

## Concluding Statement – IMF Article IV, 2026

### *Recent Developments*

- **Over the past year, the Austrian economy has begun to recover.** In 2025, Austria emerged from two years of recession, with growth reaching 0.7 percent, supported by a modest pickup in fixed investment, exports, and public consumption. Growth remained subdued, however, as residential investment continued to contract and private consumption was dampened by slowing wage growth and still-elevated savings rates. Even so, the recovery helped stabilize labor market conditions, with the unemployment rate leveling off at 5.5 percent (harmonized) in recent months. Public finances also improved, with the fiscal deficit narrowing from 4.6 percent of GDP in 2024 to 4.2 percent in 2025, driven mainly by higher revenues. Despite the strengthening of activity, inflation declined markedly ahead of the war in the Middle East, reflecting both falling energy prices and downward pressure on core inflation from a still-sizeable output gap.

### *Outlook and Risks*

- **The war in the Middle East is expected to slow, but not derail, the near-term recovery.** Based on current assumptions, the macroeconomic impact of the energy shock is projected to be more limited than in 2022. CPI inflation is projected at 2.5 percent in 2026, about 0.6 percentage points higher than the pre-war forecast. Higher petrol prices are expected to weigh on real income growth and private consumption, lowering projected growth in 2026 by about 0.4 percentage points to 0.7 percent.
- **Over the medium term, growth is projected to slow, reflecting demographic headwinds.** Despite further fiscal consolidation, growth is expected to strengthen to about 1.3 percent by 2028, as domestic and external demand gradually respond to past monetary easing and a projected decline in energy prices. However, the economy is then projected to slow again to potential growth of around 0.8 percent in 2031—below the 1.2 percent average of the past decade—reflecting persistently weak labor productivity growth and a shrinking workforce.
- **Downside risks are mainly external.** In the near term, a deeper or more persistent disruption to energy markets could further squeeze private consumption and weigh on corporate profitability, potentially dampening investment, including in green technologies critical for reducing vulnerability to future energy shocks. Over the medium term, risks stem from fragmentation and growing external competition. While wage restraint and specialization in niche export segments are currently assumed to broadly protect Austria's export market share, this may prove insufficient—particularly if German industry struggles to adapt to rising pressures from protectionism and lower-cost producers.

### *Policies*

#### Fiscal

- **The fiscal balance is projected to remain unchanged in 2026.** The fiscal deficit is expected to remain just above 4 percent of GDP, reflecting three factors. First, consolidation measures in the 2025–26 dual budget were largely front-loaded, leaving only about 0.6 percent of GDP in additional measures for 2026. Second, a series of offsetting measures—including higher aging-related spending, interest costs, and defense outlays, as well as lower revenues from cuts in energy- and

food-related taxes—are expected to weigh on the fiscal balance. Third, economic growth is no longer accelerating, as higher prices weigh on private consumption. While the still-weak cyclical position—reflected in an output gap of around 1 percent of potential GDP—argues for some caution, additional deficit reduction would nonetheless have been appropriate.

- **Measures to mitigate the impact of higher energy prices should be fair, cost-effective, and consistent with Austria’s energy security objectives.** The most effective response to the current shock is targeted income support for vulnerable households. This approach preserves price signals, encourages energy conservation, and limits fiscal costs. By contrast, the response to date—both in Austria and in many European countries—has relied mainly on broad-based tax reductions. Although the fiscal impact has so far been contained, in part due to counter-financing measures, experience suggests that such measures can expand over time and be difficult to unwind.
- **Looking beyond 2026, the deficit targets in the 2027–28 budget are appropriate but further consolidation will be needed.** The authorities’ objective of reducing the deficit to 3 percent of GDP by 2028 is a reasonable near-term target which balances debt and growth considerations. However, further measures appear necessary to reach this target: staff projects that the deficit will only reach 3.5 percent of GDP in 2028. In addition, to put debt on a firm downward path and rebuild fiscal buffers, further consolidation after 2028—bringing the deficit to around 2 percent of GDP by 2031—is needed. While public debt of around 80 percent of GDP is not yet at alarming levels - particularly given near-zero real interest rates - fiscal space should be preserved for major shocks and growth-enhancing investment rather than absorbed by rising current spending.
- **However, the composition of the planned 2027–28 adjustment could be strengthened to limit adverse growth effects and enhance credibility.** The projected reliance on revenue measures—around half of the adjustment—is high for a country that already has the third-highest revenue ratio in Europe. In addition, while the planned expenditure restraint appropriately focuses on current rather than capital spending, it relies mainly on non-parametric measures—such as temporary changes to indexation—rather than durable structural reforms to the benefits system, notably pensions and health, limiting its medium-term impact. Finally, the envisaged deficit reduction at the subnational level (about 0.4 percent of GDP in 2027–28) is based on broad commitments under the recently approved Stability Pact but is so far only partially supported by clearly specified measures at the entity level.
- **Turning to fiscal structural reforms, we strongly welcome the authorities’ forthcoming review of the institutional design of fiscal federalism.** Since the pre-COVID period, the ratio of sub-national government (SNG) expenditure to GDP has risen by around 2½ percentage points of GDP, largely due to higher spending on health, education, and other social benefits. This increase has been financed through both higher sub-national deficits and larger transfers from the central government. While aging-related costs and healthcare inflation are of course placing upward pressure on expenditures, the speed of increase in spending suggests efficiency has deteriorated following the activation of the General Escape Clause at the European level and, subsequently, the suspension of the previous Stability Pact during the pandemic. In this context, we are encouraged by the authorities’ upcoming Austrian Reform Partnership, which aims to increase the efficiency of expenditures by streamlining the currently highly complex system of federal transfers. We recommend that four principles are considered in the design of the reforms:

- Transparency – It is encouraging that the nine Länder (including Vienna) are now required to submit and publish disaggregated fiscal results monthly. This requirement should be extended to the remaining sub-national entities which account for 50 percent of SNG spending. In addition, the data should be published in a central and easy to navigate way.
- Rules-based – Austria currently has a rules-based system to determine the amount and distribution of tax revenue to the subnational governments. However, this system is often complemented by ad hoc negotiated transfers to address apparent additional spending needs which increase the likelihood of fiscal slippages.
- Accountability – Right now, there is substantial functional overlap where several different levels of government share responsibilities for one particular activity such as policy planning, financing, or execution. Such overlap should be minimized to preserve incentives for expenditure efficiency.
- Digitalization - Systematic use of digital tools (including artificial intelligence), data platforms, and interoperability to make revenue collection, spending, transfers, and oversight across levels of government more transparent, timely, and efficient.

#### Financial

- **The Financial Sector Assessment Program (FSAP) found that short-term financial stability risks were low prior to the war in the Middle East and remain contained.** Despite domestic and external headwinds, the banking sector remains well capitalized, highly profitable, and liquid. Stress tests confirm that (i) system-wide capital ratios stay above regulatory requirements even under severe but plausible adverse scenarios, and (ii) banks can withstand significant liquidity outflows. Key risks stem from a prolonged economic downturn and continued weakness in commercial real estate. There is also the potential for negative spillovers from the CESEE region, but the banking system's broad geographic region also provides diversification benefits. The authorities should continue to monitor these risks closely and stand ready to adjust financial sector policies as needed.
- **Recent improvements to Austria's already strong financial sector oversight are welcome, but further strengthening is warranted.** The new commercial and residential real estate data dashboards represent an important step forward in monitoring risks in two systemically important sectors of the economy. Even though in place for only two quarters, the residential real estate dashboard has already shown that some banks started relaxing lending standards on residential mortgages as soon as mandatory standards were replaced by voluntary guidelines. This development warrants close monitoring. We see two areas, in particular, for further action:
  - Regarding macroprudential policy, increase the voting power of the central bank at the Financial Market Stability Board given that it has the expertise and mandate for macroprudential supervision, adjust the legal framework to allow for precautionary action for binding borrower-based measures and reintroduce them as a permanent structural tool.
  - Conduct a forward-looking, joint assessment of staffing and budget needs for the supervision of less significant institutions across the FMA and OeNB to safeguard supervisory effectiveness and crisis preparedness.

- **The FSAP recommends further aligning the financial safety net with international standards.** A standing inter-agency crisis management forum should be set up to coordinate national contingency planning and respond to stressed institutions or emerging crisis events. The deposit insurance system (DIS) should be strengthened by (i) shifting to quarterly contributions; (ii) prohibiting placing funds with member institutions; (iii) removing provisions that allow the DIS funds to be used for the Institutional Protection Schemes, and (iv) establishing a credible public-sector backstop to support DIS liquidity when private sources are insufficient or delayed, accompanied by appropriate safeguards.

#### Structural

- **Reforms to raise productivity are essential to improving living standards while preserving macroeconomic stability. Priority actions include the following.**
  - *Reduce restrictive domestic retail regulations.* Retail prices in Austria remain higher than in neighboring countries, even after controlling for differences in taxes and income levels. While multiple factors may play a role, comparatively restrictive retail regulations are a likely contributor. These include constraints on both business entry—such as location-specific rules and professional licensing—and operations, including shop-opening hours. Easing these restrictions would lower prices and raise real incomes in the near term. More importantly, it would strengthen business dynamism by encouraging entry and exit and reallocating activity toward more efficient firms, thereby supporting higher productivity growth over time.
  - *Improve the efficiency of research and development (R&D) spending through better-targeted fiscal incentives.* Austria has the third-highest R&D spending in Europe, amounting to over 3 percent of GDP, reflecting highly generous fiscal incentives. However, innovation outcomes, as measured by the European Innovation Scoreboard, underperform relative to what this level of spending would predict. One factor is that a large share of the tax incentive accrues to mature firms, even though evidence suggests that young firms tend to drive innovation. Targeted changes to the design of the R&D tax credit could improve efficiency while limiting abuse. In particular, shifting from a flat, scale-based credit toward a front-loaded, growth-oriented incentive—rewarding increases in R&D spending, especially R&D wages, and delivering support earlier in cash—would better align incentives with firms' liquidity needs and experimentation rather than firm size or age.
  - *Deepen and better integrate European capital markets.* Investment in Austria is currently financed largely through retained earnings or bank credit, which suits traditional outlays such as machinery replacement and real estate. However, this financial model is not ideal for riskier investments in innovation, intangibles, digitalization, or large-scale green projects that require equity and patient capital. While Austrian firms report few financing constraints, this largely reflects the current structure of firms and the nature of investment they undertake. Expanding access to EU-wide venture capital, private equity, and public equity markets would facilitate the type of firms and investment needed to increase productivity growth. This involves two main types of reforms:
    - Domestic Reforms – Europe will not achieve deep capital markets until European households are more willing to hold capital-market assets. Policy can help by making

it easier and more attractive for households to reallocate savings from low-yielding deposits and illiquid real estate toward diversified, cross-border financial assets that better preserve purchasing power over time. A natural entry point is retirement saving, given its long-term horizon. Increasing participation in the second-pillar pension system—which currently covers only about 25 percent of employees—would support this shift, even if its primary purpose remains supplementing retirement income. For the second pillar to grow sustainably, investment guidelines are critical: products should be low-cost, well diversified, and predominantly liquid, while allowing modest exposure to private equity and venture capital where consistent with liabilities and risk-bearing capacity.

- EU level reforms – The ultimate goal is that savings throughout Europe can be easily allocated to the most promising opportunities regardless of their location and without home bias. EU level reforms to the capital market infrastructure can help make this happen but require member state support. Three such reforms are: First, reduce legal and regulatory fragmentation through initiatives such as the 28th regime with common insolvency rules and company law. Second, increase the capacity and responsibility of European level supervision of capital markets (ESMA) for key market infrastructures, large cross-border asset managers, and systemically important market activity. And third, advance market integration initiatives including enhanced passporting for trading venues, a Pan-European Market Operator (PEMO) status, and streamlining cross border distribution of investment funds.
- *Complete pending energy sector reforms.* Despite a high share of renewables in electricity generation (about 87 percent) and strong energy security supported by ample cross-border interconnections and storage, Austria continues to face relatively high energy prices compared with the rest of Europe. This partly reflects a still-low level of electrification—around 20–25 percent of total energy demand—which leaves the economy reliant on costly imported gas and oil. Recently approved reforms, including the New Electricity Act, should help lower costs by supporting smart metering and statutory dynamic pricing, simplifying supplier switching—currently very limited among Austrian households—and enabling more flexible grid access for energy providers. A key remaining priority is passage of the Renewable Energy Expansion Acceleration Act. Adoption of the Act, which requires a two-thirds parliamentary majority, would significantly shorten lengthy project approval processes—currently up to six to eight years—by designating renewable-energy acceleration areas in each of the Länder.