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Austria: 2011 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Austria

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Austria, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 14, 2011 with the officials of Austria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 5, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of September 2, 2011.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 2, 2011 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Austria.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2011 Article IV Consultation

Prepared by the Staff Representatives for the 2011 Consultation with Austria

Approved by Juha Kähkönen and Tamim Bayoumi

August 5, 2011

KEY ISSUES:

Macroeconomic prospects: GDP growth is expected to reach 3.3 percent this year, supported by external demand, re-stocking, and equipment investment, and moderate thereafter, as the cyclical recovery comes to an end. Inflation has risen to above the euro area average. The main risk factor is turmoil in the euro area periphery, especially should it extend to core euro area countries or Central, Eastern, and South-Eastern Europe (CESEE).

Bringing the public debt to safer grounds: The recovery and the current multiyear consolidation plan are reducing the deficit, but not enough to put the debt firmly on a downward trajectory in the medium-term, which is needed to address fiscal risks. With a strong economy, low unemployment, and supportive monetary policy, there is macroeconomic space to tighten fiscal policy further starting with the 2012 budget. Measures to strengthen incentives for older workers to retire later, improve efficiency in the provision of healthcare, and rationalize subsidies would cut spending while making the government more efficient. A comprehensive fiscal federalism reform to better align spending and financing responsibilities would further underpin consolidation efforts.

Strengthening private capital buffers, supervision, and regulation in the banking sector: Austrian banks are absorbing large credit costs on CESEE exposures. As profitability returns, priority should be given to building up high quality capital, as required by forthcoming international standards, and exiting government support. Progress in enhancing bank supervision and macro-prudential regulation should continue, also in coordination with ongoing international efforts.

Enhancing long-term growth prospects by increasing employment rates and human capital: While overall unemployment is low, employment rates of low-skilled workers could be improved by reducing tax wedges. Productivity growth could be boosted by education reform, particularly to increase the number of university graduates in disciplines that complement R&D.

The staff's team, comprising Ms. Detragiache (head), Messrs. Steinlein and Vandenbussche (all EUR) and Ms. Mishra (RES), visited Vienna during June 2–14, 2011. Mr. Prader (Alternate Executive Director) joined the discussions. The mission met with Finance Minister Fekter, Austrian National Bank (OeNB) Governor Nowotny, other senior officials, members of Parliament, and representatives of the social partners, the financial sector, and economic research institutes.

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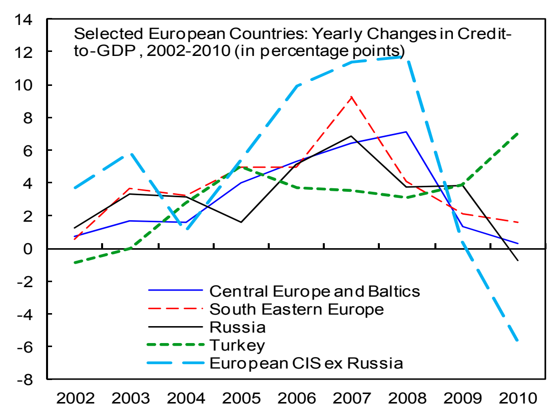
I. Context

1. **With economic growth back on track, policy discussions focused on addressing vulnerabilities in the public finances and the banking sector, as well as strategies to strengthen long-term growth**. While Austria's fiscal position compares favorably with other members of the euro area, the public finances worsened sharply during the crisis and, going forward, face pressures from population aging and health care costs, as well as risks from the large cross-border financial sector exposure. With increased market scrutiny of sovereign debt risk in advanced countries, staff argued that Austria needs to bring the public debt down more rapidly than envisaged under current consolidation plans, while the authorities thought that current plans were sufficient. In the financial sector, there was agreement that the challenges going forward are to increase the size and quality of private capital, improve liquidity management, take advantage of ongoing bank restructuring to address overcapacity in the Austrian market, and reduce risks from future foreign expansion through supervisory and regulatory reforms. Discussions also addressed structural reforms in labor markets and education.

2. **Austria is a federation and the current federal government is a coalition of the two largest political parties**. The current government coalition, in office since 2008, comprises the Social Democratic Party and the center-right Austrian People's Party. Also, in Austria's federal structure considerable political power resides with the nine federal states. Thus, decision-making often requires building a consensus across different levels of government and political parties. The next federal elections are scheduled for 2013.

II. Background–Eastward Expansion, Crisis, and Recovery

3. **In the past decades, increasing integration to the East has benefited the Austrian economy, but also created vulnerabilities that came to a head with the global financial crisis.** After the fall of the 'iron curtain,' Austria's economic fulcrum moved eastward: trade with the CESEE became increasingly important, FDI flows were directed to the region, and Austrian banks entered the newly-opened markets (Figure 1).[1] In many host countries, rapid credit expansion fueled economic growth but also a domestic demand boom and large current account deficits. In addition,



Source: WEO, IFS, and IMF Staff calculations. Regional

[1] As integration with relatively capital-poor CESEEs progressed, the pattern of output growth in Austria changed, becoming less reliant on capital deepening than in the past (Annex 1).

credit was largely denominated in foreign currency, creating vulnerability to currency depreciation. After global money markets froze following the Lehman bankruptcy, the boom in the CESEE came to a halt, and Austrian banks faced both a liquidity squeeze and deteriorating credit portfolios. Government intervention was necessary to support aggregate demand and stabilize the banking system, while a number of CESEE countries obtained support from international financial organizations and the Vienna Initiative, whereby foreign banks jointly committed to maintain exposures.

4. **A rebound in external demand, brought about a quick recovery in 2010**. In contrast with other countries, in Austria private consumption and employment held up quite well during the recession (Figure 2); when external demand (especially from Germany) rebounded in the second half of 2010 the stage was set for a rapid recovery, and GDP growth reached 2.1 percent in 2010.[2] The current account registered a surplus of 2.7 percent of GDP, reflecting continued strong performance in services (mainly tourism and business services) (Figure 3). Outward FDI recovered somewhat in 2010, but remained still well below pre-crisis levels. The real effective exchange rate remains broadly within CGER norms.[3]

III. Outlook and Risks

5. **Supported by strong external demand, output growth will accelerate in 2011 and moderate thereafter, as the cyclical recovery will have run its course**. Continuing the strong pace set at end-2010, in the first quarter of 2011 GDP grew by 0.9 over the previous quarter, surprising to the upside and triggering upward revisions by forecasters. Growth was led by exports, re-stocking, and equipment investment, while construction activity remained feeble and private consumption was subdued, reflecting declining real disposable incomes. The last readings of confidence indicators point to a slowdown in the remainder of the year. Both staff and the authorities agreed that 2011 GDP growth would be strong, with staff a bit more optimistic (3.3 percent) than the central bank (3.2 percent) and the two leading research institutes (both 3 percent).[4] There was also agreement that growth will moderate to around 2 percent in 2012. Staff viewed potential output as only marginally affected by the crisis, with the output gap all but closed next year.

6. **The food and energy price shocks, higher excise taxes, and the strong economy have pushed up consumer prices**. In recent months, inflation in Austria has exceeded the

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[2] During 2009, private consumption benefited from increasing real disposable income, as strong wage settlements followed high commodity-price inflation in 2008, and from relatively healthy household balance sheets. Unemployment was contained owing to continued growth in services employment, in-work training programs, and part-time work schemes.

[3] The macro balance and external sustainability approach indicate an undervaluation of 4 and 8 percent, respectively, while the equilibrium real exchange rate approach suggests a 3 percent overvaluation.

[4] The Ministry of Finance relies on the forecast from one of the two research institutes for the budget.

euro area average: in June 2011, headline HICP inflation registered at 3.7 percent while core inflation was 2.8 percent, about one percent above the euro area indicators. The authorities assessed that indirect tax increases at the beginning of the year accounted for 0.4 percentage points of the differential, and reckoned that it was too early to tell what might explain the rest. Staff suggested that demand pressures from the strong recovery may be an additional contributing factor, and that a reversal in commodity prices, the expected tightening of monetary conditions in the euro area, and mildly contractionary fiscal policy may help contain inflationary pressures going forward if wage settlements for 2012 remain moderate.

7. **The cyclical recovery is helping the fiscal balance, but current medium-term consolidation will not reduce debt significantly**. During 2007–10 the deficit widened from 0.9 percent to 4.6 percent of GDP, while the public debt rose by almost 12 percent of GDP (Figure 4). The government's multi-year fiscal consolidation plan would cut the deficit back to below 3 percent by 2013 (in compliance with the EU excessive deficit procedure for Austria) and further to around 2 percent in the medium term through a combination of tax increases and expenditure cuts. With growth in 2011 better than expected but budgetary implementation risks in particular at the subnational level, staff projects the deficit to decline to 3.4 percent of GDP this year and the structural deficit to stabilize at about 2 percent of GDP in the medium term, with debt remaining above 70 percent of GDP.

Staff Baseline and Authorities' Adjustment Scenario
(percent of GDP unless indicated otherwise)

	2010	2011	2012	2013	2014	2015
Staff Baseline Scenario 1/						
Headline balance	-4.6	-3.4	-3.0	-2.6	-2.3	-2.1
Structural balance	-3.7	-3.2	-2.9	-2.6	-2.3	-2.1
Debt	72.2	72.3	73.4	73.6	73.4	73.0
Output gap	-2.0	-0.4	-0.1	0.0	0.0	0.0
Real GDP (percentage change)	2.1	3.3	2.0	1.9	1.8	1.8
Authorities' Adjustment Scenario 2/						
Headline balance	-4.6	-3.9	-3.3	-2.9	-2.4	-2.0
Structural balance	-3.2	-2.8	-2.4	-2.1	-1.9	n/a
Debt	72.3	73.6	75.0	75.5	75.1	74.4
Output gap	-3.2	-2.5	-2.2	-1.9	-1.4	n/a
Real GDP (percentage change)	2.0	2.5	2.0	2.1	2.2	2.2

Sources: Austrian Stability Program 2010–14; Strategiebericht Bundesfinanzrahmengesetz 2012–15; and IMF staff projections.
1/ includes implementation risks, in particular at subnational level; furthermore, based on current macroeconomic staff projections and 2010 GDP outcome.
2/ based on authorities' April 2011 macroeconomic projections and estimates (including for 2010 GDP).

8. **In the banking system, profitability is improving despite growing NPLs, and lessons from the crisis are being distilled**.[5] NPL ratios are high in CESEE subsidiaries, albeit with notable regional differences, while loans in Austria are performing relatively well (Figure 5). The large banks and most medium-sized banks were profitable in 2010 despite continuing significant provisioning costs. Interbank interest rates have normalized; share prices and CDS spreads for the large banks have recovered, but not returned to pre-crisis levels (Figure 6). With acute crisis management over, the banks and the authorities are turning to address several important challenges: reducing bank reliance on government capital; substantially strengthening the quantity and quality of capital to boost confidence in

[5] A more detailed analysis of the banking sector is in Annex 2.

the banking system and build larger buffers to absorb shocks; adapting liquidity management to address shortcomings highlighted by the crisis; reducing excess capacity resulting in chronically low profitability in the Austrian market; and improving coordination of supervision across jurisdictions.

Box 1. The Authorities' Consolidation Plan

In connection with the federal budget for 2011, a broad array of revenue and expenditure measures was decided and enacted. On the revenue side, these included a bank levy and higher mineral oil taxes. On the expenditure side, expenditure reductions spread across several categories were complemented by simultaneous increases in priority areas, such as education and R&D.

The authorities estimate the impact of these measures, defined as difference to the no-policy-change revenue and expenditure of the same year, as follows:

The Authorities' Consolidation Measures
(In million euro, unless indicated otherwise)

	2011	2012	2013	2014
(1) Revenue increases 1/	1164	1741	1921	2191
(in percent of authorities' GDP projections)	*0.4*	*0.6*	*0.6*	*0.7*
(2) Expenditure reductions	1496	2210	2696	3226
(in percent of authorities' GDP projections)	*0.5*	*0.7*	*0.8*	*1.0*
Family benefits	246	278	278	278
Pension benefits	356	400	469	549
Other social benefits	132	182	223	266
"State aid" 2/	190	330	404	458
"Administrative burden" 3/	486	791	868	963
Interest savings	86	229	454	712
(3) Expenditure increases ("Offensive measures") 4/	502	562	634	701
(in percent of authorities' GDP projections)	*0.2*	*0.2*	*0.2*	*0.2*
(1)+(2)-(3): Total	2,158	3,389	3,983	4,716
(in percent of authorities' GDP projections)	*0.7*	*1.1*	*1.2*	*1.4*

Source: Austrian Stability Program 2010 to 2014.
1/ including tax shares of subnational levels.
2/ Mainly subsidies.
3/ Mainly personnel, goods and services, and investment.
4/ Additional spending in priority areas (e.g. education and R&D).

In addition to these measures at the federal level, the authorities' general government deficit targets assume compliance with the following subnational headline deficit targets stipulated in the recently renegotiated domestic stability pact (in percent of GDP): 0.75 in 2011 (following 1.2 in 2010), 0.6 in 2012, and 0.5 in 2013–14. Furthermore, the authorities assume a balanced social security budget throughout the period (after a surplus of 0.2 percent of GDP in 2010).

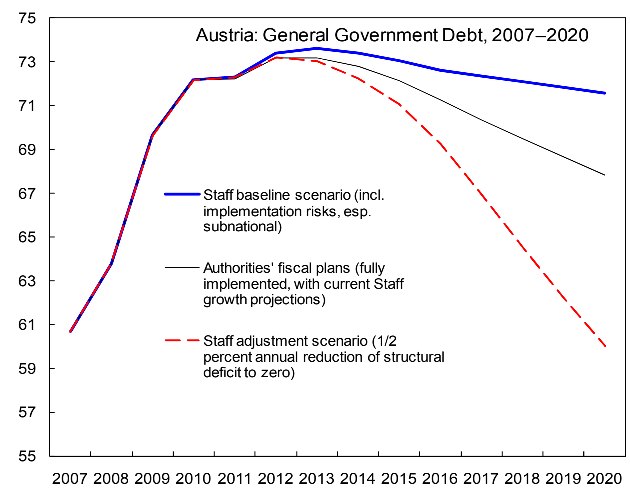
9. **Risks to the macroeconomic outlook are mainly to the downside, and relate primarily to a possible widening of the crisis in the euro area periphery**. While direct exposures of Austrian banks to Greece, Ireland, and Portugal amounted to only 2.1 of GDP at end-2010, staff argued that the main risk to the Austrian economy stemmed from possible

spillovers from generalized financial instability in the euro area, and the authorities shared this assessment.[6] Turmoil could spill over to Austria, especially should it affect wholesale funding markets, banks in the euro area core, or CESEE countries where both Greek and Austrian banks have a significant presence. Adverse spillovers to Austria could also materialize should the crisis engulf Italy, as Austria's second largest bank is a subsidiary of an Italian bank and the direct exposure of Austrian banks to Italy amounts to 5.9 percent of GDP. Further appreciation of the Swiss franc through safe-haven flows might hurt Austrian banks' loan portfolios in some CESEE countries and Austria, where loans denominated in the Swiss currency are widespread. Finally, a new economic downturn in the euro area might curtail growth in the CESEE and lead to second-round effects on credit quality. Staff also viewed as downside risks renewed food and energy price shocks and their impact on real incomes in the CESEE, while upside risk could stem from a stronger-than-expected recovery of domestic demand in the euro area or the CESEE.

IV. Policy Discussions

A. Fiscal Policy: Speeding up Debt Reduction by Increasing Expenditure Efficiency

10. **Staff and the authorities concurred that current consolidation plans will not reduce debt significantly, and staff considered this unsatisfactory in light of risks.** Even with higher growth and full implementation of the authorities' plans (including by sub-national governments), general government debt would still be at the current level of 72 percent of GDP by 2015 and only slightly below 70 percent by the end of the decade. In the staff baseline scenario, which is less optimistic about implementation (in particular of the deficit targets at subnational level), debt stays above 70 percent of GDP throughout the period. Furthermore, a number of factors, not taken into account in the baseline scenario, pose risks to the debt level in the coming years: first, there might be further debt additions from the banking sector rescue;



Sources: Austrian authorities; and IMF staff projections.

[6] Staff's econometric analysis of the recent behavior of Austrian sovereign spreads shows that, while little affected by developments in Greece, Ireland, and Portugal per se, spreads were sensitive to generalized market dislocation, suggesting that Austria would not be immune from widespread turmoil (Annex 3).

second, roughly one third of the public enterprise debt that is not part of general government (i.e., of currently some 12 percent of GDP) could be reclassified and added to general government debt in 2014, when revised national accounting rules enter into force; and, third, projections for the cost of an aging population may turn out substantially higher than currently envisaged, in particular in the health care area.[7] More generally, the large and internationally exposed banking sector and the risk of renewed turmoil in European financial markets would argue for expanding fiscal buffers.

Public Enterprise Debt 2005–2010 1/
(In billion euro unless indicated otherwise)

	2005	2010 2/
Federal Railways	5.8	14.4
o/w: infrastructure	5.1	12.7
transport	0.7	1.7
Federal Real Estate Company	3.3	3.0
Federal Highway Agency	9.3	10.0
Hospitals	0.6	2.9
Utilities and housing companies	11.7	12.6
Other	0.6	0.1
Total	31.3	43.0
(in percent of GDP)	12.8	15.1
Of which : aleady in general government debt	4.7	8.9
(in percent of GDP)	1.9	3.1

Source: Federal Ministry of Finance.
1/ Non-financial public enterprises
2/ Preliminary.

11. **Hence, staff urged for stronger consolidation measures of at least ½ percent of GDP annually, starting with the 2012 budget, until the structural deficit reaches zero.** Barring materialization of the aforementioned risks, this would pare debt back to pre-crisis levels around the end of the decade, be in closer compliance with EU requirements for structural and debt adjustment, and strengthen private sector confidence domestically and abroad.[8] Furthermore, an even stronger consolidation in the 2012 budget would be justified in light of the rapid economic recovery and the possible need to contain current inflationary pressures, should they prove more persistent than expected.

12. **The authorities viewed current consolidation plans as adequate, and further efforts as not politically feasible in the short-term.** The authorities considered that stronger-than-envisaged growth will likely lead to significantly better deficit outcomes. They also pointed to the protracted and difficult negotiations on the current multiyear package (the 2011 budget was not approved until December 2010) as a reason for not wanting to reopen the issue. All in all, the authorities were not inclined to take additional consolidation steps in the 2012 budget, or even before the next national parliamentary election in 2013**.**

13. **Staff recommended expenditure rationalization in three main areas: early pensions, health care, and subsidies.** Staff took the position that consolidation should preferably take place through expenditure cuts rather than revenue-raising measures, as

[7]See for instance, International Monetary Fund, 2010, "Macro-Fiscal Implications of Health Care Reform in Advanced and Emerging Economies," Paper by the Fiscal Affairs Department, December (Washington).

[8] The EU Council's "Recommendation on the National Reform Programme 2011 of Austria and delivering a Council opinion on the updated Stability Programme of Austria, 2011–14" of June 20, 2011 recommends an average annual fiscal effort of 0.75 percent of GDP over the period 2011–13.

Austria's revenue-to-GDP ratio is already high in international comparison. Three areas where expenditure exceeds levels in peer countries and ample scope for rationalization exists are especially amenable to reform (Annex 4):

a. Pensions and other benefits fostering widespread early labor market exit are no longer affordable and ongoing reforms should be strengthened. The early retirement scheme for long-term insured *("Hacklerregelung")* should be fully abolished in 2012 and eligibility for disability pensions further reduced, including by broadening the scope of alternative occupations against which disability is assessed. All other avenues to early inactivity for older workers without fair benefit reduction must also be closed rapidly to avoid substitution across different avenues. In parallel, job opportunities for older workers need to be improved.

b. The large efficiency gains that are possible in the health care sector should be promptly reaped. Hospital planning should be enforced on a nationwide scale to optimize size, degree of specialization, and distribution of hospitals across Austria's territory. To that end, hospital financing should be pooled at the federal level and disbursements linked to clear performance criteria. In parallel, outpatient treatment and prevention should be strengthened and better integrated.

c. Reducing the comparatively high level of subsidies requires restructuring and cost savings at public enterprises. This relates in particular to Austrian Railways (*OeBB*) where operating costs, pensions, and infrastructure investments offer scope for rationalization. The basis for subsidy cuts in other areas should be laid quickly by implementing comprehensively the authorities' initiative to develop a database on subsidies and transfers. This would enhance transparency and open the way to a broad re-evaluation of spending in this area, clarifying priorities and eliminating redundant subsidies.

The authorities broadly agreed with these expenditure reform priorities, and noted that a number of measures have already been enacted together with the 2011 budget in particular as regards early pensions. They also pointed to different working groups studying some of the above issues, but left it open whether and when specific recommendations and decisions might emerge from this work.

14. **While recognizing that fiscal federalism in its current form is too complex and hampers expenditure rationalization efforts, the authorities were lukewarm to staff's calls for a comprehensive revamping and an ambitious timetable for reform.** Austrian fiscal federalism is characterized by a disconnect between spending and financing responsibilities in key areas, such as health and education; in addition, spending responsibilities in some areas are excessively fragmented across levels of government. Expenditure rationalization would therefore benefit from a reconfiguration of tasks across government levels and better alignment between spending decisions and their financing

(Annex 5). Staff proposed that a comprehensive fiscal federalism reform to address these problems be agreed upon before the negotiations on the next fiscal equalization law. With preparatory work already far along, this goal should be achievable and would further cement investor confidence in Austria's consolidation drive. While the authorities did not rule out this idea and had commissioned studies on the issue, a concrete timetable for following-up on this work and initiate reforms had not yet been decided.

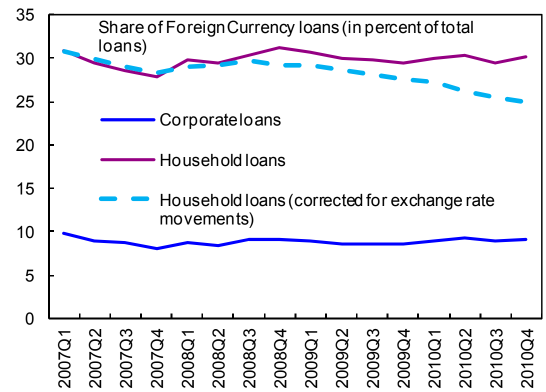
15. **In the staff's view, fiscal federalism reform would also help achieving compliance with the domestic stability pact, which would furthermore benefit from enhanced budgetary planning.** The domestic Austrian stability pact has recently been revised and foresees a reduction of the deficit of sub-national governments from 1.2 percent of GDP in 2010 to 0.5 percent in 2014. Staff pointed out that subnational deficit objectives have consistently been missed in the past, while the authorities were more optimistic about the fulfillment of the current targets, also in light of the stricter sanctions for non-compliance envisaged under the new pact. Staff also suggested that better compliance could be fostered by more ex-ante budgetary coordination and harmonization of planning instruments across government levels, and that medium- and long-term sustainability analysis should become an integral and prominent part of planning at all levels so as to strengthen awareness of debt dynamics and help control the costs of aging. This analysis could be used to derive long-term expenditure target paths for crucial expenditure categories.

B. The Financial Sector: Managing Credit Risk and Building a More Stable System

16. **Staff reviewed with the authorities and the banks strategies to deal with NPLs in the CESEEs**. As growth has resumed in the region, NPL ratios are expected to peak this year. To deal with the large stock of problem loans, banks have put in place or strengthened loan collection and restructuring departments in their CESEE subsidiaries; some banks also report sales of NPL portfolios to local recovery specialists. The authorities estimate that, as of end-2010, the top six Austrian banks had restructured loans corresponding to about 5 percent of their total risk exposure. At around 42.5 percent, the ratio of provisions to NPLs in the CESEE subsidiaries is low compared to that of Austrian operations (70.8 percent), and the authorities expect it to increase going forward as new flows of NPLs slow down. Staff and the authorities agreed that the extent of 'evergreening' remains uncertain, complicating the assessment of the future evolution of NPLs.

17. **In Austria, while Swiss-franc denominated loans are performing well so far, they may pose a risk in the medium-term.** Uncharacteristically for an advanced country, Austria has a sizable share of loans denominated in foreign currency. These loans, mostly Swiss franc mortgages, grew in popularity during the 2000s when the exchange rate was relatively stable and the interest rate on the Swiss currency was attractive. Following the financial crisis, however, the Swiss franc appreciated by over 20 percent vis-à-vis the euro, increasing the value of the obligations. So far, these loans are performing well, in line with domestic currency loans. This may reflect relatively conservative lending standards in the Austrian

mortgage market but also the nature of the contracts, whereby loans are tied to repayment vehicles and have bullet maturity. With large mortgage vintages beginning to mature in 2017, repayment problems may surface down the road if exchange rate developments remain unfavorable. After discouraging foreign-currency lending through a number of measures beginning in 2003, supervisors took stronger action in 2008, effectively prohibiting new foreign currency lending to unhedged retail customers, and are now pushing banks to develop strategies to reduce the stock. Staff agreed that such measures were appropriate.



18. **The crisis is fostering restructuring among medium-sized banks, which could be an opportunity to reduce chronic excess capacity in the market.** Fragilities remain among medium-sized banks, one of which was nationalized during the crisis. The restructuring plan for this bank is under examination by the European Commission. Another medium-sized bank is thinly capitalized and failed the recent EBA stress test, but the announced sale of most of its foreign subsidiaries and further deleveraging should help make it more stable. Another, smaller nationalized bank has been restructured, with problem assets placed in a separate entity. The mission expressed hope that the post-crisis restructuring would reduce chronic excess capacity in the Austrian market, where interest margins are among the lowest in the euro area, so that banks would be less dependent on profits from foreign operations. The authorities were optimistic that this would happen.

19. **Stress tests performed by the OeNB suggest that the Austrian banking system would be robust to a deterioration in credit quality triggered by a large negative growth shock**. The OeNB conducted a stress test of the Austrian banking system in the spring of 2011 and published the results in its latest Financial Stability Report. In an adverse scenario more severe than that envisaged by the 2011 EBA stress test, the Core Tier I capital ratio (defined as in the 2011 EBA stress tests) declined from 9.2 percent to a still comfortable 8.5 percent in the aggregate at the end of the two-year projection horizon, and remained above 7 percent in each of the three largest banks.

20. **Banks and supervisors are distilling the lessons from the crisis, and changing risk management and supervisory practices accordingly**. Both banks and supervisors are more attentive to liquidity management, a major worldwide source of weakness during the crisis. A new system established in late 2008 allows supervisors to perform weekly stress tests for liquidity and funding risk. Implementation of the new Basel III liquidity regulation will also be instrumental in this regard. Banks report that internal models did not adequately reflect aspects such as the likelihood that host country authorities would restrict intra-group liquidity and capital transfers during times of distress, the downward flexibility in nominal

wages and its effects on loan affordability indicators, and the risk of political intervention 'legitimizing' nonpayment of loan installments in crisis times. Staff welcomed the intention to capture these events in future liquidity and risk models, and noted that supervisors nonetheless need to remain vigilant. Newly-created colleges are coordinating the supervision of banking groups operating across multiple jurisdictions and will work towards joint risk assessments at the group level for the first time this year.

21. **Rapid progress toward achieving higher bank capital standards and early exit from government support should take precedence over shareholder remuneration or further cross-border expansion.** With large NPLs, risks from possible heightened turmoil in the euro area, and large cross-border exposures, banks need to urgently build up high-quality capital to bolster confidence and improve future loss absorption capacity. In addition, while the government guarantee program for bank liabilities has expired, capital injections have not been repaid yet, though two banks (one large and one medium-sized) have declared their intention to begin repayment soon. Staff emphasized that shareholder remuneration and cross-border expansion plans should come only after capital build-up and exit from government support. The authorities agreed that capital strengthening was a priority for Austrian banks (also because many competitors in CESEEs are better capitalized), but noted that dividend suspension was not a condition for receiving government aid and exit should be conditional on a strong capital position.

22. **A strategy to address the too-big-to-fail (TBTF) problem needs to be put in place, including through higher capital buffers for systemic banks, using the flexibility provided by the forthcoming EU-wide rules.** The recent crisis has raised the question of how to curb potential future fiscal contingent liabilities from bank rescue operations.[9] The authorities are exploring options specifically targeted to the vulnerabilities of the Austrian banking sector. The mission welcomed this initiative and emphasized the need to build up stronger buffers against future risks and avoid some of the imprudent lending behavior observed in the past. Given the specific risks posed by Austrian systemic banks (large size relative to the country GDP, significant cross-border exposure concentrated in a single region, high NPLs), capital add-ons for systemic banks would provide needed additional loss-absorbing buffers in bank balance sheets. Limits on parents' funding of subsidiaries could be calibrated to bind in periods when intra-group loans fuel excessive credit growth in host countries, as was the case in a number of CESEEs in the mid-2000s. They could thus be useful to avert future unsustainable credit booms, but would not impede beneficial international financial integration. This instrument would have to be coordinated with host country supervisors. Staff and the authorities also agreed that an EU-level bank resolution and burden-sharing mechanism would be the first-best solution for Austria in the medium-

[9] Austria has imposed a tax on total bank assets as a contribution to the fiscal costs of the current crisis. Since its proceeds go to the general budget, the tax does not build up a fund to finance future rescue operations.

term. Staff also welcomed as a useful step forward the establishment at the end of June 2011 of a cross-border financial stability group with authorities from most new EU member states where Austrian banks operate, with the objective to improve crisis prevention and management.

23. **The reform agenda should include stronger early intervention powers for supervisors and revisit the institutional framework for bank supervision and regulation, including with respect to macro-prudential policy**. In the past, staff called for legislation to strengthen supervisors' early intervention powers and, more broadly, improve the bank resolution framework. The authorities agree that this is an important part of the reform agenda and are awaiting a proposal on a harmonized set of tools at the EU level to move forward. This proposal is expected before the end of the year. In Austria, responsibility for both on-site and off-site bank supervision resides with the OeNB while enforcement powers are assigned to the Financial Market Authority (FMA). While the authorities and the banks report much improved coordination between the two agencies, the benefits from this division of labor remain unclear. A review of the supervisory architecture would be an important topic for the next FSAP update, which the Austrian authorities have requested for FY 2013. This review would also be an opportunity to discuss in depth the design and implementation of macro-prudential policy, for which a proper legal framework appears to be lacking according to the OeNB and the FMA.

24. **Significant progress has been achieved since the Financial Action Task Force (FATF) identified strategic deficiencies in 2009.** The February 2011 FATF follow-up report was very positive in light of the substantial package of legal measures enacted in June and July 2010. Upcoming actions will focus on effective implementation of the new legal provisions, including the drafting of new or updated FMA circulars, training of reporting entities and supervisors, as well as on-site inspections.

C. Structural Issues: Enhancing Labor Utilization and Human Capital

25. **Staff stressed two keys areas of structural reform to raise potential growth: labor markets and education**. Overall, the employment rate in Austria is high by OECD standards, but there is room for improvement. As discussed above, Austrian workers exit the labor market at a relatively young age burdening the public pension system but also depriving the economy of a valuable factor of production. Closing avenues to early labor market exit and enacting policies to encourage employment of older workers would increase long-run growth potential. In addition, employment levels among the low skilled could be raised and education reform could enhance human capital.

26. **The authorities acknowledged that "tax wedges" were high, and saw measures in this area as part of a possible more comprehensive tax reform after the next elections**. Employment rates among low-skilled workers are modest (Figure 7). For instance, immigrant workers, who are disproportionately low skilled, have an unemployment rate of 8.5 percent,

compared to 3.1 percent for the native population. While low-wage workers do not pay income taxes, social security contributions are high in international comparison, pushing labor costs beyond the productivity of many low-skilled workers, thereby curtailing labor demand. Staff pointed out that a reduction in social security contributions at the low end of the wage distribution (coupled with offsetting measures to make it budget neutral) would increase employment of low-skilled workers and, through it, potential output. The authorities noted that tax reform is likely to be prominent in the electoral platform of the major political parties ahead of the 2013 elections, and labor taxation issues would be debated in that context.

27. **Staff also called the authorities' attention to the large school achievement gap for immigrant and first generation children, now about 20 percent of the population**. Unfavorable educational outcomes for this segment of the population increase the stock of low-skilled workers going forward, leading to lower employment rates and limiting human capital accumulation. Policies to close this gap are important also in light of potentially large new immigrant flows following the elimination of the remaining restrictions on labor movements with countries that joined the EU in 2004 (Annex 6).The authorities acknowledged better integration of immigrant children in the school system as a long-standing challenge.

28. **Both staff and the authorities saw tertiary education reform as key to accelerate human capital accumulation**. Staff observed that for a high-income country like Austria, continued economic growth requires moving up with the technology frontier. While private sector R&D activities are strong (and generously supported by the government), the accumulation of human capital, a necessary input to R&D activities, lags behind. In Austria only 18 percent of the population has a tertiary degree or equivalent compared with 26 percent in high income OECD countries, consistent with low rates of return on tertiary education (particularly for women) in Austria. The quality of university education is hampered by liberal admission policies causing overcrowding and high drop-out rates, and by a lack of financial resources. A 2004 reform gave more financial and hiring autonomy to universities while increasing their accountability. However, admission policies remain liberal, and enrollment continues to exceed capacity in several disciplines. The authorities recognize that policy initiatives to raise tertiary attainment are crucial to raising long-term growth. The introduction of entrance admission tests (as in medicine, where there has been a sharp fall in drop-out rates), policies to attract enrollment in engineering and natural sciences, and measures to obtain private funding for education are possible policies under discussion.[10]

[10] Private spending on education in Austria is 0.1 percent of GDP, compared to 1.1 percent of GDP on average for the EU.

V. Staff Appraisal

29. **The crisis, though short-lived in Austria, has highlighted old challenges and created new ones that must now be addressed**. While Austria's fiscal position compares favorably with other euro area countries, the growth of public debt needs to be put into reverse to better face risks and cost pressures. The banking sector requires more, high quality, private capital, and, as the CESEE convergence process resumes, expansion needs to become more prudent. To foster medium-term growth, increasing employment of low-skilled and older workers and building up more human capital are key priorities.

30. **To put the public finances on more solid ground, additional consolidation measures are needed starting with the 2012 budget.** Total measures of at least ½ percent of GDP per year, until the fiscal accounts are structurally balanced, would bring the debt-to-GDP ratio on a clear downward trajectory in the medium term. An even stronger effort in the 2012 budget is warranted in light of the excellent economic performance, rapidly disappearing slack in the economy, and inflationary pressures. Priority should be given to pension, health care, and subsidy reform—areas where government intervention can be made more efficient and supportive of long-term growth.

31. **A broad reform of fiscal federalism would underpin consolidation efforts.** Incentives for an efficient use of public resources are weakened by a strong disconnect between spending and financing responsibilities and the sharing of spending mandates among different levels of government. A comprehensive fiscal federalism reform to address these problems should usefully be agreed upon before the next negotiations on the fiscal equalization law.

32. **The banking sector's return to more normal levels of profitability creates the conditions for a further build-up of high-quality capital and exit from government support**. Taking advantage of improved financial results, banks should move quickly to strengthen their capital base, increasing both the quantity and quality of their capital and exiting government support. This should take priority over shareholder remuneration and further cross-border expansion**.** The ongoing restructuring of some banks is an opportunity to address overcapacity in the Austrian market.

33. **During the transition to EU-level bank resolution mechanisms, measures should be taken to address the risk posed by systemic banks**. With a large, internationally active banking sector, Austria has much to benefit from an EU-wide bank resolution and burden-sharing mechanism for internationally active banks. Until a new framework is in place, the risk that systemic banks pose to Austrian taxpayers should be reduced through macro-prudential measures, including tighter capital requirements and, possibly, macro-prudential constraints on intra-group funding models to prevent future credit booms. In general, greater supervisory vigilance of lending activities, accompanied by pre-emptive action, is necessary wherever financial deepening can quickly turn into an unsustainable credit boom. In this

respect, the establishment of a cross-border financial stability group with authorities from most new EU member is welcome.

34. **Policies to foster labor market participation by low-skill workers and human capital accumulation would increase long-term growth.** High social security contributions are an obstacle to the employment of the low-skilled and should be reduced (in a budget-neutral way). Measures to close the large educational attainment gap of children with an immigrant background, some 20 percent of primary school pupils, would improve average skill levels and productivity growth. Reform of the university system, which is burdened by low graduation rates and has low enrollment in engineering and the natural sciences, could usefully include stricter admission criteria. These would reduce overcrowding and drop-out rates, thus making better use of existing resources, and could be used to steer students toward disciplines complementary to R&D.

35. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle**.

Table 1. Austria: Selected Data, 2007–12

Total area	83,850 square kilometers
Total population (2010)	8.4 million
GDP per capita (2010)	US$ 44,988 (33,905 Euro)

	2007	2008	2009	2010	2011	2012
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	3.7	2.2	-3.9	2.1	3.3	2.0
Total domestic demand	2.5	1.3	-2.3	1.3	2.0	1.4
Consumption	1.1	1.4	1.1	0.7	0.7	1.1
Gross fixed capital formation	3.9	4.1	-8.8	-1.0	3.7	2.5
Net exports (growth contribution in pp)	1.3	1.1	-2.0	1.1	1.4	0.7
Exports of goods and nonfactor services	8.6	1.0	-16.1	10.6	8.8	4.9
Imports of goods and nonfactor services	7.0	-0.9	-14.4	9.4	7.0	4.2
Output gap (percent of potential GDP)	2.9	3.3	-2.4	-2.0	-0.4	-0.1
Employment and unemployment						
Employment	1.9	1.3	-1.5	0.6	1.5	0.8
Unemployment rate (in percent)						
Registered (national definition)	6.2	5.8	7.2	6.9	6.6	6.6
Standardized (Eurostat)	4.4	3.8	4.8	4.4	4.1	4.1
Prices						
Consumer price index (period average)	2.2	3.2	0.4	1.7	3.2	2.2
General government finances (percent of GDP)						
Revenue	48.0	48.3	48.8	48.3	48.3	48.3
Expenditure	49.0	49.3	53.0	52.9	51.7	51.3
Balance (EDP-definition)	-0.9	-0.9	-4.1	-4.6	-3.4	-3.0
Structural Balance	-2.3	-2.4	-3.0	-3.7	-3.2	-2.9
Gross debt (end of period)	60.7	63.8	69.6	72.2	72.3	73.4
Balance of payments						
Trade balance (goods) (in billion euro)	1.3	-0.6	-2.3	-3.2	-2.8	-3.1
Current account (in billion euro)	9.6	13.8	8.5	7.8	8.8	9.3
(In percent of GDP)	3.5	4.9	3.1	2.7	2.9	3.0
Interest rates						
Three-month interbank rate	4.3	4.6	1.2	0.8	...	...
10-year government bond	4.3	4.4	3.9	3.2	...	...
Exchange rates						
Euro per US$	0.73	0.68	0.72	0.75	...	...
Nominal effective exchange rate (2000=100)	101.3	102.4	103.3	100.6	...	...
Real effective exchange rate (1990=100)						
ULC based	97.6	95.9	96.5	97.0	...	...
CPI based	100.1	100.9	101.5	98.8	...	...

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

Table 2. Austria: Medium-Term Macroeconomic Framework, 2007–16

(in percent of GDP unless indicated otherwise)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
							Projections			
National accounts										
GDP (growth in percent)	3.7	2.2	-3.9	2.1	3.3	2.0	1.9	1.8	1.8	1.8
Total domestic demand	2.5	1.3	-2.3	1.3	2.0	1.4	1.3	1.0	1.0	1.1
Consumption	1.1	1.4	1.1	0.7	0.7	1.1	1.0	1.1	1.1	1.2
of which: Private consumption	0.7	0.5	1.3	1.1	0.9	1.2	1.2	1.2	1.2	1.2
Gross fixed capital formation	3.9	4.1	-8.8	-1.0	3.7	2.5	2.3	1.2	1.2	1.2
Exports of goods and nonfactor services	8.6	1.0	-16.1	10.6	8.8	4.9	5.2	5.2	4.9	4.7
Imports of goods and nonfactor services	7.0	-0.9	-14.4	9.4	7.0	4.2	4.5	4.3	4.2	4.1
Growth contributions (percentage points)										
Final domestic demand	1.6	1.8	-1.1	0.3	1.3	1.3	1.2	1.0	1.0	1.0
Net exports	1.3	1.1	-2.0	1.1	1.4	0.7	0.8	0.9	0.9	0.8
Inventories and statistical discrepancies	0.8	-0.7	-0.7	0.7	0.6	0.0	0.0	0.0	0.0	0.0
Prices and unemployment										
CPI inflation (pa; annual percent change)	2.2	3.2	0.4	1.7	3.2	2.2	1.9	1.9	1.9	1.9
Unemployment rate (percent)	4.4	3.8	4.8	4.4	4.1	4.1	4.0	4.0	4.0	4.0
Current account balance	3.5	4.9	3.1	2.7	2.9	3.0	3.0	2.9	2.9	2.8
Goods and services balance	4.6	4.8	3.8	3.6	3.6	3.6	3.4	3.3	3.2	3.1
General government accounts										
Revenue	48.0	48.3	48.8	48.3	48.3	48.3	48.2	48.1	48.1	48.0
Expenditure	49.0	49.3	53.0	52.9	51.7	51.3	50.8	50.4	50.1	50.1
Balance	-1.0	-1.0	-4.1	-4.6	-3.4	-3.0	-2.6	-2.3	-2.1	-2.1
Gross debt	60.7	63.8	69.6	72.2	72.3	73.4	73.6	73.4	73.0	72.6
Structural balance	-2.3	-2.4	-3.0	-3.7	-3.2	-2.9	-2.6	-2.3	-2.1	-2.1
Memorandum items:										
Gross national saving	26.7	28.0	24.4	24.6	25.6	25.8	25.8	25.6	25.4	25.1
Gross domestic investment	23.2	23.2	21.3	21.9	22.7	22.8	22.9	22.7	22.5	22.3
Potential output (growth in percent)	1.9	1.8	1.8	1.7	1.7	1.7	1.8	1.8	1.8	1.8
Output gap (in percent of potential output)	2.9	3.3	-2.4	-2.0	-0.4	-0.1	0.0	0.0	0.0	0.0
GDP (current prices, in billion euro)	272.0	283.1	274.3	284.4	301.0	313.5	325.4	337.4	349.8	362.5

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

Table 3. Austria: Balance of Payments, 2007–16

(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
					Projections					
Current account	3.5	4.9	3.1	2.7	2.9	3.0	3.0	2.9	2.9	2.8
Trade	4.6	4.8	3.8	3.6	3.6	3.6	3.4	3.3	3.2	3.1
Exports	58.2	58.3	49.7	53.6	56.1	57.3	58.7	60.5	62.8	65.1
Imports	53.6	53.4	45.9	50.1	52.5	53.7	55.2	57.1	59.5	62.0
Goods	0.5	-0.2	-0.8	-1.1	-0.9	-1.0	-0.9	-0.8	-0.6	-0.5
Exports	43.6	42.9	35.4	39.1	41.5	42.6	43.8	45.5	47.8	50.0
Imports	43.2	43.1	36.2	40.3	42.5	43.5	44.7	46.4	48.4	50.5
Nonfactor services	4.1	5.0	4.7	4.7	4.5	4.5	4.3	4.1	3.9	3.5
Exports	14.6	15.3	14.3	14.5	14.5	14.7	14.8	14.9	15.0	15.1
Imports	10.5	10.3	9.7	9.8	10.0	10.2	10.5	10.8	11.2	11.5
Balance on factor income	-0.6	0.6	-0.1	-0.1	0.0	0.1	0.2	0.3	0.4	0.4
Credit	11.5	10.7	9.2	9.4	8.8	9.0	9.2	9.2	9.2	9.2
Debit	12.1	10.1	9.3	9.5	8.8	8.9	9.0	8.9	8.8	8.8
Current transfers, net	-0.4	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Capital and financial accounts	-4.2	-5.3	-3.3	-1.2	-2.9	-3.0	-3.0	-2.9	-2.9	-2.8
Capital account, net	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
FDI, net	-2.0	-5.4	0.2	-1.3	-1.2	-1.1	-1.0	-0.9	-0.8	-0.8
Portfolio investment, net	8.3	9.4	-2.5	-2.7	-2.3	-0.8	-0.6	0.1	1.3	1.8
Financial derivatives	-0.3	0.1	0.2	0.1	0.0	-0.1	-0.2	-0.2	-0.2	-0.2
Other	-9.6	-9.5	-2.2	3.0	0.5	-1.1	-1.3	-2.0	-3.3	-3.7
Reserve assets	-0.7	0.2	0.9	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.6	0.4	0.2	-1.5	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 Operations, 2007–16

(In percent of GDP, unless indicated otherwise)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
					Projections					
Revenue	48.0	48.3	48.8	48.3	48.3	48.3	48.2	48.1	48.1	48.0
Taxes	27.5	28.1	27.5	27.3	27.7	28.0	28.1	28.3	28.4	28.5
Indirect taxes	14.0	14.1	14.7	14.6	14.7	14.6	14.5	14.4	14.3	14.2
Direct taxes	13.4	14.0	12.8	12.8	13.0	13.4	13.6	13.8	14.1	14.3
Social contributions	15.8	15.9	16.6	16.4	16.2	16.0	16.0	15.9	15.8	15.7
Other current revenue	4.7	4.4	4.7	4.6	4.4	4.3	4.1	4.0	3.9	3.8
Expense	49.1	49.4	53.1	53.0	51.7	51.3	50.8	50.4	50.1	50.1
Compensation of employees	9.1	9.2	9.9	9.7	9.5	9.4	9.3	9.2	9.1	9.1
Goods and services	4.3	4.5	4.7	4.6	4.4	4.3	4.2	4.2	4.1	4.1
Interest	2.9	2.7	2.8	2.7	2.8	2.9	3.0	3.0	3.0	3.1
Subsidies	3.3	3.5	3.6	3.5	3.5	3.3	3.2	3.1	3.0	3.0
Social benefits	23.4	23.6	25.6	25.5	25.1	25.2	25.2	25.3	25.4	25.4
Other expense	6.1	6.0	6.5	7.0	6.5	6.2	5.9	5.8	5.5	5.4
Net operating balance	-1.1	-1.1	-4.2	-4.7	-3.4	-3.0	-2.6	-2.3	-2.1	-2.1
Net acquisition of non-financial assets	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / Net borrowing	-1.0	-1.0	-4.1	-4.6	-3.4	-3.0	-2.6	-2.3	-2.1	-2.1
Memorandum item:										
Overall balance (EDP-definition)	-0.9	-0.9	-4.1	-4.6	-3.4	-3.0	-2.6	-2.3	-2.1	-2.1
Primary balance	1.9	1.7	-1.3	-2.0	-0.7	-0.1	0.4	0.7	0.9	1.0
Structural balance	-2.3	-2.4	-3.0	-3.7	-3.2	-2.9	-2.6	-2.3	-2.1	-2.1
Change in structural balance	0.1	-0.1	-0.6	-0.7	0.5	0.3	0.4	0.3	0.2	-0.1
Public debt	60.7	63.8	69.6	72.2	72.3	73.4	73.6	73.4	73.0	72.6

Sources: Authorities and IMF staff projections.

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2006–10 1/
(In percent)

	2006	2007	2008	2009	2010
Capital adequacy					
Regulatory capital to risk-weighted assets 2/	13.2	12.7	12.9	15.0	15.4
Regulatory Tier I capital to risk-weighted assets 2/	8.0	8.8	9.3	11.1	11.7
Capital to assets	5.2	6.5	6.3	7.0	7.5
Asset composition					
Sectoral distribution of bank credit to total gross bank credits (as percentage of total bank credits)					
Nonbank financial institutions	3.7	3.3	3.2	3.2	3.2
Nonfinancial corporations	19.7	18.4	16.6	17.2	18.7
Households	18.9	17.7	15.4	16.4	18.4
Of which: housing loans	10.4	9.6	8.6	9.3	10.7
personal loans	8.5	8.1	6.8	7.1	7.7
Public Sector	4.9	4.0	3.1	3.5	3.8
Nonresidents	13.7	15.7	15.6	15.6	16.4
Domestic and non-domestic banks	39.1	40.9	46.1	44.1	39.5
Geographical distribution of loans to total loans					
Domestic	68.6	65.7	67.5	68.7	70.1
Cross-border	31.4	34.3	32.5	31.3	29.9
Of which: EMU	10.2	11.7	9.7	9.9	9.2
CEEC	9.6	11.6	12.9	13.2	13.5
Other	11.6	11.1	9.9	8.2	7.2
Asset quality					
Nonperforming loans to total gross loans 3/	2.7	2.2	2.0	2.3	2.8
Loan loss provisions (as % of loans to non-banks, domestic and non-domestic)	2.9	2.4	2.2	2.8	3.2
Loan-loss provisions to nonperforming loans 3/	75.3	76.4	64.0	73.8	70.8
Nonperforming loans net of loan-loss provisions to Tier 1 capital 3/	9.6	6.0	8.8	6.3	8.2
Total foreign currency-denominated loans to total loans	24.8	23.6	25.9	22.4	22.1
Foreign currency-denominated loans to residents to total claims on residents	18.7	16.2	18.0	17.2	18.3
Foreign currency-denominated loans to households to total claims on househ.	30.8	27.4	30.7	29.1	29.7
Foreign currency-denominated loans to corporations to total claims on corp.	10.8	8.1	9.1	8.5	9.1
Large exposures to capital	77.5	56.4	67.8	55.5	64.8
10-largest credit to net credits (loans to nonbanks) 3/	6.8	6.0	8.8	10.4	11.0
Earnings and profitability					
Return on assets 2/ 3/	0.7	0.8	0.1	0.1	0.5
Return on equity 2/ 3/	16.9	17.0	2.6	1.5	7.9
Net interest margin (net interest income as % of interest bearing assets)	1.0	1.0	0.9	0.9	1.0
Gross income as a percentage of average assets	2.2	2.1	2.0	1.7	1.9
Net interest income to gross income 2/ 3/	71.1	70.7	64.6	69.7	67.4
Noninterest income to gross income 2/ 3/	28.9	29.3	35.4	30.3	32.6
Trading income as a percentage of gross income	4.1	1.7	-4.0	2.8	3.4
Noninterest expenses as a percentage of gross income 2/	68.8	66.6	90.4	86.0	83.0
Personnel expenses as a percentage of noninterest expenses	50.5	50.4	50.6	51.4	50.3
Spread between domestic lending and deposit rates	0.9	0.8	1.3	1.0	1.1

Table 5. Austria: Financial Soundness Indicators for the Banking Sector, 2006–10 1/ (concluded)
(In percent)

	2006	2007	2008	2009	2010
Liquidity					
Liquid assets to total assets	27.6	26.8	26.8	26.1	23.5
Liquid assets to short-term liabilities	68.6	67.2	67.8	76.2	68.0
Foreign currency-denominated liabilities to total liabilities	20.0	17.2	19.4	14.4	11.3
Deposits as a percentage of assets	63.8	62.6	63.4	61.5	61.2
Loans as a percentage of deposits	115.8	116.3	117.7	119.0	119.3
Sensitivity to market risk					
Off-balance sheet operations as a percentage of assets	208.1	200.2	190.2	198.2	152.1
Of which: interest rate contracts	170.7	159.5	140.2	155.2	122.4
forex contracts	35.1	38.6	47.4	40.5	27.9
other derivatives	2.5	2.2	2.6	2.5	1.7
Duration of assets (in percent of total assets)					
Less than 3 months	59.3	62.4	67.3	69.8	73.3
Between 3 months and 1 year	12.2	13.4	13.7	11.9	12.7
Between 1 and 5 years	11.5	10.7	10.1	11.5	13.6
More than 5 years	8.1	7.6	7.1	8.1	9.4
Duration of liabilities (in percent of total liabilities)					
Less than 3 months	54.4	56.9	60.0	61.7	62.4
Between 3 months and 1 year	13.5	14.6	16.4	13.9	15.9
Between 1 and 5 years	14.0	12.4	12.3	16.8	19.1
More than 5 years	8.9	10.0	9.4	9.4	10.3
Net open position in foreign exchange to capital	3.8	2.5	1.6	0.6	0.5
Memorandum Items (EUR billions)					
Regulatory capital 3/	59.5	63.1	87.8	92.7	92.0
Regulatory Tier 1 capital 3/	41.8	47.1	66.9	72.2	73.3
Risk-weighted assets 3/	393.3	362.3	454.8	443.9	448.0
Total assets	797.8	899.5	1,069.1	1,034.0	978.6
Total loans	589.4	654.9	797.5	756.5	714.0
Total deposits	509.2	563.2	677.5	636.0	598.4
Net interest income	7.2	7.4	8.2	8.8	9.1
Noninterest income	9.4	10.1	12.3	9.1	10.6
Of which: Income from securities and participating interests	2.9	3.5	7.2	3.3	4.0
Net fee-based income	4.3	4.7	4.2	3.6	3.9
Net income from financial transactions	0.7	0.3	-0.8	0.5	0.7
Other operating income	1.6	1.6	1.7	1.6	1.9
Noninterest expenses	10.8	10.8	11.4	11.1	11.5
Total operating income	16.6	17.5	20.6	17.9	19.7
Total operating expenses	10.8	10.8	11.4	11.1	11.5
Pre-tax operating profit	5.8	6.7	9.1	6.8	8.2
Pre-tax total profit	4.5	5.2	2.1	0.6	4.8
After-tax profit	4.0	4.8	1.9	0.2	4.2
Profits accrued from subsidiaries abroad	3.1	5.0	7.2	8.1	7.1
Net open foreign exchange position	1.5	2.0	1.4	0.6	0.3

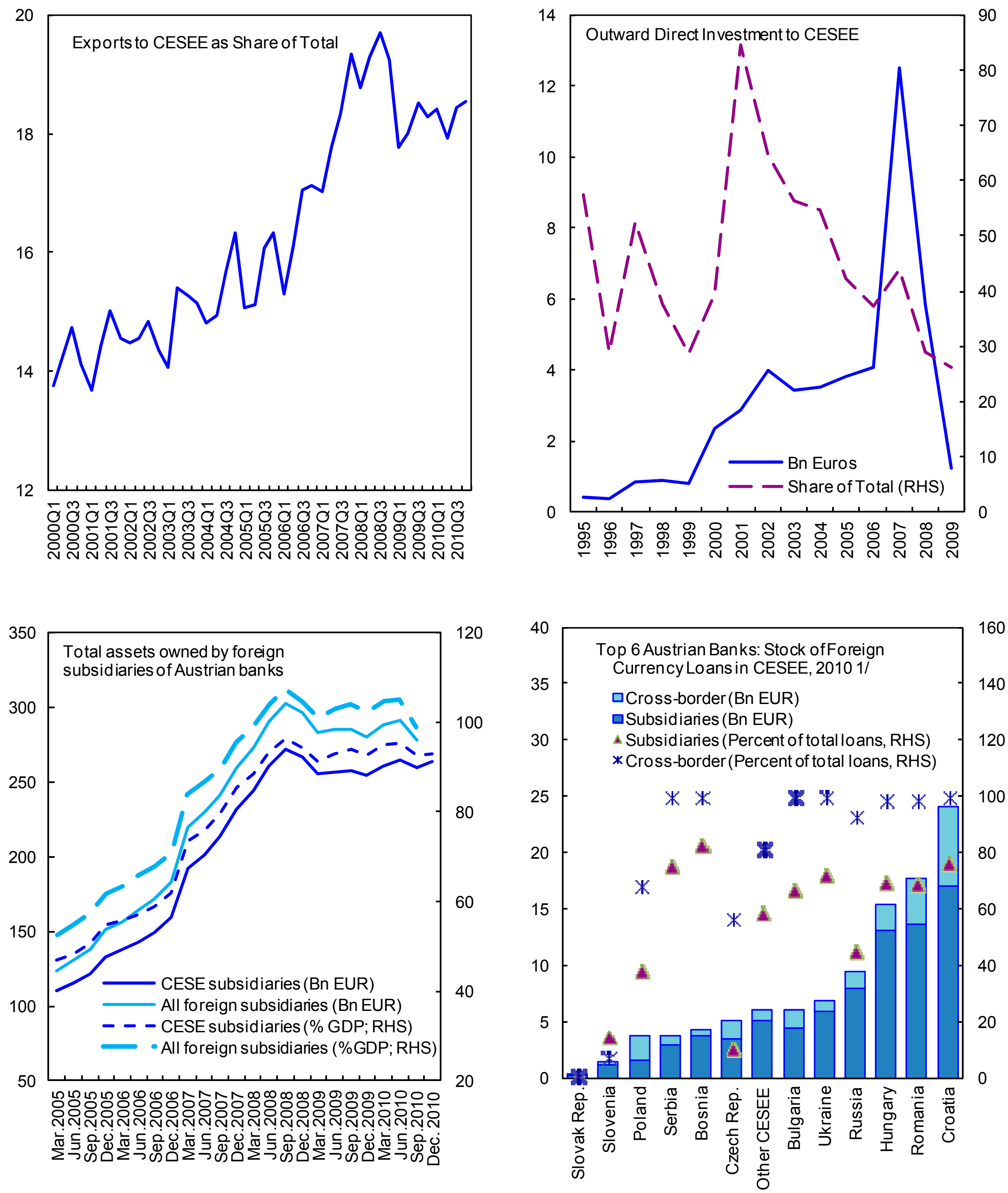
Source: Austrian National Bank.

1/ Unless otherwise indicated, figures refer to the whole banking system (i.e., including foreign owned banks) on an unconsolidated basis (i.e., without subsidiaries abroad)

2/ Figures refer only to Austrian-owned banks on a consolidated basis (i.e., with subsidiaries abroad)

3/ Comparability in 2008 and 2009 is limited due to changes in reporting requirements or introduction of new reporting schemes.

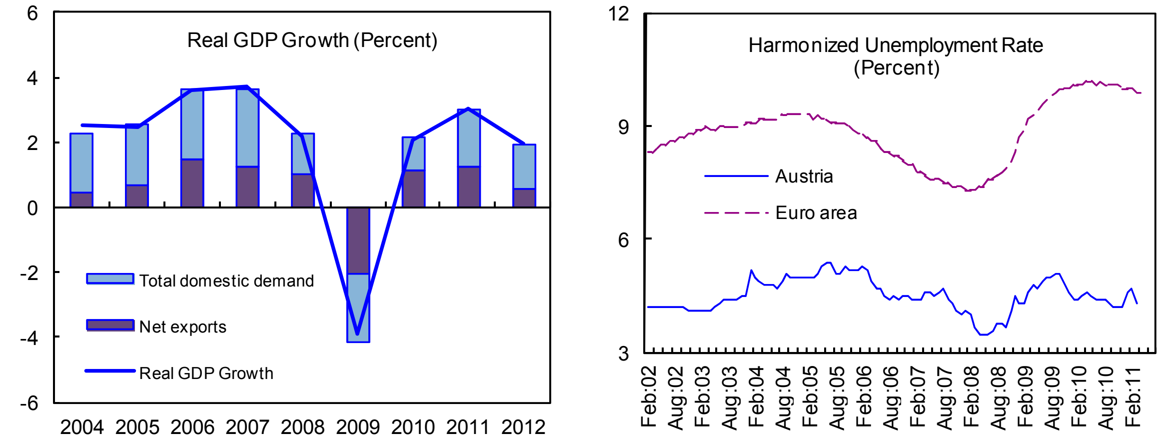
Figure 1. Austria: Expansion to the East



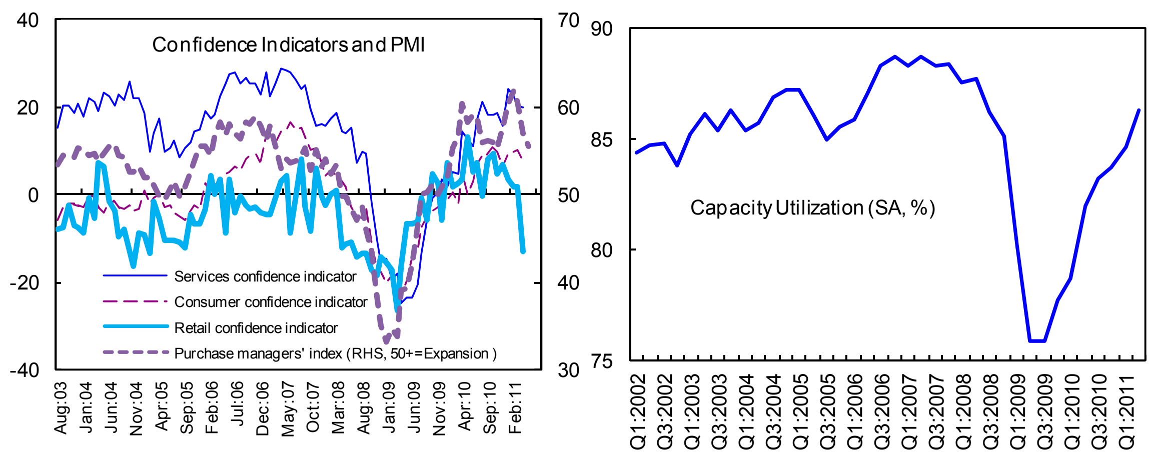
Sources: OeNB; IMF; DOT; and IMF staff calculations.
1/ Data cover loans to households and non-financial corporations only.

Figure 2. Austria: Macroeconomic Developments

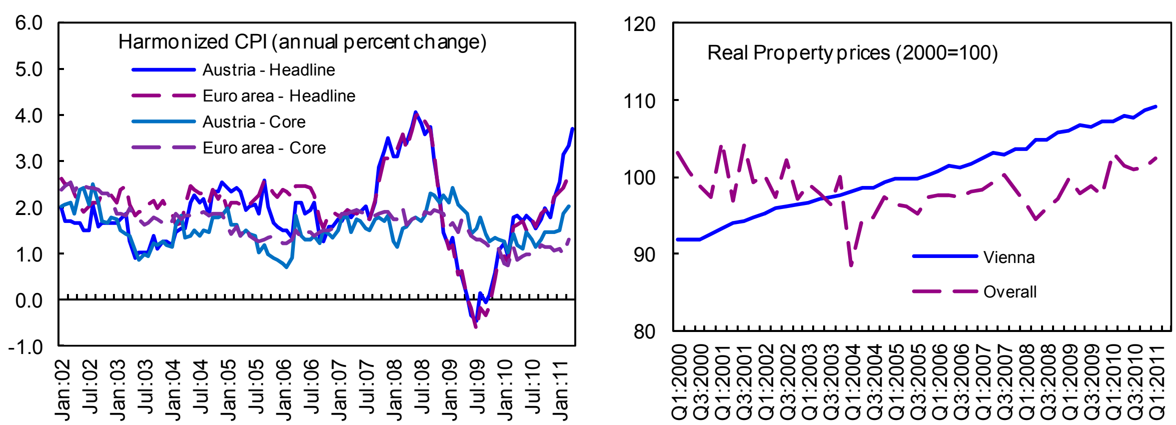
Helped by a revival in export demand, Austria quickly recovered from the sharp economic contraction of 2009, while unemployment, which increased only modestly, is back to historical levels.



As capacity utilization is close to full, there are some signs that growth will slow down in the near term.

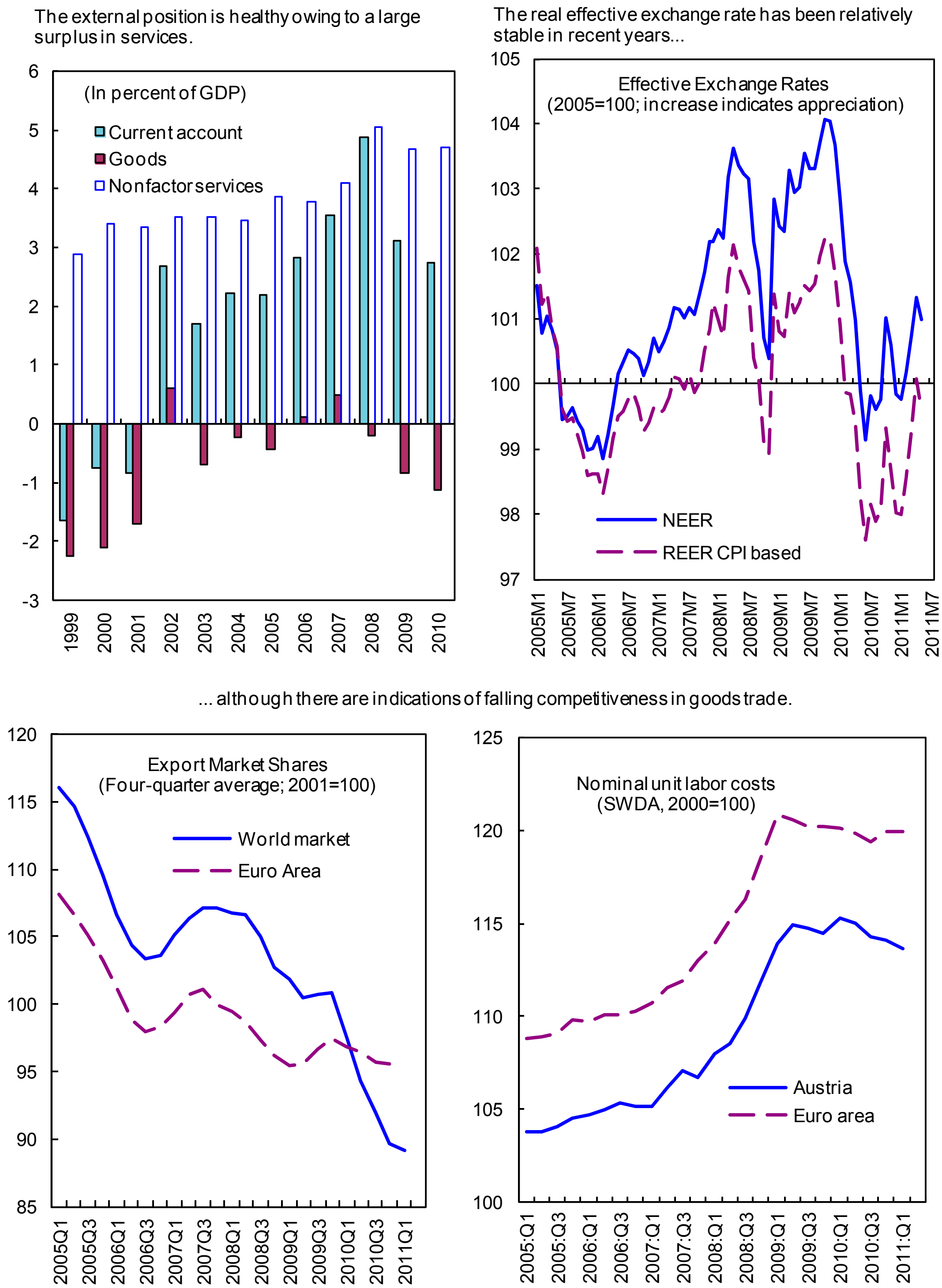


Both headline and core inflation are on the increase and exceed euro area averages, while real estate price growth is contained



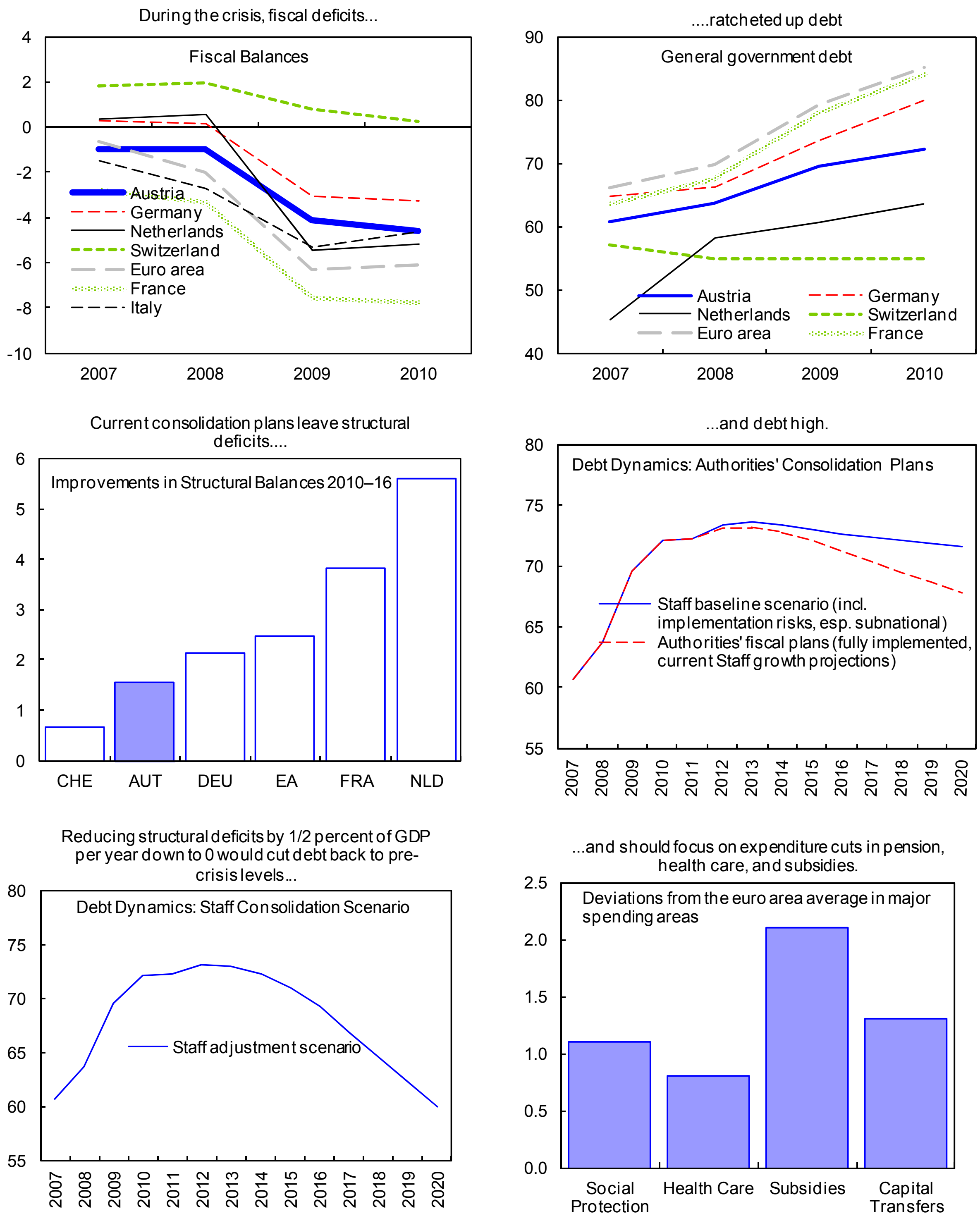
Sources: Austrian authorities; IHS; WIFO; ECB; Haver; WEO; REO; and other IMF staff estimates.

Figure 3. Austria: External Sector



Sources: Austrian National Bank; Haver; IMF; DOT; and WEO; and IMF staff calculations.

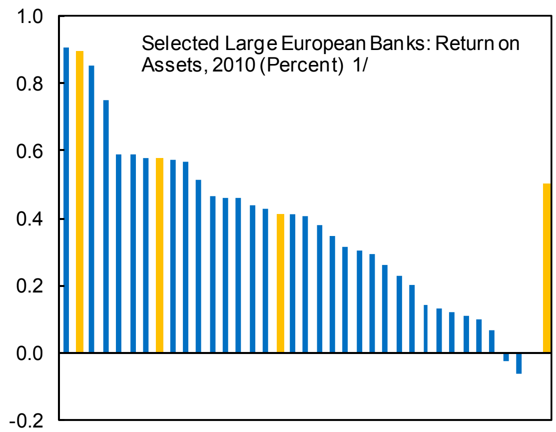
Figure 4. Austria: Fiscal Developments and Outlook
(In percent of GDP, if not indicated otherwise)



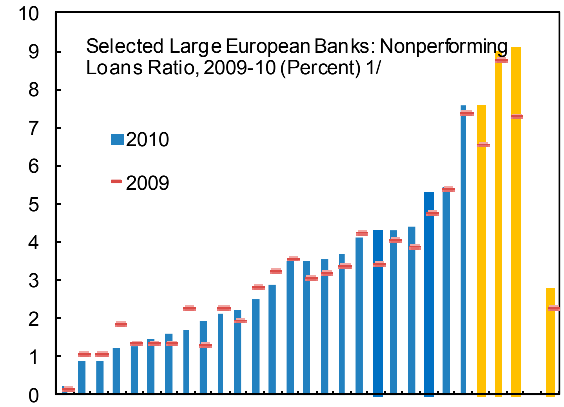
Source: Authorities; WEO; IMF staff calculations and projections.

Figure 5. Austria: Banking Sector, 2010

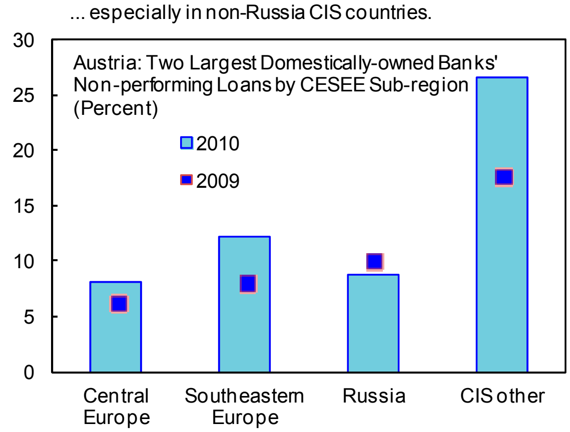
Banks' profitability compares favorably with peers'...



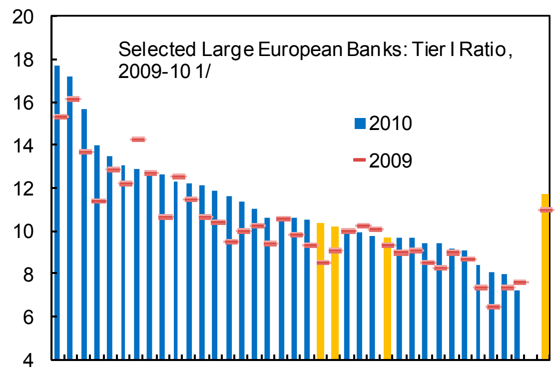
... but NPL ratios keep rising...



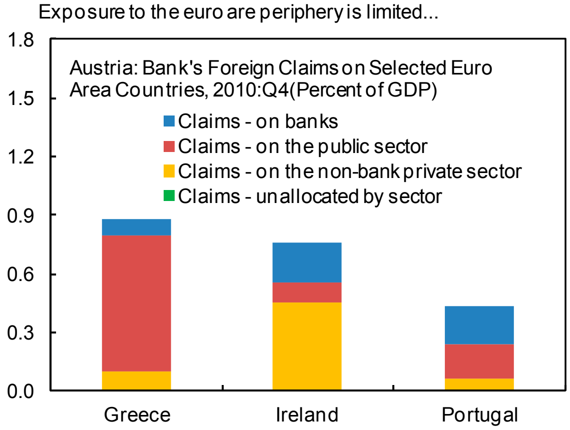
... especially in non-Russia CIS countries.



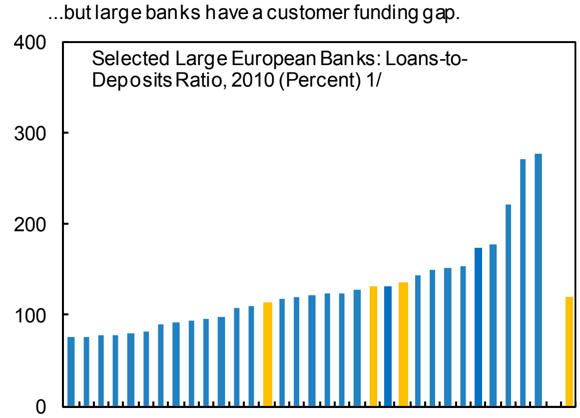
Tier I ratios are slightly below the peer group's median



Exposure to the euro are periphery is limited...

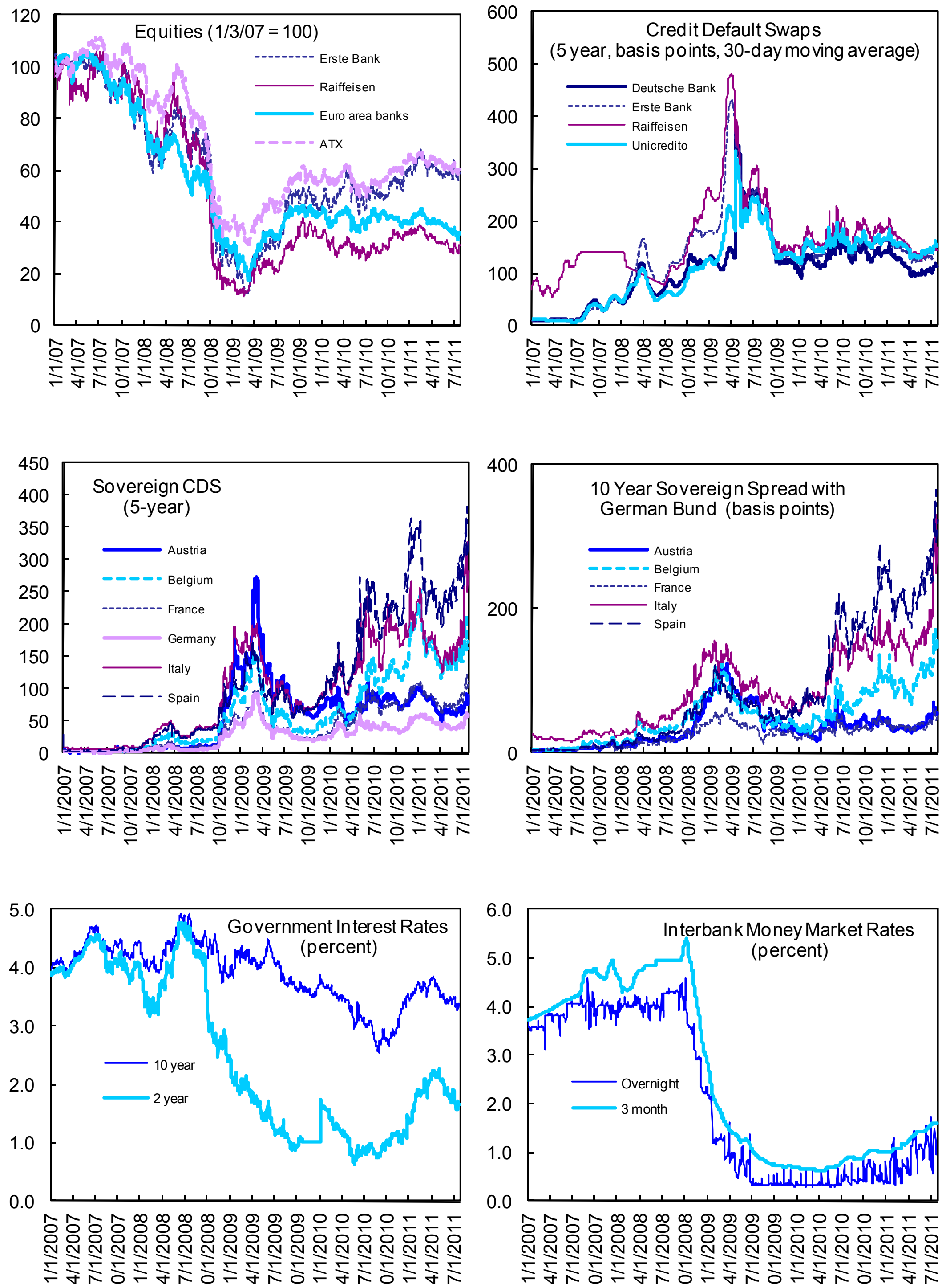


...but large banks have a customer funding gap.



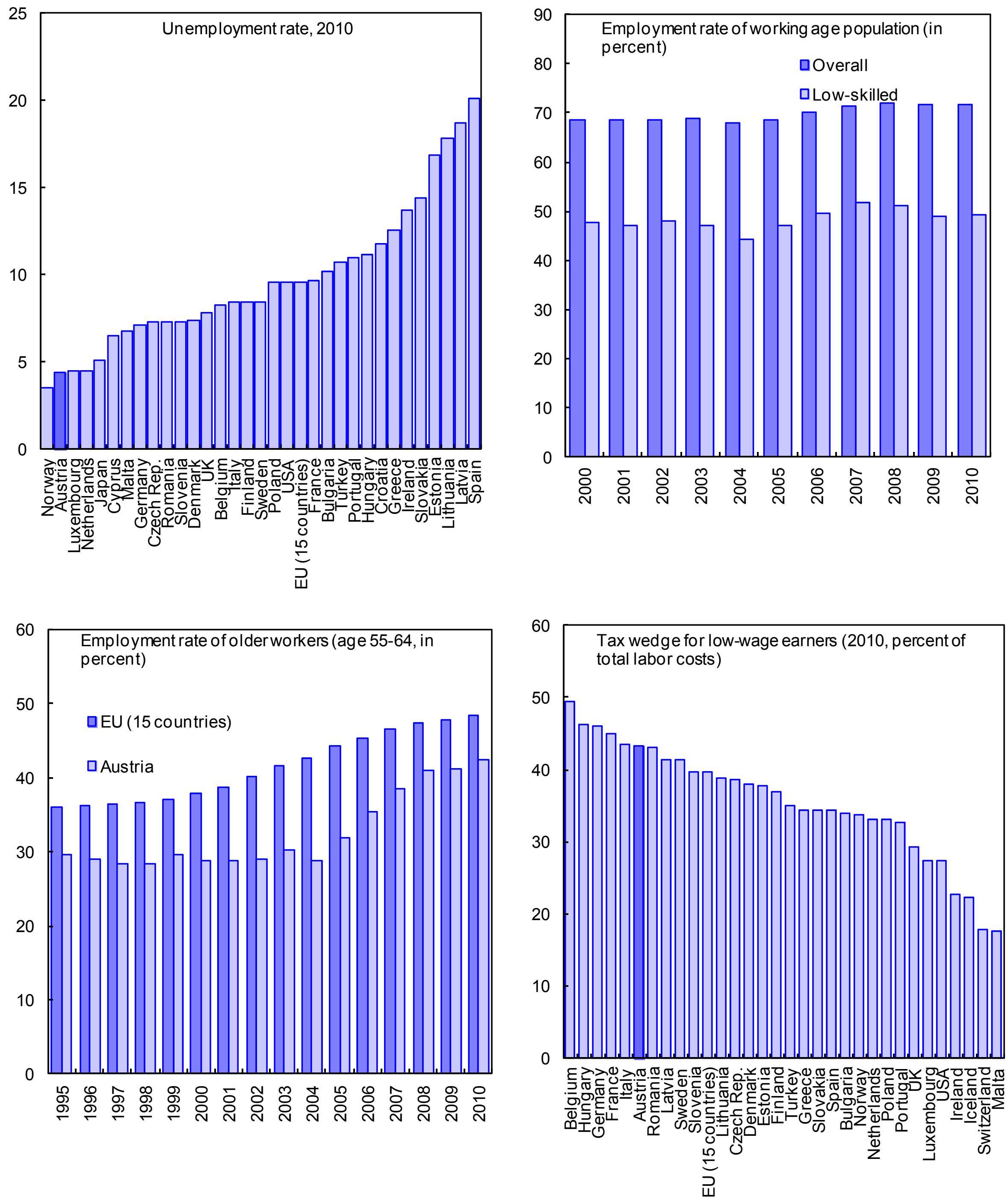
Sources: Banks' annual reports; OeNB; and IMF staff calculations.
1/ Austrian banks are shown in yellow and non-Austrian banks are shown in blue. The yellow bar at the extreme right represents the Austrian banking sector on an unconsolidated basis, except for ROA and Tier ratio where it refers to Austrian-owned banks on a consolidated basis. Return on assets includes profit attributable to noncontrolling interests. The set of "large European banks" includes 2 Belgian banks, 4 French banks, 4 German banks, 5 Italian banks, 2 Dutch banks, 1 Norwegian bank, 5 Spanish banks, 3 Swedish banks, 2 Swiss banks and 5 British banks.

Figure 6. Austria: Selected Financial Market Indicators 1/



Sources: Thomson Financial/DataStream and Bloomberg.
1/ Data through June 23, 2011.

Figure 7. Austria: Labor Market Performance



Source: Eurostat.

Annex 1. Potential Output in Austria: Structural Shifts[1]

This Annex derives an estimate of potential output in Austria and selected euro area countries using a production function approach to shed light on the determinants of medium-term growth in the country.

Methodology: Potential output in Austria is estimated using a production function approach, in which trends in labor force participation, worked hours, and employment are estimated separately. The starting point is a Cobb-Douglas production function with constant returns to scale,

$$Y = AK^{\propto}H^{1-\propto} \tag{1}$$

where *Y* is real GDP, *A* is total factor productivity (TFP), *K* is the stock of physical capital, *H* is total hours worked, and α is the share of GDP paid to capital, set at 0.3 for Austria based on historical data and previous studies.[2] Total hours worked are:

$$H = WAP * LFPR * ER * AHW$$

where *WAP* is working-age population, *LFPR* is the labor force participation rate, *ER* is the employment rate, and *AHW* is average hours worked per worker. Taking logs of (1), and denoting the logs by lower case,

$$y = a + \propto k + (1-\propto)h \tag{2}$$

TFP can be derived as a residual from (2):

$$a = y - \propto k - (1-\propto)h \tag{3}$$

To derive potential output growth, an HP filter (assuming a smoothing parameter of 100—the usual value for annual frequency data) is used to smooth the factor inputs that exhibit cyclical behavior, namely the labor force participation rate, the employment rate, and average working hours.[3] Since HP-filtered data are sensitive to end-point conditions, the sample period is artificially prolonged through a path for TFP and factor inputs reflecting a recovery from the 2009 recession. The data are then HP-filtered using the extended sample. The smoothed or trend values are denoted by bars. These values are used to derive the trend in total hours worked H as:

[1] Prepared by Prachi Mishra.

[2] E.g. see Gnan et. al. (2004) and Koman and Marin (1999).

[3] E.g. see Estevao and Tsounta (2010).

$$H = WAP * \overline{LFPR} * \overline{ER} * \overline{AHW} \tag{4}$$

TFP is also smoothed with an HP filter. Finally, trend total hours, capital, and trend TFP are combined to compute potential or trend GDP as follows:

$$\bar{y} = \bar{a} + \propto \bar{k} + (1-\propto)\bar{h} \tag{5}$$

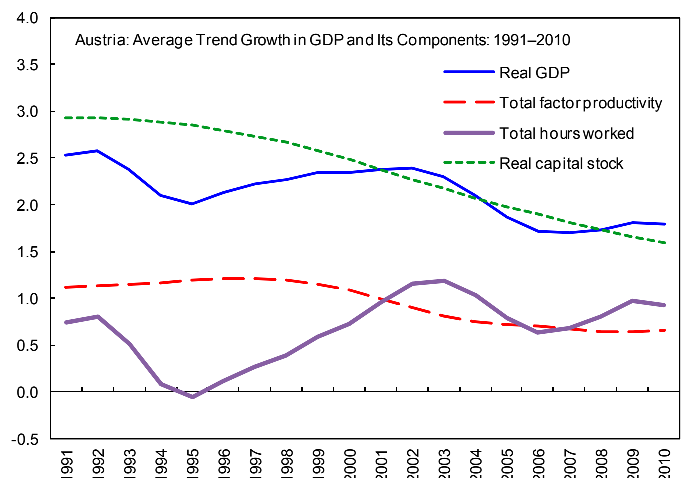
Potential growth can be broken down into three components: TFP growth, capital accumulation, and growth in worked hours:

$$d\bar{y} = d\bar{a} + \propto d\bar{k} + (1-\propto)d\bar{h} \tag{6}$$

Results: Using the production function approach to estimate potential output in Austria during 1991-2010 the following stylized facts emerge:

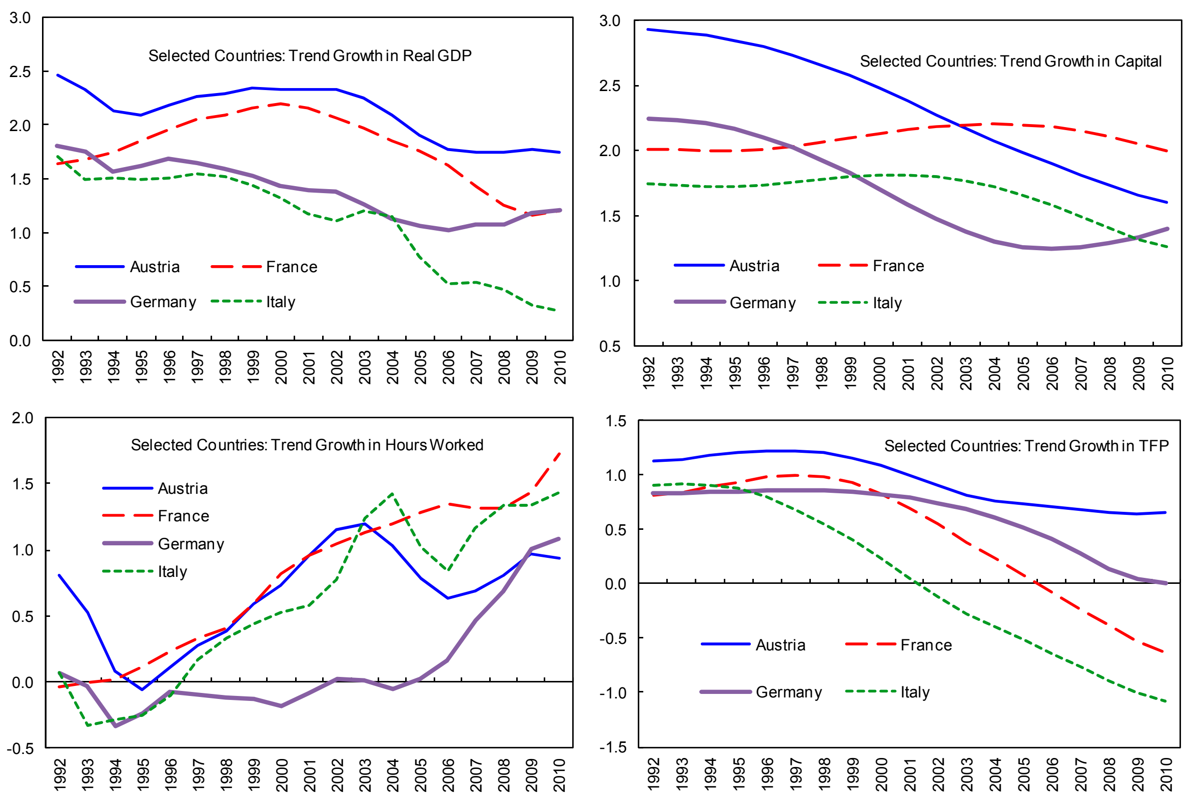
a. The average trend GDP growth rate has dropped from 2.3 percent in 1991–2000 to 2.0 percent over 2001–2010.

b. The global financial crisis did not have a sizable effect on the level of potential output or its growth rate in Austria.



c. The rate of capital accumulation slowed down markedly from 3 percent in the early 1990s to about 1.5 percent in recent years. There was a less pronounced decline in trend growth in TFP from 1.2 percent during 1991–2000 to 0.8 percent over 2001–2010. The trend growth in total hours worked, on the other hand, increased from 0.4 percent to 0.9 percent over the same period, owing mainly to an increase in labor force participation.

These patterns of growth seem to share some but not all features with those of other euro area countries, such as Germany, Italy, or France**.** While the trend growth rate declined in all the four countries, in Austria it remains the highest. In all countries, improved labor utilization helped support potential growth, though in Germany this process started only in 2006. The deceleration in capital accumulation observed in Austria is also visible in Germany and Italy, but not in France. In the latter country, as in Italy, there was a sharp slowdown in TFP growth.



One possible interpretation of the shifting patterns of growth in Austria is that increased economic integration with relatively-capital poor CESEEs resulted in a reduction in the trend increase of the capital/labor ratio in the Austrian economy. This interpretation is consistent with the observed deceleration in capital accumulation in Austria, as well as the increase in FDI toward CESEEs. In addition, slower growth in capital intensity would also slow down labor productivity growth and, hence, equilibrium real wage growth. Indeed, in Austria average real wage growth decelerated from 3.7 percent in 1991–1999 to 0.7 percent in 2000–2010.

References

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Gnan, Ernest, Jurgen Janger, and Johann Scharler, 2004, Determinants of Long-Term Growth in Austria—A Call for National Growth Strategy, Monetary Policy and the Economy, Q1/04

Koman, Reinhard, and Dalia Marin, 1999, Human Capital and Macroeconomic Growth: Austria and Germany 1960–1997, An Update, mimeo.

Annex 2. Recent Developments in the Banking Sector[1]

Austria's financial sector is dominated by traditional retail banks. Financial stability concerns are mainly related to credit risk in the banks' large loan portfolios in the CESEEs, where NPLs have mounted following the 2009 financial crisis.

A. Profitability has Improved, But Credit Quality in the CESEEs Remains Problematic

Total consolidated bank assets amounted to around EUR 1.15 trillion at end-2010, stable from 2009, while the capital-to-assets ratio increased to 7.5 percent from 7 percent in 2009 (Table 5). The net interest margin in the Austrian market was 1 percent—among the lowest in the euro area—reflecting long-standing overcapacity. The loans-to-deposits ratio in the Austrian operations remained close to 130 percent, as loan growth remained subdued and deposits stagnated. Loans-to-deposits ratios in CESEE subsidiaries were also broadly stable. Overall profitability improved, with the aggregate ROA rising to 0.5 percent in 2010 from 0.2 percent in 2009, as operating income remained strong while credit risk costs declined by 30 percent.

Austria: Large- and Medium-Sized Banks' Selected FSIs, 2010 (in percent)

	Tier I ratio		ROA		NPL ratio		Provisions/NPLs	
	2010	2009	2010	2009	2010	2009	2010	2009
Large banks:								
Bank 1	10.2	9.2	0.5	0.4	7.6	6.6	60.0	57.2
Bank 2	10.4	8.7	0.4	0.6	9.1	7.3	48.4	51.9
Bank 3	9.7	9.4	0.9	0.4	9.0	8.8	66.4	69.5
Medium-sized banks:								
Bank 1	9.4	9.2	0.1	-2.2	11.6	7.9	43.7	52.1
Bank 2	6.6	6.6	-2.7	-3.8	26.8	19.8	35.3	34.8
Bank 3	8.9	9.1	0.3	-0.1	5.2	6.6	60.2	56.0

Source: OeNB; and IMF staff calculations. ROA excludes profit attributable to non-controlling interests.

NPL ratios in CESEE subsidiaries are high, particularly in non-Russia CIS countries, where over one quarter of outstanding loans is non-performing, and in Southeastern Europe, where the NPL ratio is over 12 percent. Loan portfolios in Russia and Central Europe are performing better. NPL ratios are expected to peak in mid-2011, as the growth outlook is generally positive in CESEEs; pockets of macroeconomic weakness remain, however,

[1] Prepared by Jérôme Vandenbussche.

particularly in Croatia and Romania.[2] Furthermore, coverage ratios (provisions/NPLs) suggest that some banks may need to continue adding to their provisions even as NPL growth slows down.

The quality of loan books is subject to a non-negligible degree of uncertainty for several reasons. First, the amount of loan "evergreening" is difficult to quantify, and the treatment of performing restructured loans in provisioning rules may not fully reflect their higher probability of default. Second, foreclosing real estate has proven challenging as a result of official or unofficial administrative barriers and lack of market liquidity. Third, anecdotal evidence suggests that in a few countries a weak legal system is hampering loan recovery.

In response to the shock to the quality of their loan book, banks have been strengthening debt work-out and collection strategies, focusing first on early collection as well as loan restructuring and, more recently, on late collection and collateral recovery. In parallel, the OeNB and the FMA have stepped up their monitoring activities and are in intense dialogue with all large credit institutions regarding credit risk developments and loan work-out strategies in CESEEs.

Despite sizable exchange rate depreciation in some countries, foreign currency loans in CESEEs are generally not performing worse than local currency loans in the aggregate. In the CESEEs, 47.6 percent of loans by Austrian banks' subsidiaries were in foreign currency at end-2010, higher than the average of other competitors in the region. Cross-border loans were predominantly in foreign currency (77 percent at end-2010). Available evidence does not point to significantly higher aggregate NPL ratios for foreign currency loans, likely because these loans are disproportionately in the secured category which is performing relatively better. Nonetheless, the large stock of foreign currency loans is problematic as it limits policy responses during crises (for instance, by making currency depreciation more costly) and makes domestic demand less resilient following an external shock.

NPLs on exposures booked in Austria are low, but the large share of Swiss franc-denominated loans is a cause for concern. Recent exchange rate developments have adversely affected 30 percent of household loans that are denominated in foreign currency (mainly Swiss francs mortgages). So far, only a small share of these mortgages is non-performing, but this might change should the Swiss franc continue to appreciate strongly, as it has done since 2009. Furthermore, since most of these loans are linked to investment vehicles and have bullet maturity, the full impact of the appreciation will be felt only when sizable loan vintages mature starting in 2017. Following strong supervisory measures—but

[2] According to spring 2011 REO forecasts, GDP growth will accelerate in 2011 by 0.8 percentage points in New EU Member States, 1.7 percentage points in non-EU South-Eastern Europe, and 0.7 percentage points in European CIS countries.

also unfavorable exchange rate movements acting as a deterrent—the stock of household foreign-currency loans (adjusted for exchange rate movements) is now on a declining trend.

B. Capitalization is Comfortable on Average, but Some Medium-sized Banks Are Weak and Capital Quality Needs to Improve

The average CAR in the banking system stood at 13.2 and the Tier I CAR at 10.0 at end-2010, well above the current regulatory minima. Tier I CAR ratios for the three largest banks were also significantly above regulatory minima but slightly below the average of European peers (Figure 5). However, the quality of capital is unlikely to be sufficient given new emerging international standards.[3]

Among medium-sized institutions, one bank which was nationalized in 2009 reported large losses in 2010 as a result of write-downs on its CESEE portfolio. A restructuring plan has been drafted and is under examination by the European Commission. A second troubled medium-sized bank returned to profit in 2010, but relies heavily on government capital. This bank failed the recent EBA stress test and is planning further significant deleveraging. Finally, a smaller bank taken over by the government has been restructured, and its impaired assets transferred to a separate entity; however, the medium-term viability of the new institution remains to be demonstrated.

During the crisis, the Austrian government injected participation capital (a form of non-voting shares) into five of the six largest banks in the amount of €5.88 billion. One large bank has begun the administrative process to repay the injection, and a medium-sized bank is planning to make a partial repayment to avoid conversion of the participation capital into ordinary shares.[4] The other large bank received shareholders' authorization to repay the government but has not announced yet the timing of this operation. In the meantime, it has resumed paying dividends at pre-crisis levels and has acquired a bank in the CESEEs.

Besides repaying the government, banks need to improve the quantity and quality of their capital to meet new international standards, as incorporated in the forthcoming CRD IV directive that will enact the Basel III agreement in the EU. Key issues for Austrian banks will be the recognition of controlling interests and participation capital in the EU legislation (see table below). The capital gap is particularly large for some medium-sized banks. The

[3] The numbers in this paragraph differ from the ones in table 5 mainly because the latter exclude foreign-owned banks operating in Austria and abstract from market and operational risk.

[4] Repayment of participation capital is subject to supervisory approval of the adequacy of the bank's capital.

implementation of Basel II enhancements on capital requirements for market risk by the end of 2011 will contribute to increase risk-weighted assets.[5]

Austria: Large and Medium-Sized Banks' Tier I Capital and Selected Components, 2010
(in percent of risk-weighted assets)

	Total Tier I capital	Hybrid capital	Republic of Austria participation capital	Non-controlling interests 1/
Large banks:				
Bank 1	10.2	1.0	1.0	2.9
Bank 2	10.4	0.3	0.0	0.5
Bank 3	9.7	0.8	1.8	1.0
Medium-sized banks:				
Bank 1	9.4	1.1	3.6	2.5
Bank 2	6.6	0.7	5.0	1.9
Bank 3	8.9	1.6	2.2	1.5

Source: OeNB; and IMF staff calculations.
1/ A sizable share of non-controlling interest capital is likely to be recognized as Core Tier I capital under forthcoming new capital rules.

The OeNB regularly performs stress tests to assess the resilience of the banking system. The latest test included a downside macroeconomic scenario with a sharp negative shock to investor confidence leading to a cumulative GDP shortfall of 5.8 percentage points in Austria and 4.7–7.8 percentage points in CESEE sub-regions relative to the baseline scenario over a two-year simulation period. In this refinancing crisis scenario, the aggregate Core Tier I ratio of the banking system declined from 9.2 percent to 8.5 percent.[6]

Banks exhibit solid liquidity and have reduced their dependence on Eurosystem operations**.** The net funding gap (cumulated over 12 months, before money market operations) has remained stable around €40 billion while the counterbalancing capacity exceeds €80 billion. These indicators are monitored and stress-tested weekly by the OeNB using data from a forward-looking liquidity reporting system introduced at the beginning of the crisis. The net position of the Austrian banking system in the unsecured money market remains in a range of 1 to 1.5 percent of total assets, while the share of the Austrian banks in the outstanding amount of Eurosystem tender operations has decreased significantly. At the beginning of May 2011, Austrian banks owed €5.7 billion to the ESCB while the pre-crisis average was about €10 billion.

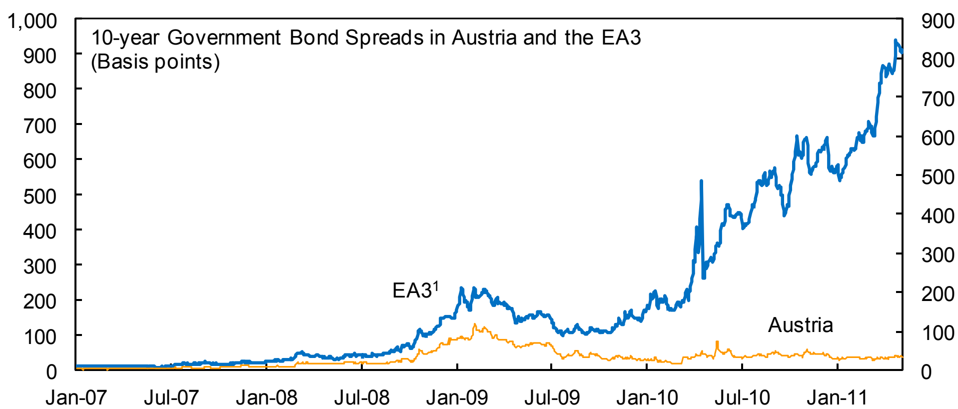
[5] A December 2010 OeNB simulation study suggested that Austrian banks needed to raise € 8.9 billion. Together with the capital needed to repay the government, capital needs would total €14.8 billion. As a benchmark, total after-tax profits of the banking system peaked at € 9.8 billion in 2007.

[6] The Core Tier I capital definition was the same as the EBA for its June 2011 stress tests. It included public participation capital and non-controlling interests.

Annex 3. Spillover Risks from the Euro Area Periphery to Austria[1]

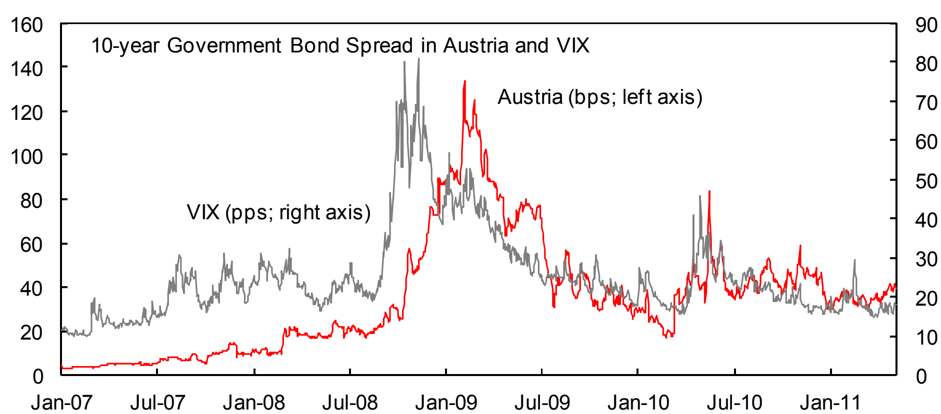
Though spreads on Austrian government debt are higher than before the financial crisis, recent financial tensions in the euro area periphery have not prompted financial markets to price in an extra risk premium for Austria so far. This annex examines the correlation between sovereign bond spreads for Austria and spreads for the three euro area countries that have received international financial assistance, Greece, Ireland, and Portugal (the EA3). This exercise is a test of whether markets expect that increased risk in those countries would spill over to Austria.

After increasing sharply for a brief period in early 2009, over the past two years the Austrian sovereign spread has been trending downward while EA3 spreads have risen substantially.



Sources: Bloomberg; Datastream; and IMF staff calculations.
1/ Simple average for Greece, Ireland, and Portugal.

Changes in financing conditions in Austria seems to be more closely correlated with indicators of global risk appetite, such as the VIX, than with EA3 risk.



Sources: Bloomberg; Datastream; and IMF staff calculations.

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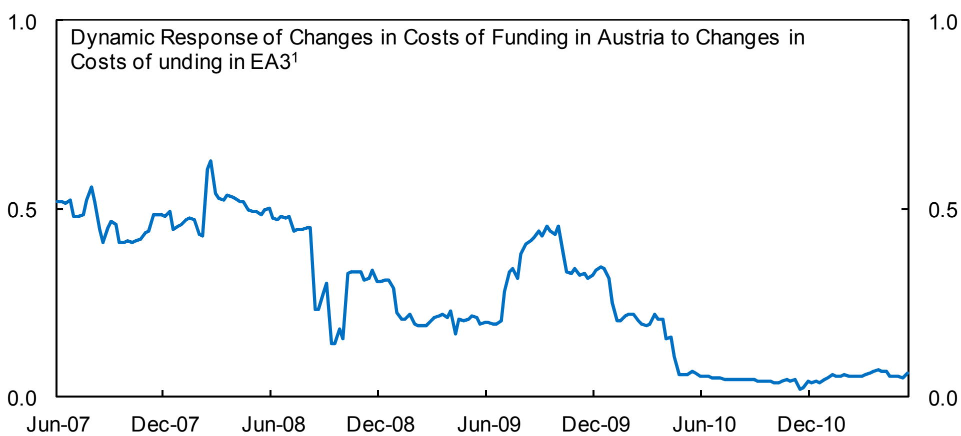
[1] Prepared by Jérôme Vandenbussche.

To estimate the relationship between Austrian and EA3 perceived sovereign risk more rigorously, we regress changes in sovereign bond spreads in Austria on changes in spreads for similar bonds in the EA3 (and a constant term) during a moving window over 26 weeks. In the regression, global financial market conditions including the TED spread, the VIX, and their interactions with the crisis occurrence are controlled for. The results show that Austrian spreads have become considerably less sensitive to EA3 spreads in recent months, particularly since the spring of 2010, when the international assistance package for Greece was put together. Thus over the past year, financing conditions in the EA3 affected Austria only to the extent they registered on a global scale. This suggests that, while it is unlikely to be affected if market concerns remain confined to the EA3 countries, Austria would likely suffer should these concerns lead to generalized market turmoil.



Sources: Bloomberg; Datastream; and IMF staff's analysis.
1/ Dynamic response is the regression coefficient from regressing changes in costs of funding in Austria on counterpart changes in other regions together with a constant term based on a moving window over 26 weeks. Costs of funding refer to sovereign bond spreads. Changes in costs of funding are also controlled for global financial market conditions including TED, VIX, and their interactions with the crisis occurrence.

Annex 4. Options for Government Expenditure Rationalization in Austria[1]

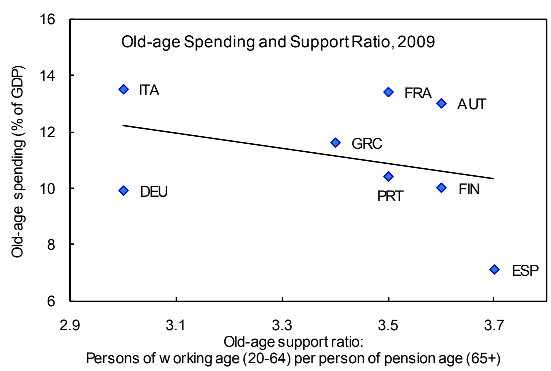
International comparison suggests that the following three areas offer particular scope for efficiency gains and rationalization: early labor market exit (Section A), health care (Section B) and subsidies (Section C).

A. Early Labor Market Exit

In Austria, early labor market exit occurs mainly through early retirement, disability, special old-age part-time arrangements, and specific unemployment benefit rules for workers with retirement options in sight. While the statutory retirement age is 65 years for men and 60 years for women (with stepwise equalization to 65 scheduled from 2024 onwards), the average age at which either a disability or an old-age pension is drawn is much lower. For members of the social security system it was 59.1 years for men and 57.1 years for women in 2010. This is the second lowest age in the OECD. Specifically, the average entry age for invalidity pensions was 53.5 years for men and 50.1 years for women, and for old-age pensions it was 62.6 years for men and 59.3 years for women. The latter contributes to rendering Austria's share of old-age expenditure in GDP one of the highest in the euro area, while the old-age support ratio compares rather favorably (see text figure below).

The authorities consider closing the gap between the statutory retirement age and the average effective pension age a reform priority and have recently enacted the following main measures:

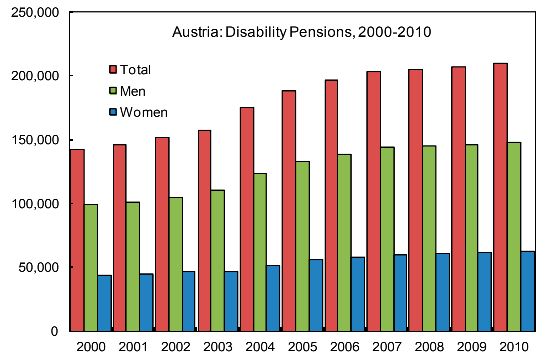
- Restrictions on the penalty-free early retirement of workers with long contribution periods (*"Hacklerregelung")*. In particular, effective in 2011, the price for the frequently-used purchase of imputed contribution years needed to fulfill the minimum insurance period of 40 year for women and 45 years for men was increased; and, effective in 2014, the minimum qualifying age will be raised by two years (to 62 for men and 57 for women, with further stepwise increases to 62 thereafter). Also by 2014, the purchase of imputed contribution times will be abolished. The *"Hacklerregelung"* was introduced in 2006 and extended in 2008, offsetting earlier attempts to reduce early retirement in the context of the pension reforms of 2003 and 2004.



Sources: Eurostat; and OECD.

[1] Prepared by Siegfried Steinlein.

- Eligibility criteria for disability pensions were tightened. Specifically, rehabilitation efforts before a pension can be drawn were strengthened. However, the range of alternative occupations against which disability is assessed remains narrow. The authorities are also introducing workplace measures to gradually enhance the prevention of disability cases.



Source: National authorities.

However, there are still other schemes that may bias incentives towards early inactivity and may now be taken up more frequently. Examples for other possibilities to exit the labor market before the statutory retirement age are:

- The "regular" early retirement scheme ("corridor pensions") with eligibility from age 62 (only relevant for men as the statutory retirement age for women is 60);

- Early retirement pensions for workers with particularly heavy working conditions during part of their work history, with eligibility from age 60 (again, not relevant for women). If they also have a long contribution period, these workers will be able to continue to benefit from the current rules of the *"Hacklerregelung"* beyond their phase-out date of 2014;

- Subsidized old-age part time work arrangements, which are accessible up to seven years before the statutory retirement age with a salary cut that is less than proportional to the work-time reduction. The arrangement can be "front-loaded," i.e. it is possible to work full-time in the first half of, for instance, a five-year period, while reducing the working time to zero in the second half;

- Extension or increase of unemployment benefits for unemployed older workers. These rules are intended to facilitate the transition to early retirement, thereby reducing the incentive to continue the search for work.

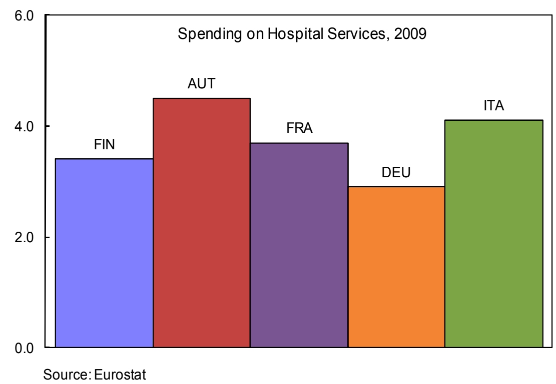
The penalties in the form of benefit discounts for early inactivity differ across these options but they are generally too low to be actuarially fair.

All in all, given the range of existing early inactivity options, the recently enacted restrictions may not fully reach their objective. To the extent that they succeed in reducing the take-up of long-term insured and disability pensions, they may just divert potential claimants to other avenues.

B. Health Care

Total health expenditure and public health spending rank among the highest in the OECD and have been growing faster than in most other OECD countries. Going forward, health care costs are likely to continue to be subjected to considerable pressures from aging and technological advances (IMF, 2010). On the other hand, health outcomes such as life expectancy are not correspondingly better: for instance, a recent cross-country analysis in the 2011 OECD survey on Austria suggests that a move of the country to the "health care efficiency frontier" would either imply a life expectancy increase by two years and a half or, alternatively, spending that is 2 percent of GDP lower.

Hospitals are the main contributors to the high health expenditure. Spending on hospitals was 4.7 percent of GDP in 2009, above most other euro area countries. Other indicators of overcapacity and/or an over-use of hospital services are the number of hospital beds, in particular acute care beds, which in per-capita terms is the highest in the OECD, and the very high hospital case load.



Although the authorities are aware of these problems, hospital reform is still in its infancy. The states are the key decision makers in the hospital area but bear only part of the costs, which are shared with the federal and municipal levels and health insurance funds . Hence, the hospital area is a prime example for disconnected spending and financing responsibilities in the Austrian federal system with consequent incentive-distorting effects. Also, possible hospital specialization advantages on a national scale are not reaped, as existing planning instruments at federal level are not adequately enforced to optimize the size and geographical distribution of hospitals on Austria's territory. In addition, studies show that hospital efficiency differs from state to state. Discussions on health care and hospital reform have intensified and include a more streamlined hospital financing mechanism that bundles resources at the federal level (at a very minimum, between the federal government and health insurance funds). Disbursements could then be linked to strict performance criteria. In the long-term care area, a streamlining of financing and benefit administration has recently been achieved, while for the hospital sector it is not clear when decisions will be taken and implemented.

The use of out-patient care and prevention is lagging behind and the health care system is not sufficiently integrated. Outpatient and prevention services remain insufficiently used, leaving a major source for efficiency gains untapped. Again, this mirrors incentives: in contrast to in-patient care, health insurance funds carry the full cost for out-patient care. Also, there is no gate-keeping function by general practitioners. A recent promising initiative towards a better integrated care system consisted of facilitating polyvalent group practices but was subsequently amended to only cover group practices of the same medical specialty.

C. Subsidies

Austria spends around 6 percent of GDP on subsidies and capital transfers, about 3½ percent of GDP more than the euro area average. The composition is as follows:

Austria: Subsidies and Capital Transfers
(In billion euro unless indicated otherwise)

	Federal level	State level	Municipalities
Hospitals 1/	1.3	2.4	1.3
Railways (OeBB) 1/ 2/	3.1		
R&D	0.5		
Active Labor Market Policies (ALMP)	0.8		
Private enterprises, incl. agriculture 3/	0.6	1.0	0.7
Housing		0.2	0.3
Sport and culture		0.2	0.3
Other	2.4	0.7	1.0
Total:	8.6	4.4	3.6
(in percent of GDP)	*3.0*	*1.6*	*1.3*

Source: Ministry of Finance, 2008 data.
1/ includes effects of March 2011 deficit and debt revisions.
2/ an additional major expenditure item in the federal budget (apart from subsidies/capital transfers) are pension benefits for former OeBB employees (around 2 billion euro)
3/ at federal level: includes agriculture only; at subnational levels: branch unspecified.

Almost half of total subsidies and capital transfers are disbursed to hospitals and Austrian Railways (OeBB). More broadly, OeBB-related expenditures stem from three areas:

- Compensation for passenger and cargo services;
- Pensions for employees hired as officials before 1995, which are reimbursed from the federal budget;
- Capital transfers for railway infrastructure projects.

There seems to be potential for rationalization in all three areas:

- Performance indicators, such as the turnover per employee (compared to, for instance, the Swiss Railways), seem to suggest that there is scope for rationalization in the operational business. This would also reduce the need for budgetary compensation for passenger and cargo services.
- With respect to pensions, the low average effective retirement age of OeBB employees (about 52) indicates possible savings from improved utilization of older workers, for instance by transferring employees to other posts (coupled with

necessary retraining) rather than sending them into early retirement on grounds of disability or organizational needs. Furthermore, even after a transition period, the final statutory retirement age for OeBB employees hired before 1995 will be 61½, still 3½ years below the standard one.

- On infrastructure investment, reconsidering the cost (including potential cost overruns) and benefits of several large projects approved in recent years could reveal scope for downsizing.

As regards other subsidies, a recent report under the auspices of the "Administrative Reform Working Group" highlights a number of shortcomings. The group was instituted by the authorities in 2009 and has examined different areas of public spending. As for subsidies, it stresses in particular the following deficiencies (with varying relevance across specific programs): lack of strategic long-term orientation, objectives, and priorities; unclear decision criteria, missing focus on results and insufficient targeting (e.g., with respect to subsidies for housing); unsatisfactory benefit analysis and ex-post evaluation; transparency gaps as regards duplication of benefits for the same objective and recipient and overlapping competences across government levels; and, in consequence, room for more administrative efficiency and coordination within and across government levels.

The authorities have taken initiative to create a "transparency databank" to improve the situation. However, important design issues are still under discussion, especially with respect to the scope of subsidies and benefits that should be included at different levels of government. If successful, this initiative could be the first step to a comprehensive stock-taking and evaluation of all programs. This could then be the basis for setting clear priorities with a focus on growth enhancement and eliminating redundant subsidies.

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Annex 5. Austria: Reforming Fiscal Federalism[1]

Austria is a federal country with 8.4 million inhabitants living in nine states (Laender) and some 2,350 municipalities. Sub-national governments spend some 30 percent of general government outlays. Intragovernmental fiscal relations and equalization arrangements are highly complex and offer scope for increasing the efficiency of public service delivery.

Against this background, the Ministry of Finance commissioned several studies in the context of a review of the current fiscal equalization law.[2] The latter came into force in 2008 and has recently been extended by one year until 2014. The studies consider the Austrian fiscal equalization and fiscal federalism arrangements in urgent need of reform and follow earlier reform discussions (e.g., 2003–05 Austria Convent). However, a study on tax autonomy at the subnational level, a key instrument for enhancing financing accountability, is still under preparation.

Pivotal recommendations in the studies focus on the following areas:

- A comprehensive streamlining of the distributions of tasks within and across government levels. Current task assignments in several public spending areas, such as health care and education, are fragmented, overlapping, and duplicative.

- A closer alignment of spending and financing responsibilities. Following a better task assignment across government levels, financing would need to be realigned accordingly.

- Enhanced realization of economies of scale at the local level. Some of Austria's municipalities and districts are too small for efficient public service provision. While mergers might be politically difficult, cooperation could be further strengthened. For instance, stronger incentives for cooperation could be incorporated into the next vintage of the financial equalization law.

Reformed fiscal federalist arrangements would also further strengthen incentives to comply with the domestic Austrian Stability Pact. After the old pact became obsolete during the crisis, a new pact covering the period until 2014 was agreed this year, stipulating a reduction of the combined deficit of subnational governments from 1.2 percent of GDP in 2010 to 0.75 percent in 2011 and further to 0.5 percent in 2014. While sanctions for noncompliance

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[1] Prepared by Siegfried Steinlein.

[2] These studies are published on the website of the Ministry of Finance: https://www.bmf.gv.at/Budget/BesondereBudgetthemen/Finanzbeziehungenzu_658/5361/StudienzurReformdes_11884/_start.htm.

have been enhanced and states have committed to introduce individual ceilings for guarantees, it remains to be seen if the current set up is strong enough to prevent recurrence of non-compliance. Also, there is still room to improve ex-ante co-ordination of budgetary plans and to strengthen the medium-term budgetary planning frameworks. A medium- and long-term fiscal sustainability analysis that becomes an integral and prominent part of the budget planning process at all levels of government would create more awareness of debt dynamics and help deal with cost pressures in the pension and health systems. It would also be instrumental in deriving medium-term expenditure target paths for crucial expenditure categories.

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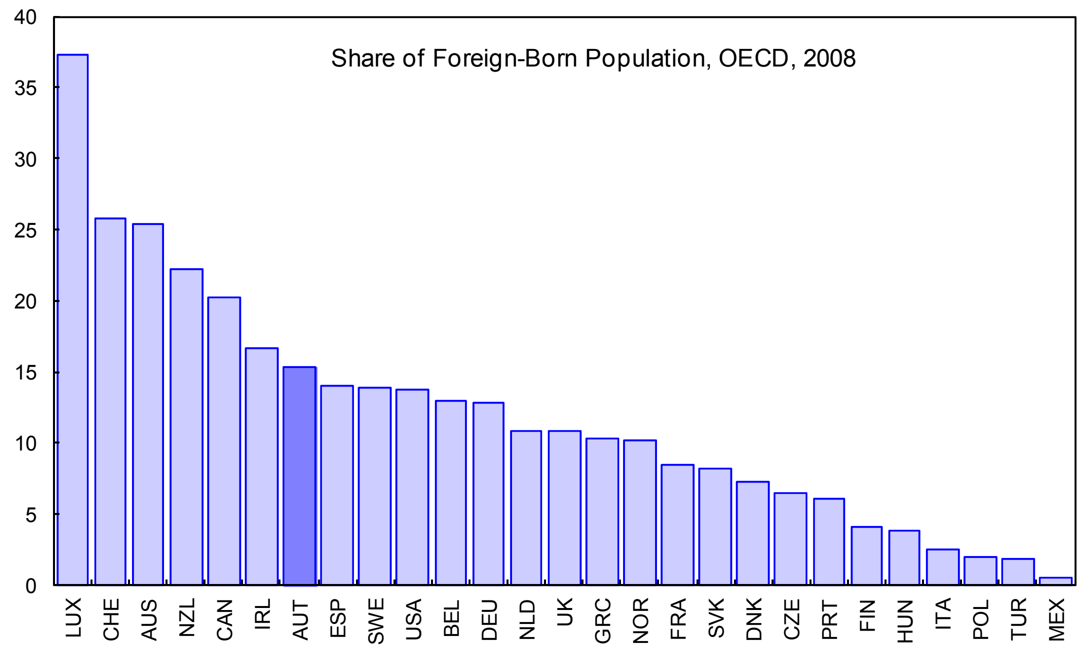
Annex 6. Immigration in Austria[1]

The share of immigrants in the Austrian population has been increasing steadily in recent years, rising from 11 percent in 1999 to over 15 percent in 2008, one of the highest in the OECD.



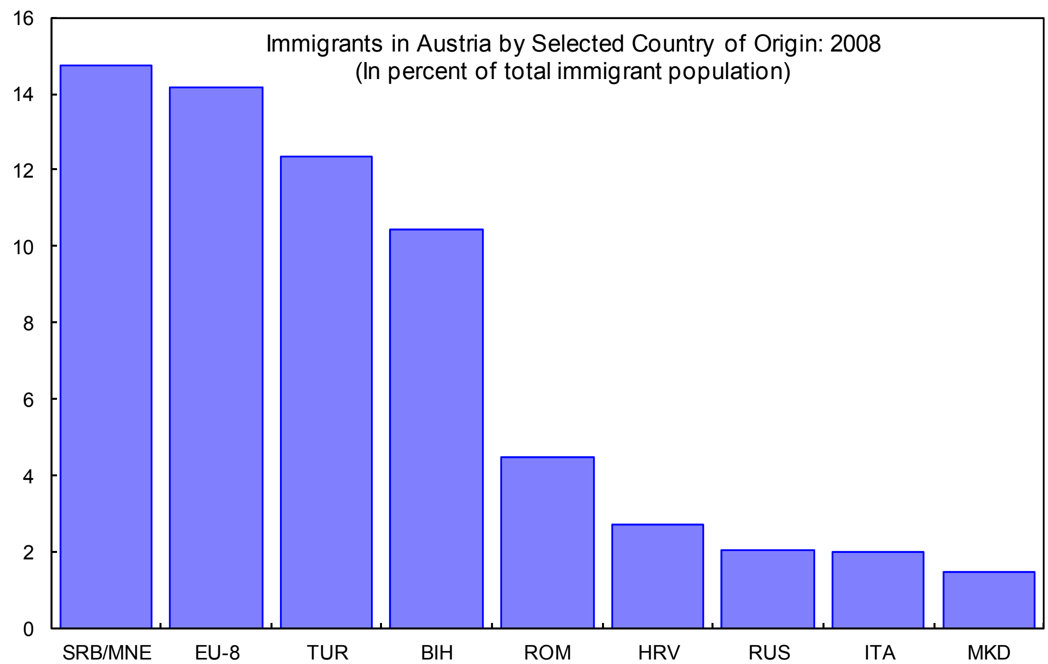
Source: OECD International Migration Outlook, 2008; and staff calculations.
Notes: Data for the latest year is used for Countries on which immigrant share of population in 2008 is not available.

Beginning in the 1960s, immigrants came to Austria as guest workers without families to fill labor demand in low-wage jobs. After the break-up of Yugoslavia, there was a sizable new wave of immigrants; increasing labor market integration within the EU contributed to push up the number of foreign workers in the following years.

Close to half of the immigrants have only primary education, another 40 percent have a secondary education degree, while tertiary-educated immigrants are a minority. More recently, immigration of EU citizens with higher skills has grown in importance as the EU labor market became more integrated. In 2007, the share of immigrants with a tertiary education was about 16 percent, up from 11 percent in 2000. With an unemployment rate of 8.5 percent versus 3.1 percent for Austrian-born workers, the labor market performance of immigrants is disappointing.

[1] Prepared by Prachi Mishra.

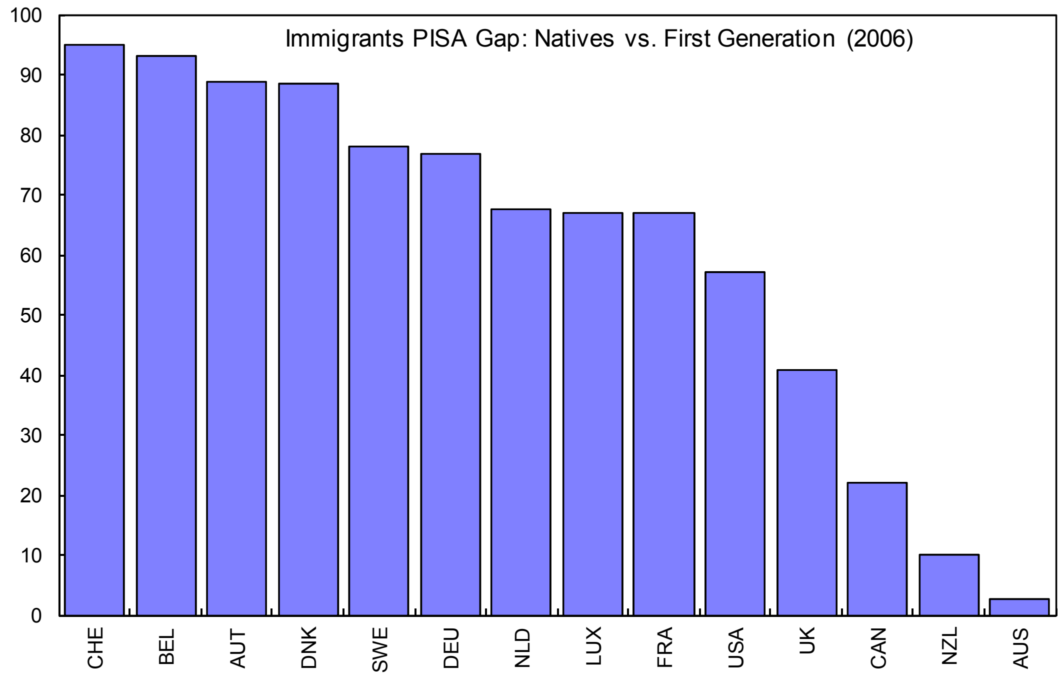
On May 1, 2011, Austria lifted all restrictions on mobility of workers from countries that joined the EU in 2004. In order to address the implications of the EU's enlargement in 2004 and 2007, several member states including Austria introduced transitional restrictions on the movement of workers from the new member states. These curbs could be maintained for a maximum of seven years—until May 2011 in the case of workers from the eight countries that joined the union in 2004 (EU-8), and until 2014 in the case of workers from Bulgaria and Romania. Most countries lifted the restrictions gradually, with Austria and Germany the only countries opting to maintain compulsory work permits beyond 2009.



Source: OECD International Migration Statistics; and IMF staff calculations.

The elimination of the restrictions on labor mobility is expected to lead to stronger immigration flows. Currently, around 15 percent of immigrants in Austria are from EU-8 countries; immigrants from these countries are mainly in the working age-group (60 percent in the 25–64 age group), and are predominantly low-skilled (86 percent have secondary education or less). The elimination of the remaining restrictions is expected to lead to immigration flows of roughly 80,000 through the end of 2013 (or 30 percent of the average gross immigrant inflow per year). These projections are based on a survey carried out by the Austrian Economic Research Institute (WIFO) in the Czech Republic, Slovakia and Hungary. Further opening to Romania and Bulgaria by 2014 is not expected to lead to large flows, though precise projections are not available.

While in many countries school performance of immigrant and first generation children is significantly worse than that of native children, in Austria this attainment gap is larger than elsewhere. Part of the explanation is that parents' education is an important determinant of children's educational attainment, and immigrant parents in Austria are less well educated than in other countries. Furthermore, in the Austrian educational system parental effects are especially strong, a phenomenon that has been attributed to the early streaming of students at the age of 10. However, even controlling for parental effects the attainment gap in Austria is large in international comparison.[2] With immigrant and first generation children accounting for 20 percent of elementary school children, improving the school performance of this group would have positive effects on overall human capital. In addition, given weak labor market performance of low-skilled workers in Austria, policies to improve the educational attainment of immigrant children are also likely to improve overall labor utilization.



Source: OECD Economic Surveys, 2009.

[2] OECD Secretariat, "Children of Immigrants in the Labour Market of EU and OECD Countries: An Overview," DELSA/ELSA/MI (2009).

INTERNATIONAL MONETARY FUND

AUSTRIA

Staff Report for the 2011 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2011 Consultation with Austria

(In Consultation with Other Departments)

August 5, 2011

Contents Page

Annex I. Austria: Fund Relations
(As of June 30, 2011)

Mission: Consultation discussions were held in Vienna during June 3−June 14, 2011. The authorities released the mission's concluding statement, which is available at:
http://www.imf.org/external/np/ms/2011/061411.htm

Staff team: Ms Detragiache (head), Messrs. Steinlein and Vandenbussche (all EUR) and Ms. Mishra (RES). Mr. Prader, Alternate Executive Director for Austria, attended the meetings.

Country interlocutors: Finance Minister Fekter, Austrian National Bank (OeNB) Governor Nowotny, other senior officials, members of Parliament, and representatives of the social partners, the financial sector, and economic research institutes.

Fund relations: Austria is on a 12-month consultation cycle. The last consultations were held June 18–30, 2010 and the staff report is available at:
http://www.imf.org/external/pubs/cat/longres.aspx?sk=24187.0

FATF: The Fund published its report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism in November 2009. The report is available at:
http://www.imf.org/external/pubs/ft/scr/2009/cr09299.pdf
Based on its action plan and commitments, the FATF plenary removed Austria from the specific review list in June 2010.

I. **Membership Status:**
(a) Joined: August 27, 1948
(b) Status: Article VIII, as from August 1, 1962

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	2,113.90	100.00
Fund holdings of currency	1,545.81	73.13
Reserve position in Fund	568.10	26.87
Lending to the Fund:		
New Arrangements to Borrow	223.00	

III.	**SDR Department:**	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	1,736.31	100.00
	Holdings	1,688.18	97.23

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:** None

VI. **Projected Payments to Fund:**
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	--	--	--	--	--
Charges/Interest	0.13	0.29	0.29	0.29	0.29
Total	0.13	0.29	0.29	0.29	0.29

VII. **Implementation of HIPC Initiative:** Not Applicable

VIII. **Exchange System:**

As of January 1, 1999, the currency of Austria is the euro. Austria's exchange system is free of restrictions on the making of payments and transfers for current international transactions with the exception of restrictions notified to the Fund in accordance with decision No.144-(52/51) resulting from UN Security Council Resolutions and EU Council Regulations, including the implementation of the sanctions on Iran according to EU Council Resolution No. 961/210 as amended and on Libya according to EU Regulation 204/2011 as amended. Furthermore, national restrictions apply with respect to certain terror organizations and their activists within the EU, implementing decisions in the Common Foreign and Security Policy (CFSP) framework of the EU.

Annex II. Austria: Statistical Issues

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

The transition to the new European System of Accounts 1995 (ESA 1995) has complicated the analysis of national accounts and fiscal data. The reclassification of public hospitals in 1997 introduced a break in the national account series on public and private consumption. Annual fiscal data for 1995 onward are derived from ESA 1995 data reported to Eurostat. Data on outlays by function have been revised and are available from 1995 onward on a comparable basis according to major functional categories. Quarterly fiscal data reported through Eurostat are disseminated in the IFS.

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

Austria: Table of Common Indicators
(as of July 30, 2011)

	Date of latest observation	Date received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rates	07/29/11	07/30/11	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	June 2011	07/20/11	Monthly	Monthly	Monthly
Reserve/Base Money	June 2011	07/30/11	Monthly	Monthly	Monthly
Broad Money	June 2011	07/30/11	Monthly	Monthly	Monthly
Central Bank Balance Sheet	June 2011	07/15/11	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	June 2011	07/30/11	Monthly	Monthly	Monthly
Interest Rates[2]	07/29/11	07/30/11	Daily	Daily	Daily
Consumer Price Index	June 2011	07/14/11	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2011:Q1	06/30/11	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	June 2011	07/30/11	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	June 2011	07/30/11	Monthly	Monthly	Monthly
External Current Account Balance	2011:Q1	06/30/11	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	2011:Q1	06/30/11	Quarterly	Quarterly	Quarterly
GDP/GNP	2011:Q1	06/11/11	Quarterly	Quarterly	Quarterly
Gross External Debt[5]	2011:Q1	06/30/11	Quarterly	Quarterly	Quarterly

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

Statement by the Staff Representative on Austria
September 2, 2011

1. **This statement provides information that has become available since the Staff Report was circulated to the Executive Board on August 8, 2011**. The information does not alter the thrust of the staff appraisal.

2. **GDP growth in the second quarter remained strong, but prospects for 2012 have dimmed**. While exports, equipment investment, and inventory accumulation slowed down relative to the previous quarter, resilient private consumption and weaker imports resulted in second quarter growth accelerating to 1 percent, up from 0.8 percent in the first quarter, and above the staff forecast of 0.7 percent. Looking forward, the less favorable external environment, including the slowdown in Germany, suggests that the expected deceleration of growth in the second half of the year may be stronger than originally envisaged. Thus, on balance, annual growth for this year is likely to remain close to the 3.3 percent projected in the staff report, while the outcome for 2012 is expected to be less favorable (1.6 percent rather than 1.9 percent). Inflation in July remained elevated (3.8 percent), but favorable commodity price developments and softening demand pressures should bring about the projected decline in price growth in the remainder of the year.

3. **While the heightened financial market turbulence in recent weeks did not spare Austria, investors' perception of Austrian sovereign risk did not deteriorate significantly.** The 10-year sovereign spread over German bunds remained volatile around an average of 60 bps in August. CDS spreads rose about 30 bps during the month, broadly in line with changes in German and Dutch spreads. Stock prices and CDS spreads for the two largest Austrian-owned banks registered the generalized stress in the European banking sector, though to a lesser degree than banks with large exposures to the euro area periphery. First half financial results at the three largest banks showed an improvement in banks' profitability owing to a decline in provisioning expenses while nonperforming loans ratios appeared to be stabilizing.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/117
FOR IMMEDIATE RELEASE
September 6, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Austria

On September 2, 2011 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

With a rebound in external demand and sound fundamentals, the Austrian economy recovered rapidly from the 2009 recession. Private consumption and employment held up well during the downturn and, when external demand (especially from Germany) picked up, the stage was set for a swift recovery. GDP growth reached 2.1 percent in 2010, with a marked acceleration in the second half of the year. Strong growth performance is projected to continue in 2011, but decelerate after a strong first half as the cyclical recovery runs its course and external demand loses strength. At only slightly over 4 percent, unemployment is among the lowest in Europe.

Following food and energy price shocks, inflation has increased sharply in the first half of 2011, exceeding the euro area average by about one percentage point, in part owing to indirect tax increases at the beginning of the year. The current account registered a surplus of 2.7 percent of GDP in 2010, reflecting the competitiveness of the economy especially in the services sector. Outward FDI recovered somewhat but remains well below pre-crisis levels.
The fiscal deficit widened from 0.9 percent in 2007 to 4.6 percent of GDP in 2010, but the cyclical recovery and consolidation measures—a combination of tax increases and expenditure

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

cuts—are projected to bring the deficit down to some 3½ percent of GDP in 2011 and to around 2 percent in the medium term. However, with the government's current measures, and taking into account implementation risks, debt will likely remain above 70 percent of GDP even in the medium run.

In the banking system, the negative effects of the crisis on credit quality are still in evidence in Central, Eastern, and Southeastern European (CESEE) subsidiaries, where the nonperforming loans ratio continued to grow in 2010. As provisioning costs have fallen, however, profitability has recovered, and improved macroeconomic prospects in the CESE region should ease the situation further going forward, while direct exposures to Greece, Ireland, and Portugal are small. Banks have improved liquidity and capitalization, but have not exited government support yet, and conditions in the medium-sized bank segment remain challenging, with one bank in the segment failing the recent EU-wide stress tests.

Executive Board Assessment

Executive Directors commended the authorities for policies that have supported a swift recovery and laid the foundations for a sustained expansion. Nonetheless, in view of the still fragile global outlook and heightened vulnerabilities in the euro area, Directors agreed that important challenges remain. Reducing the debt burden, bolstering financial stability, and enacting structural reforms to boost long-term growth should top the policy agenda for the period ahead.

Directors welcomed the recent fiscal consolidation package and noted that Austria's fiscal position compares favorably with that of other euro area countries. However, they considered that current plans may not be sufficient to put the debt ratio on a firm downward path and that a more ambitious fiscal adjustment is needed to cope with longer-term spending pressures and the cross-border exposure of the banking system.

Directors recommended that expenditure measures be the main element of the consolidation strategy, given an already high tax burden compared to peers. In this regard, they noted that savings could be achieved through further reforms in the pension system, health care, and government subsidies. A careful rationalization of the fiscal relations among different levels of government could also facilitate the necessary budgetary adjustment.

Directors considered that Austria's financial sector has on the whole recovered from the global crisis but that remaining risks call for further strengthening the framework for financial stability. They noted that improved bank profitability should set the stage for upgrading their capital base and exiting government support, while the restructuring of some financial institutions provides an opportunity to address overcapacity in the sector. Directors also encouraged the authorities to monitor closely risks related to foreign-currency lending, including mortgages.

Directors welcomed the role Austrian banks have played in regional emerging markets. Noting the need to limit the domestic risks posed by this engagement, they recommended reinforcing macro-prudential measures that address cross-border credit exposure. Directors also supported ongoing steps to improve international coordination among supervisors, as well as plans to strengthen the bank resolution framework.

Directors stressed the importance of persevering with structural policies to boost Austria's long-term growth prospects. In this regard, they encouraged the authorities to step up reforms of the labor market and the education system, with a view to increasing labor market participation and boosting skills, including of the immigrant population.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with Austria is also available.

Austria: Selected Economic Indicators, 2007–12

	2007	2008	2009	2010	2011	2012
					Projections	
	(change in percent unless indicated otherwise)					
Demand and supply						
GDP	3.7	2.2	-3.9	2.1	3.3	2.0
Total domestic demand	2.5	1.3	-2.3	1.3	2.0	1.4
Consumption	1.1	1.4	1.1	0.7	0.7	1.1
Gross fixed capital formation	3.9	4.1	-8.8	-1.0	3.7	2.5
Net exports (growth contribution in pp)	1.3	1.1	-2.0	1.1	1.4	0.7
Exports of goods and nonfactor services	8.6	1.0	-16.1	10.6	8.8	4.9
Imports of goods and nonfactor services	7.0	-0.9	-14.4	9.4	7.0	4.2
Employment and unemployment						
Employment	1.9	1.3	-1.5	0.6	1.5	0.8
Unemployment rate (in percent)						
Registered (national definition)	6.2	5.8	7.2	6.9	6.6	6.6
Standardized (Eurostat)	4.4	3.8	4.8	4.4	4.1	4.1
Prices						
Consumer price index (period average)	2.2	3.2	0.4	1.7	3.2	2.2
General government finances (percent of GDP)						
Revenue	48.0	48.3	48.8	48.3	48.3	48.3
Expenditure	49.0	49.3	53.0	52.9	51.7	51.3
Balance	-1.0	-1.0	-4.1	-4.6	-3.4	-3.0
Gross debt (end of period)	60.7	63.8	69.6	72.2	72.3	73.4
Balance of payments						
Trade balance (goods) (in billion euro)	1.3	-0.6	-2.3	-3.2	-2.8	-3.1
Current account (in billion euro)	9.6	13.8	8.5	7.8	8.8	9.3
(In percent of GDP)	3.5	4.9	3.1	2.7	2.9	3.0
Interest rates						
Three-month interbank rate	4.3	4.6	1.2	0.8	...	...
10-year government bond	4.3	4.4	3.9	3.2	...	...
Exchange rates						
Euro per US$	0.73	0.68	0.72	0.75	...	...
Nominal effective exchange rate (2000=100)	101.3	102.4	103.3	100.6	...	...
Real effective exchange rate (1990=100)						
ULC based	97.6	95.9	96.5	97.0	...	...
CPI based	100.1	100.9	101.5	98.8	...	...

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

Statement by Mr. Johann Prader, Alternate Executive Director for Austria
September 2, 2011

The Austrian authorities welcome the consultations with the Fund and appreciate the high quality of the staff report. They broadly agree with the staff's assessment of Austria's economic and financial situation and its general recommendations on economic, fiscal and financial policies.

The staff report shows that Austria has weathered the crisis well and the recovery is on firm grounds. Supported by generous automatic stabilizers and targeted labour market policies, consumption and employment held up well during the crisis, contributing to economic stability and setting the stage for a quick rebound in output growth as external conditions improved. The fiscal position is favourable in international comparison, although public debt is expected to remain above 60 percent of GDP for some time. The Austrian authorities take note of the issues raised regarding public finances, the financial sector and the long-term growth strategy.

Short-term and medium-term outlook

On the back of strong external demand, output growth accelerated in the first half of 2011. With capacity utilization back to pre-crisis levels, the export-led recovery spilled over to investment, thus sustaining and broadening the recovery. Private consumption increased steadily but moderately, as high inflation and subdued wage growth weighed on real disposable incomes. The short-term outlook for the remainder of the year is positive, though output growth will slow down as the cyclical upswing will have run its course. The Austrian authorities concur with the staff's view on the main risks to the outlook, which are external, but refer to the efficiency of the crisis-mitigation measures and the muted overall effect of the crisis in 2008-2010. It is also noteworthy that Austrian sovereign bonds were regarded as a safe haven in the most recent turmoil on financial markets.

The staff report points out areas which would benefit from reform in order to support medium- and long-term growth, such as the education system and the employment rate of low-skilled and older workers. The Austrian authorities have already taken steps in this direction and will continue to give priority to these issues in the formulation of the medium-term economic and fiscal strategies.

Fiscal policy

The government has put in place a consolidation package to reduce the deficit to below 3 percent of GDP by 2013 and bring the debt ratio back on a downward path. According to the projections in the report, staff expects the government to outperform on the deficit targets for the years 2011-2014 as set out in the Stability Program, thus underlining the credibility of the government's consolidation strategy. The new budgetary framework in place at the federal level has proven successful in avoiding expenditure slippages. Moreover, the *Domestic Stability Pact*, which sets the deficit targets for the three levels of government, has benefited from a reinforcement of the sanctioning mechanism, thus reducing the risk of budgetary shortfalls at sub-federal levels. While taking note of risk factors to the public finance situation as outlined in the staff report, the authorities consider the currently planned pace of budgetary adjustment sufficient to forestall financing risks.

The staff report recommends reforms to improve public expenditure efficiency, in particular with regard to health care and pensions. In both areas, important reform steps have recently been taken and further consideration will be given to the issues referred to in the staff report.

Financial sector

Bottom-line profitability of the Austrian banking system benefited from the favorable macroeconomic conditions in Austria and the CESEE region during 2010 but banks continue to suffer from low interest margins in the domestic market. On the back of the economic recovery, the crisis-related growth in risk provisioning for non-performing loans decelerated in recent quarters and the overall NPL ratio of the banking system is now expected to reach its peak in 2011. Due to the focus of their foreign exposure in the CESEE region, the direct country exposure of Austrian banks to the Euro Area periphery appears manageable.

As evidenced by the latest Austrian National Bank (OeNB) stress test, the Austrian banking system features a reasonable risk-bearing capacity. Based on the framework of the EBA stress test 2011, the OeNB stress testing exercise of Spring 2011 includes an additional adverse scenario that focuses on the CESEE and CIS region. The results show a manageable decline in the core tier 1 ratio of the aggregate banking system with an increased dispersion of results on a single bank level that was also reflected by the recently published results of the EBA stress tests. The Fund's assessment of existing weaknesses in a few medium-sized banks is shared by the authorities, who play an active role in the ongoing intense restructuring process in these institutions.

The strong commitment of Austrian banks to the CESEE region was a key ingredient in maintaining financial stability in the region during the financial crisis since end-2008 and supported the successful implementation of EU/IMF programs in several CESEE countries. While this positive role has to be acknowledged, the crisis also revealed vulnerabilities of the banks' business models in the run-up to the crisis, in particular the significant level of foreign currency lending combined with an unsustainable credit growth in some markets, and the reliance on intra-group funding by many CESEE subsidiaries. Looking ahead, both the large Austrian banks and the Austrian sovereign would clearly benefit from the fostering of local sources of funding in the CESEE region and the further strengthening of the parent banks' capital base. The authorities therefore agree with the Fund that the current recovery in profitability and the favorable market sentiment towards the CESEE region provides an opportunity for improvement in these areas. The forthcoming implementation of the CRD IV/CRR in the EU also supports the case for a quantitatively and qualitatively improved capital position of Austrian banks in the medium term.

In the wake of recent developments in FX markets, the high outstanding levels of Swiss franc-denominated loans in Austria and some CESEE countries have come into the spotlight once again. The total volume of outstanding Swiss franc loans by Austrian banks amounts to approx. 70 billion EUR on a consolidated basis. The authorities' long standing skeptical view on Swiss franc-lending both in Austria and CESEE has resulted in supervisory initiatives that led to a stop in new Swiss franc lending both in Austria (since October 2008) and CESEE (since Spring 2010). The implications of the appreciation on the credit quality of the stock of outstanding Swiss franc-denominated loan portfolios, however, deserve close monitoring by banks, customers and supervisors as well as a general readiness to implement risk-mitigating measures, if needed. The authorities are currently repeating a review of Swiss franc loans and loans with repayment vehicles last undertaken in 2009.