

**LAPSE OF  
TIME**

SM/22/215

Correction 1

August 25, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Austria—Staff Report for the 2022 Article IV Consultation**

Board Action: The attached corrections to SM/22/215 (8/23/22) have been provided by the staff:

**Evident Ambiguity** **Pages 28 (duplicate charts removed) and 56**

**Factual Errors Not Affecting the Presentation of Staff's Analysis or Views** **Pages 4, 7, 10, 13, 15 (para. 19, line 1 "liquidation" and footnote 19), 42**

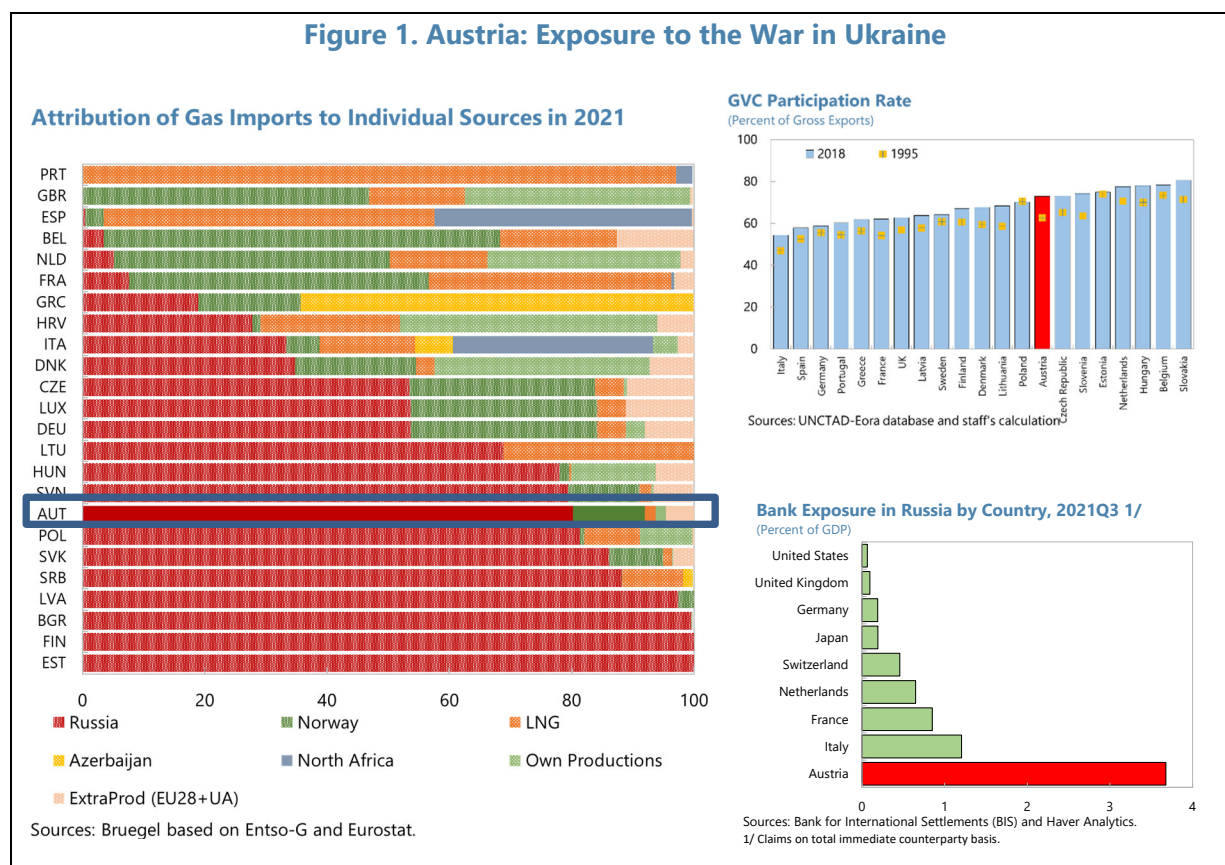
**Typographical Errors** **Pages 15 (para. 19, lines 1, "Europe" and line 6; and para. 20) and 40**

Questions: Mr. Franks, EUR (ext. 36347)  
Ms. Suphaphiphat, EUR (ext. 38773)



## CONTEXT AND RECENT DEVELOPMENTS

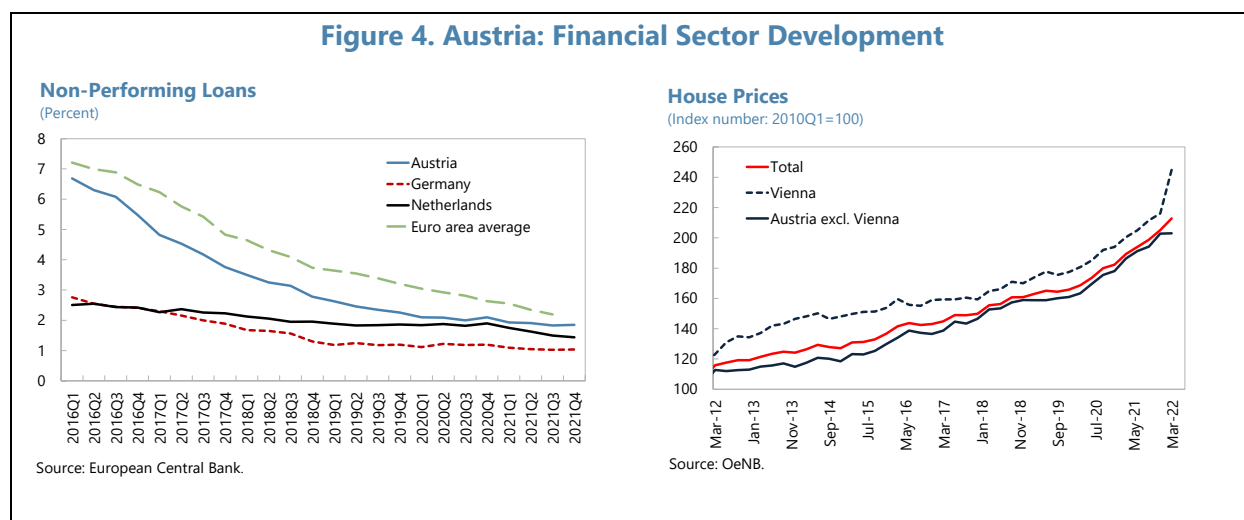
**1. Austria is highly vulnerable to the economic impact of Russia’s invasion of Ukraine (Annex I).** Although trade with Russia declined significantly after the 2014 sanctions, Austria remains dependent on Russia for some 80 percent of its gas, with limited access to alternative sources. Austrian banks are among the most exposed to Russia and Ukraine through subsidiaries. The country may also be affected indirectly through its high integration into global value chains.



**2. Prior to the war in Ukraine, the recovery was robust notwithstanding multiple waves of the pandemic.** The infection rate surged during the Omicron and its subvariant outbreaks. But with a relatively high vaccination rate—around 78 percent of the population has received at least two doses—hospitalization, ICU admission, and mortality rates have been relatively low. After a ~~partial~~ lockdown in December, the authorities gradually eased restrictions and economic activity has been less constrained by the virus. Real output surpassed the 2019:Q4 level in 2021:Q4<sup>3</sup>. Nevertheless, Austria’s annual growth—at 4.8 percent in 2021—was still relatively low compared to peers, partially due to the strong concentration of the winter tourism and hospitality sectors. Manufacturing production surpassed its pre-crisis level, while economic activity in the hospitality sector was still 13 percent below. Strong growth in 2022:Q1 narrowed the GDP gap with peers, but Austria’s greater vulnerability to the Ukraine war shock will depress growth in the second half of the year.

repeated waves of the pandemic, while recovery measures such as an investment premium<sup>1</sup> and climate investment were ~~initiated~~ continued. Total pandemic-related spending (about 6 percent of GDP in 2021) was effective at cushioning the economic ramifications of the pandemic.

**6. The financial sector proved resilient during the pandemic but war- and housing-related risks have increased.** Austrian banks had ample liquidity and capital buffers and rising profitability. Aggregate profits reached a historical record (€7.2 billion) and consolidated non-performing loans (NPLs) declined to 1.8 percent at end-2021 (from 2.3 percent pre-COVID), while corporate defaults decreased, thanks to public support measures. Early effects from the war in Ukraine and ensuing sanctions have been contained, with no signs of deposit outflows and profitability remaining strong. Nonetheless, Austria's high financial exposures to Russia, Ukraine, and Central Eastern Southeastern European countries (CESEE) make its banking sector vulnerable to spillovers. Sberbank Europe was liquidated effectively in early March, ensuring that financial stability and confidence were maintained (€119). On the domestic front, house prices rose sharply and further deviated from fundamentals.<sup>2</sup> Mortgage lending has risen considerably, much of which did not comply with Financial Market Stability Board (FMSB) recommendations on borrower-based limits.



**7. The external position is assessed to be broadly in line with medium-term fundamentals and desirable policies (Annex III).** The current account balance registered a deficit for the first time in twenty years at 0.5 percent of GDP in 2021, due to a sharp deterioration in the merchandise trade and services balance. Both export and import volumes rebounded in 2021, but imports grew faster and this—combined with a sharp increase in energy import prices—drove the deficit. Furthermore, the surge of the Delta and Omicron variants and associated lockdowns during the winter season resulted in weak exports of services.

<sup>1</sup> The Investment premium is a subsidy for all companies undertaking new investments. The subsidy is 14 percent of investment costs in areas of digitalization, green, health, and R&D, and 7 percent in other areas.

<sup>2</sup> The ESRB, the OeNB, and IMF staff calculations suggested house price overvaluation in 2021 in the range of 10–40 percent.

largely due to the unwinding of the pandemic emergency support and robust nominal GDP growth.<sup>6</sup> In addition, some reform measures, including the investment premium and broadband expansion, are expected to be financed by the Recovery and Resilience Fund (RRF).<sup>7</sup> To ensure transparency in the use of public resources, staff welcomes the authorities' publication of ex-post audit reports on COVID-19 spending, in addition to the publication of the monthly spending report of COVID-19 implementation.<sup>8</sup>

	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
Overall fiscal balance	-5.9	-3.1	-1.6	-1.3
Cyclically adjusted balance	-4.6	-2.7	-1.2	-1.1
o.w. COVID-19 emergency response 1/	-4.7	-1.6	-0.2	-0.2
o.w. Excluding energy relief/refugee measures		-2.0	-0.7	0.0
Underlying fiscal balance	0.1	0.9	-0.3	-0.9

Source: IMF staff calculations  
1/ Excluding guarantees and structural recovery and reallocation measures.

**12. Energy and inflation compensation measures were initially reasonably well-targeted and temporary, but have become less focused and more distortionary in recent iterations.** The authorities substantially increased relief support measures in June to over 2 percent of GDP, during 2022–23.<sup>9</sup> While most of these measures are timebound, some actions, e.g. a temporary energy tax cut, are costly, less targeted, and could undermine green transition efforts. In addition, various income support, particularly additional climate and anti-inflation bonuses are generous, untargeted, and might contribute to higher inflationary pressure.<sup>10</sup> Going forward, relief measures should be means tested in order to promote efficient use of public funds.

**13. Additional spending to accelerate the green and digital transitions, boost employment, and fight poverty is welcome.** In addition to strategic reform priorities and the RRF, which focus on green and digital transitions, the authorities approved a comprehensive eco-social tax reform to green the economy and boost employment (Text table 3). The reform includes the introduction of a carbon tax and associated compensatory measures to households and firms,

<sup>6</sup> The pandemic-related spending is expected to decline from 6 percent of GDP in 2021 to 2.3 percent of GDP in 2022, of which 0.8 percentage points of GDP reflects emergency support (health-related, short-term work scheme, and other measures).

<sup>7</sup> Austria is expected to receive €3.5 billion grants under the EU Recovery and Resilience Facility, where 59 and 53 percent of total grants specified in the Austria's Resilience and Recovery Plan (ARP) have been tagged as green and digital transitions, respectively.

<sup>8</sup> See examples. Court of audit-COVID measures, COVID-19 crisis management, COVID-19-Kurzarbeit, and <https://www.bmf.gv.at/themen/budget/das-budget/budget-2021.html>

<sup>9</sup> Excluding structural measures (indexation of PIT and social benefits to inflation and reduction of non-wage cost)

<sup>10</sup> Every adult residing in Austria is expected to receive €~~500~~250 for anti-inflation bonus and €250 for climate bonus

should be targeted and geared toward inclusive growth-stimulating reforms such as green investment and digitalization.

**Text Table 2. Austria: Measures Cushioning the Impact of War in Ukraine**  
(In percent of GDP, Deviation from No-Policy Scenario)

Measures	2022	2023	2024	2025	2026
<b>Strategic gas reserve</b>	<b>0.36</b>				
<b>Ukrainian refugees</b>	<b>0.13</b>	<b>0.12</b>			
<b>Foreign disaster fund</b>	<b>0.01</b>				
<b>Energy and inflation relief</b>	<b>1.49</b>	<b>0.60</b>	<b>0.02</b>	<b>0.05</b>	<b>0.0</b>
<i>Broad-based compensation measures</i>	<i>1.08</i>	<i>0.44</i>	<i>0.22</i>	<i>-0.05</i>	
Energy cost compensation for households	0.14				
Energy price compensation for firms	0.00	0.05			
Reduction of energy tax	0.14	0.11	-0.05		
<del>Cost-of-living tax credit</del>	<del>0.00</del>	<del>0.22</del>			
Climate and anti-inflation bonus	0.64				
Energy price subsidy for firms	0.10				
Tax-and-duty-free cost of living premium	0.07	0.07			
<i>Targeted to specific groups</i>	<i>0.38</i>	<i>0.13</i>	<i>0.35</i>	<i>0.05</i>	<i>0.03</i>
To vulnerable groups	0.09	0.22			
To family and children	0.10	0.04			
To pensioners	0.10				
To agriculture sector	0.03	0.00	0.00		
To commuters	0.06	0.08	0.05	0.03	
<i>Green transition</i>	<i>0.02</i>	<i>0.02</i>	<i>0.01</i>	<i>0.01</i>	
Incentives for green vehicles	0.01	0.01			
Energy independence investment	0.01	0.01	0.01	0.01	
<i>Others</i>	<i>0.00</i>	<i>0.00</i>	<i>0.00</i>	<i>0.00</i>	<i>0.0</i>
<b>Total</b>	<b>1.99</b>	<b>0.72</b>	<b>0.02</b>	<b>0.05</b>	<b>0.0</b>

Source: The Austrian authorities.

## B. Financial Sector Policies

**17. Despite the strong buffers of Austrian banks, the effects of the war in Ukraine warrant careful monitoring of asset quality and war-related risks, and enhanced supervision.** The impact from the war has been manageable so far, partly due to limited cross-border exposures, strong local liquidity management in CESEE subsidiaries, and Austria's robust regulatory framework (Annex I). Nonetheless, a prolonged war and spillovers to the CESEE countries could deteriorate credit quality, create pressures on lending, while dimming profitability perspectives, thereby warranting close monitoring of asset quality and bank exposures to vulnerable sectors and CESEE countries.<sup>14</sup> Accordingly, the authorities should calibrate the parameters of existing systemic risk buffers (SyRB and O-SII) for banks with pronounced exposures in Russia and CESEE countries.

<sup>14</sup> Subsidiaries in Russia, Belarus, and Ukraine account for 2 percent of Austria's banking sector assets. At end-2021, about 40 percent of banking profits (€3 billion out of €7.2 billion) came from subsidiaries in CESEEs.

persist, additional macroprudential measures (such as a sectoral systemic risk buffer calibrated to RRE exposure) should be implemented.<sup>17</sup> Depending on the evolution of the macroeconomic outlook and credit growth (currently slightly beyond prudential thresholds), the authorities could consider activating the counter-cyclical capital buffer (CCyB), which has thus far been kept at zero.<sup>18</sup>

**19. The failure-liquidation of Sberbank Europa-Europe in early March 2022 successfully tested Austria's deposit guarantee arrangements between the three different deposit guarantee schemes (DGSs).** The bank—headquartered in Vienna—faced cash outflows before being prohibited from continuing operations in early March 2022. This triggered a €947 million payout from the main banking DGS (ESA), involving support by the other Austrian DGSs.<sup>19</sup> The outlay has already been fully recovered from the prompt sale of Sberbank Europa-Europe's assets, which were easily absorbed by the market. The schemes are on track to achieve the requirement of 0.8 percent of covered deposits by mid-2024. Nevertheless, the fragmentation of the DGS still raises issues of fragmented resources and complex mobilization.

**20. The authorities are making progress on the 2020 FSAP recommendations, including those related to the supervision of the less significant institutions (LSIs).** Staff welcome the establishment of a working group to strengthen the supervision of LSIs and recommend that the authorities implement its proposals. Headcount increases for LSI supervision are already underway. The authorities have also strengthened onsite supervision for insurance, low risk institutions, and cross-border exposures involving exchange of information with non-EA non-European authorities. The toolkit in the oversight of the Raiffeisen group now includes its new deposit guarantee scheme and enhanced monitoring. Progress was made on monitoring exposures to NFCs in CESEE countries using the ECB's AnaCredit dataset and to retail and commercial real estate sectors—which have become more vulnerable from the shift to teleworking and e-commerce. However, there is no change to the financial sector oversight framework and commercial real estate data remains sparse. (see Annex VII).

**21. Austria has made progress in aligning its AML/CFT framework with the Financial Action Task Force international standard.** The authorities have recently introduced a biometric procedure for remote customer identification, strengthened the regulatory framework related to customer due diligence, reporting obligations, and risk analysis requirements. The authorities also broadened the scope of the money laundering offense to criminalize the self-laundering, bolster the sanctions, and cover all types of assets. Progress was also made in providing the Financial Intelligence Unit with direct access to financial and bank account information which should facilitate financial intelligence and support financial investigations and prosecutions of money laundering and

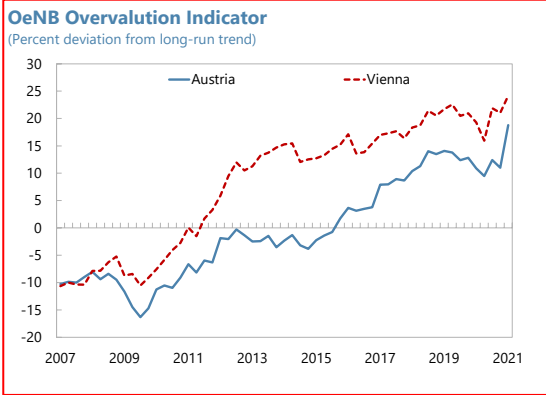
<sup>17</sup> The Capital Requirements Directive (CRD) V, which has been implemented into Austrian Law since June 2021, introduces a sectoral systemic risk buffer (SyRB) to address structural risks related to specific sectors (e.g., residential mortgages versus investment loans to nonfinancial corporates).

<sup>18</sup> The FMSB maintained the CCyB at zero percent at its May 2022 meeting, citing heightened risks and assumed dampening effects from the tighter borrower-based measures.

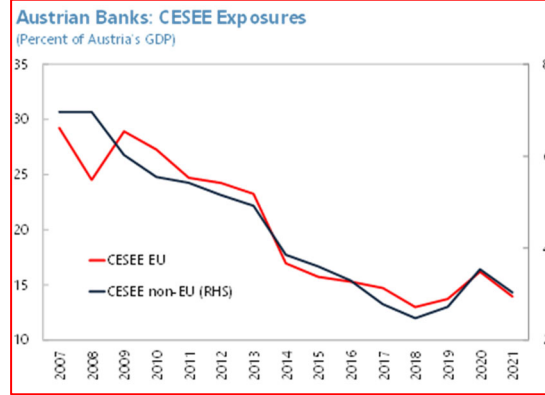
<sup>19</sup> The magnitude of the payout-licensing date triggered the conjoint mobilization of the resources available to all DGSs. They include ESA, savings banks, and the newly created Raiffeisen group DGS.

**Figure 11. Austria: Banking Sector**

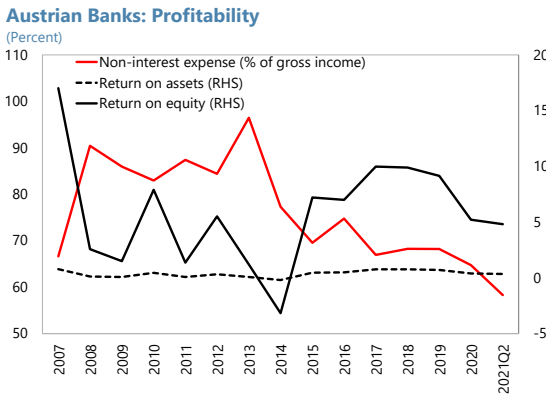
Capital has improved steadily.



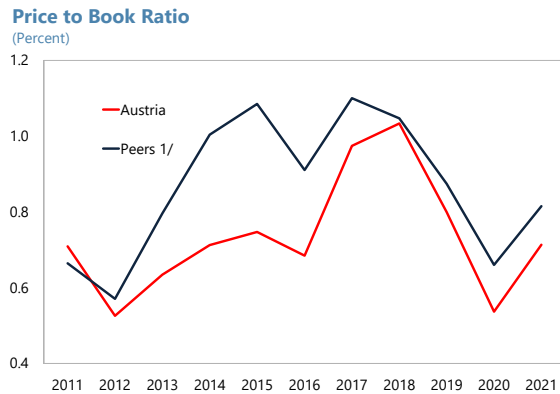
The CESEE exposure is on a long term decline despite a recent uptick...



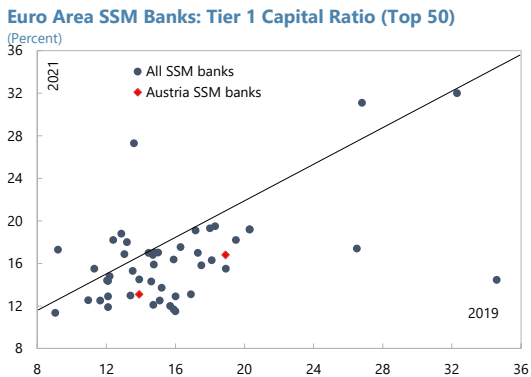
Profitability remained stable while non-interest expenses have been steadily declining.



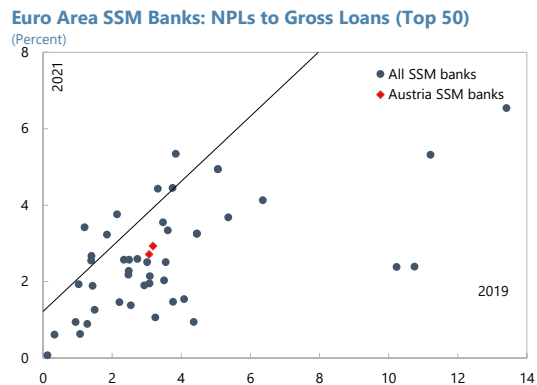
Austrian banks' valuations rebounded in 2021 given high profits and dividend payouts.



The banking sector capitalization remained at a high level...



...while NPLs remained subdued.



Sources: Bloomberg; SNL; Haver; IMF, Fitch Connect, Financial soundness Indicators; and IMF staff estimates.  
1/ Top 50 banks based on 2021 assets; 2020 assets if 2021 is not available.

**Text Table I. 3. Austria: Potential Output Losses From a Gas Shut-off Scenario**

	No measures <sup>1</sup>	Only supply-side <sup>2</sup>	All measures <sup>3</sup>
Aggregate Shortfall	56.0%	12.0%	4.0%
Industry Shortfall	80.0%	26.7%	8.9%
<i>Output Loss</i>			
Cobb Douglas with full substitution	1.0%	0.3%	0.1%
Hybrid with low substitution	5.5%	1.8%	0.6%
Leontief with no substitution	10.0%	3.0%	1.0%
Hybrid with no substitution + Demand amplification	15.0%	5.5%	1.8%

1. No measures includes use of storage, including from the strategic reserve, up-to historical minimum levels.

2. Supply-side measures includes storage and additional imports and diversification.

3. All measures include all supply and demand measures.

**8. A gas supply shock could also raise inflation and further negatively affect growth.** Even if households and essential sectors are protected against large gas price increases, they could still be affected indirectly through an overall increase in inflation as the gas price increase reverberates through supply chains. This could occur when affected firms pass-on the input price shock through to the sales price; their ability to do so will depend on various factors such as their reliance on gas as an input, profit margins and degree of industrial competition. Firms with high reliance on gas with lower profit margins are more likely to increase their sales prices in response to the negative gas supply shock as they would be unable to absorb the price increase in the profit buffer. This effect could be large in industries which are more competitive and where the demand for their products is high. Back of the envelope calculations suggest that in the intermediate scenario with only supply measures and low gas substitution possibility (with aggregate output loss of about 2 percent), the corresponding gas price increase of about 600 percent could raise inflation by 10 percent.

### **Financial Exposure**

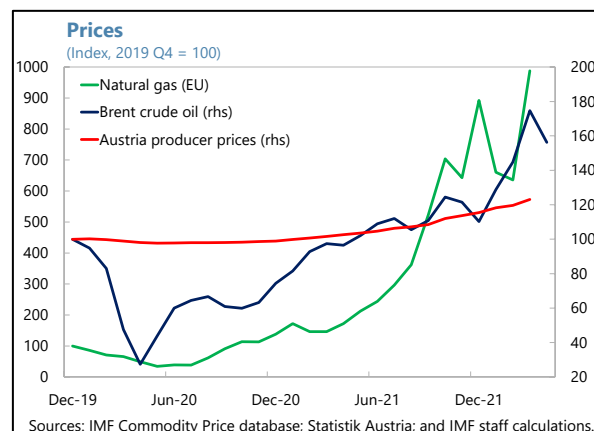
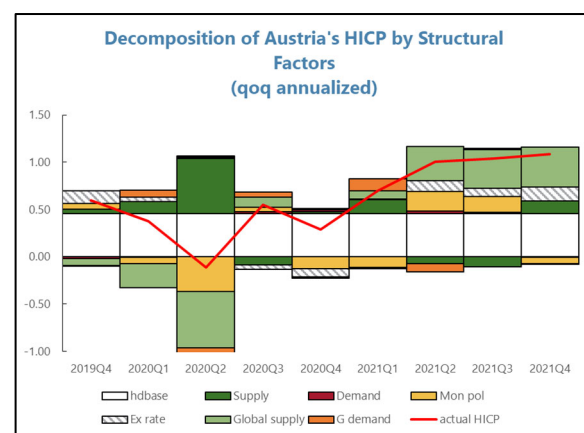
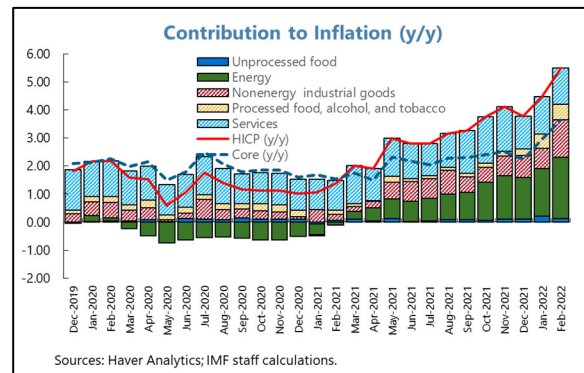
**9. Austria has one of the most exposed foreign banks in Russia.** Based on the BIS data, as of 2021:Q3, Austrian banks' have an exposure to Russia of €20 billion (4.6 percent of GDP). Out of the €20 billion, €3.2 billion are cross-border (loans and equity claims in Russia), €12.6 billion are domestic loans in Russia (i.e., loans granted by local subsidiaries in Russia), and the remaining are derivatives, commitment, and guarantees. As the majority of exposure in Russia are in local currency and claims are mainly to non-financial private sector (less likely to default), credit risk will likely be manageable.

## Annex II. Inflation in Austria

**1. Headline and core inflation in Austria picked up strongly in recent months.** Since the second half of 2021, inflation in Austria has rapidly accelerated. It remains lower than the euro area average, partly reflecting Austria's lower growth in energy prices and weight in the HICP basket. Core inflation also rose sharply since 2022, contributed by increases in prices of non-energy industrial goods and processed food, alcohol, and tobacco.

**2. Supply bottlenecks and energy prices are the main contributors to accelerating inflation.** Since the reopening of the economy in mid-2021, household spending on goods has rebounded while supply has not kept up with demand due to higher delivery times and costly international shipping, resulting in shortages of intermediate inputs, especially in the auto sector. These drove up the Producer Price Index and prices of non-energy industrial goods. During May 2021–Feb 2022, average inflation of non-energy industrial goods was more than double that before and during the pandemic. A sharp increase in prices is particularly notable in vehicles and furniture. Similarly, energy prices rose around the same time, reflecting both rebounding demand and supply cuts that started in late 2020 Q2:2021. In the second half of 2021, global oil and gas prices rose over 80 and 560 percent (y-o-y), respectively, contributing significantly to headline inflation. Staff analysis suggests that the supply shock, both domestic and global, is a key contributor to inflation. The preliminary discussion of the wage negotiation among social partners suggested limited second-round effects, but this could change if pressures persist.

**3. The war in Ukraine will likely exacerbate inflation.** Soaring energy costs sparked by the war in Ukraine have caused a surge in inflation in Austria to 8.7 percent in June, from 5.5 percent in February. Going forward, energy prices—in particular gas prices—will likely be volatile given the uncertainty of supply from Russia. In addition, as Ukraine and Russia are major producers of global commodities (such as wheat and fertilizers) and major exporters of iron ore to Austria, an increase in commodity prices will also put pressure on Austria's inflation. The prolonged war could further intensify inflationary pressure and entrenched into expectations and long-term contracts in the near future.



Recommendations	Time Frame*	Status
<b>Financial Sector Oversight</b>		
		<p>of the measures implemented. Due to COVID-19, some of the measures had to be modified. At the start of the COVID-19 crisis risk-based onsite inspections extended also to insurance companies, where AML/CFT risk is deemed minor. Routine inspections are set to resume, albeit staffed with remote and/or hybrid teams. (iv) Non-EU/non-EA exchange of information: improvement of cross-border information exchange is part of the ongoing supervision. The FMA has an explicit legal basis to share information. MoUs help practical modalities. FMA is also conducting routine reviews of group-wide strategies during its on-site inspections. The FMA is currently updating its MoU for insurance supervision with Montenegro; the UA Emirates is seeking to engage the FMA on a MoU, where a symmetrical involvement for EBA will be needed for an equivalence assessment. Furthermore, the FMA hosts and takes part in so-called AML/CFT colleges in which authorities of third countries are also involved.</p>
<p>Monitor the effectiveness of the FMSB's sustainable lending guidance and prepare regulatory actions, such as binding macroprudential limits, if the risk profile does not improve.</p>	<p>NT</p>	<p>Despite various actions by macroprudential authorities the buildup of systemic risks accelerated in 2020 and 2021. Therefore, Austria's Financial Stability Board (FMSB) adopted new recommendations for action by the Austrian Financial Market Authority (FMA) to contain systemic risks arising from housing mortgages in its March 2022 meeting (for details please refer to the recommendation at: <a href="https://www.fmsg.at/en/publications/warnings-and-recommendations/2022/recommendation-fmsb-2-2022.html">https://www.fmsg.at/en/publications/warnings-and-recommendations/2022/recommendation-fmsb-2-2022.html</a>), which carries the activation of binding borrower-based measures and associated monitoring. The FMA has finalized its work on a regulation implementing the FMSB's recommendation, which will enter into force in August 2022.</p>