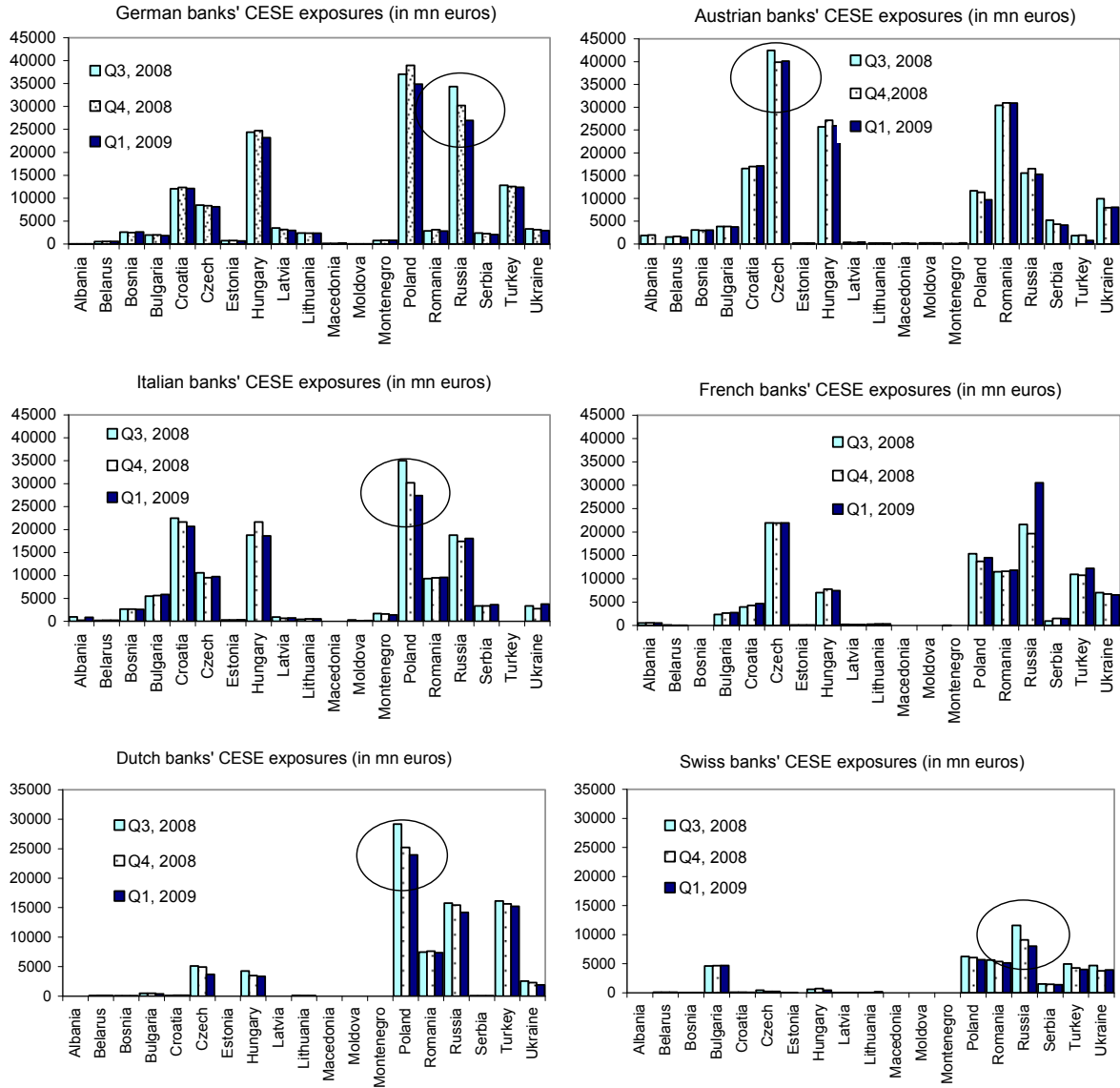
Source: BIS (July, 2009), Provisional data release, Table 9B: Consolidated foreign claims of reporting banks - immediate borrower basis, on individual countries by nationality of reporting banks.

1/ The numbers in a row do not necessarily add up to the total in the first column due to differences in the population of banks included, resulting from data limitations and definitional differences.

Possible interpretations:

- Western banks seem to have scaled back some of the more risky exposures (for example, Ukraine), while trying to maintain positions in markets where they have long-term strategic interests.
- Some of the banks' Eastern European portfolio rebalancing may have been motivated by the need to reduce concentration of exposures. For example, among the notable reductions in bank positions were those of German banks vis-à-vis Russia, Austrian and Belgian banks' vis-à-vis the Czech Republic, and Italian banks' vis-à-vis Poland (see Figure A2).
- Other considerations might have been the feasibility of scaling back exposures without putting excessive pressure on local economies or without reputational damage (for example, by reducing lending to unaffiliated entities, rather than the banks' affiliates).

Figure A2: Selected Western Banks' Exposures to Eastern European Countries



Source: BIS Table 9B: Consolidated foreign claims of reporting banks - immediate borrower basis, on individual countries by nationality of reporting banks.

Annex 2. Regulatory Reform Priorities in Austria

Financial regulation is undertaken by the FMA, an integrated regulator created in 2002. Since January 1, 2008, responsibilities for onsite inspection and offsite analysis of banks that were formerly shared between the FMA and the ANB have been allocated to the ANB but the FMA remains the decision-taking authority for banks and is jointly responsible for international cooperation.

Crisis lessons relating to weaknesses in prudential regulation will be addressed in Austria through its implementation of changes in EU legislation such as the Capital Requirements Directive. For insurance, the FMA's approach will be transformed from 2011 by the Solvency II directive, which will introduce market consistent approaches to asset and liability valuation. The ANB will be a member of the new European Systemic Risk Board.

In the meantime, the FMA has addressed certain features of Austrian crisis experience, including:

- The high level of foreign currency lending in Austria. Such loans have not been prohibited; instead, the FMA issued a recommendation in October 2008 on bank practices, which has contributed to the ending of new foreign currency loans to Austrian households. In June, the FMA announced an approach that will result in banks reducing outstanding lending year by year in line with targets agreed with the regulators. However, most of the intermediaries involved in arranging such loans will remain unregulated.
- Weaknesses in the conduct of investment business, particularly sales practices in respect of property funds and investment-linked vehicles for the repayment of bank loans ("Tilgungsträger"). Enforcement action has been taken, which has contributed to a sharp reduction in the number of licensed companies.

Some material gaps in the FMA's powers have been highlighted by the crisis. As elsewhere, banks have not been required to include certain off-balance sheet vehicles and conduits in the calculation of prudential ratios. There are also gaps in FMA's investigative powers and its powers of sanction are limited by the low ceiling (€75,000 in cases of market manipulation) on administrative penalties (fines). Under official secrets legislation, the FMA is unable to make public its administrative decisions and supervisory measures other than in the most exceptional cases. One further significant gap was recently filled when Parliament removed limits on FMA's powers to set capital requirements for individual firms above the minimum generally applicable level set out in law.