FOR AGENDA

SM/09/212
Correction 1

September 3, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Austria—Staff Report for the 2009 Article IV Consultation**

The attached corrections to SM/09/212 (8/5/09) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 20, para. 20, line 14: for "the stock of debt will rise above"
read "the stock of debt could rise above"

Page 45, para. 1, line 2: for "for onsite regulation and offsite"
read "for onsite inspection and offsite"

Page 45, para. 1, line 4: for "for banks and is responsible for"
read "for banks and is jointly responsible"

Questions may be referred to Mr. Hilbers (ext. 35337) and Mr. Clausen (ext. 34653) in EUR.

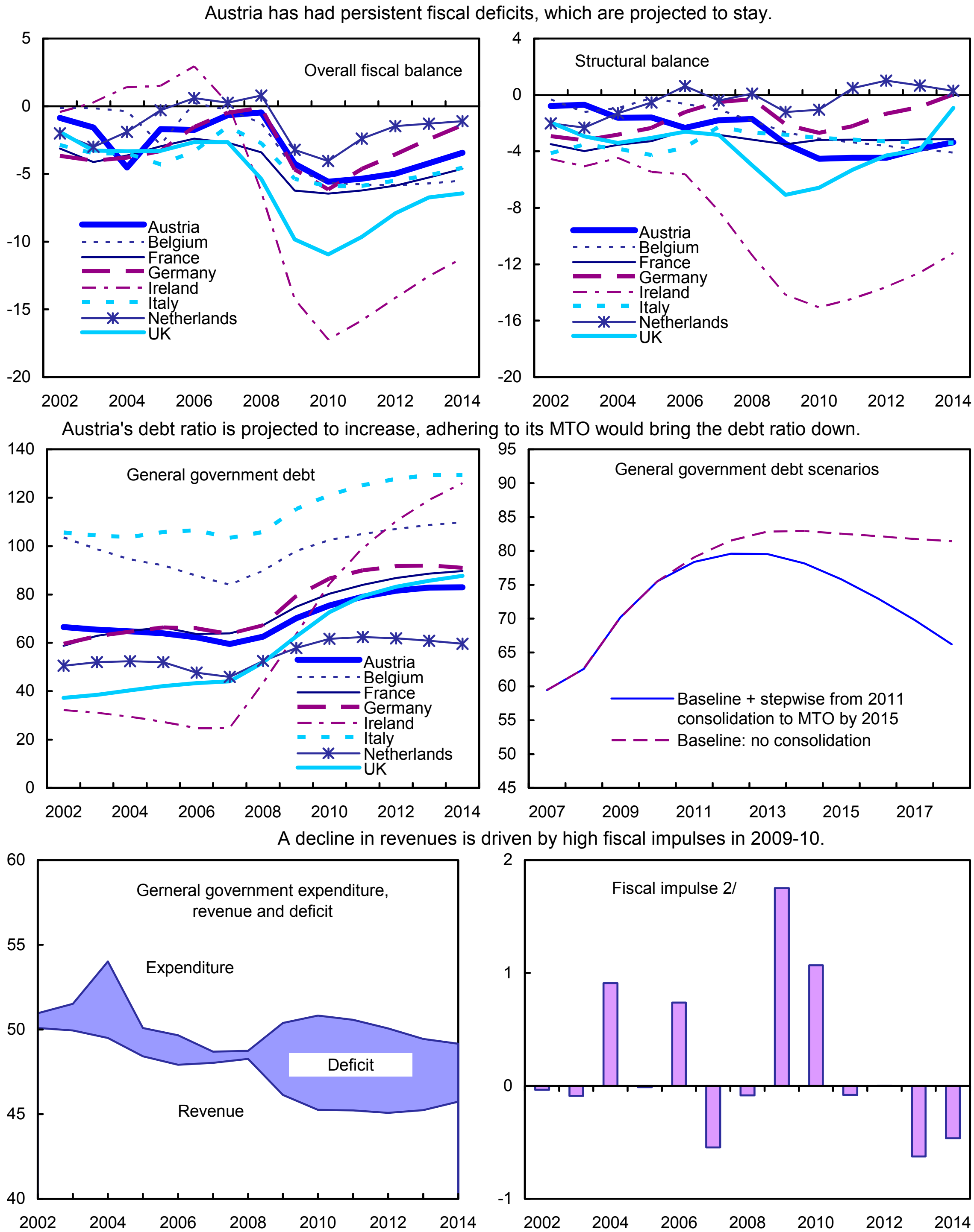
This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

Other Distribution:
Department Heads

Figure 9. Austria: Fiscal Trends 1/

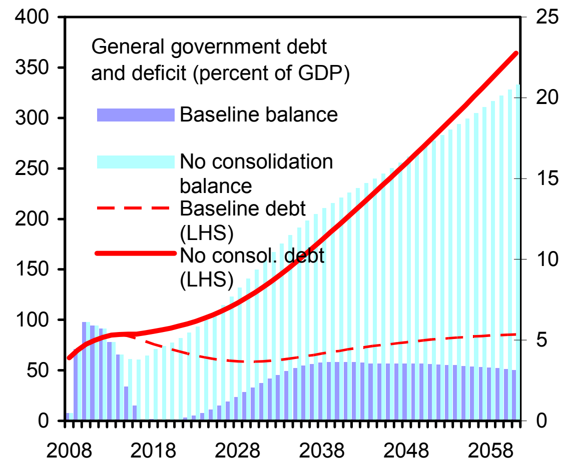
(In percent of GDP)



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

B. Fiscal Sustainability

20. **The underlying fiscal position has deteriorated significantly as a result of recent policy measures.** Absent consolidation measures, current policies put fiscal sustainability at risk. Under current policies, deficits are projected to be above the Maastricht reference value of 3 percent of GDP throughout the forecast horizon; this compares with medium-term deficit projections of 1 percent of GDP that formed the basis for earlier long-term projections. Aging-related costs for social security pensions, health, and long-term care will add to these deficits about 4-5 percent of GDP annually in the medium and long term. Without a consolidation to deficits below 1 percent of GDP by the middle of the next decade, the stock of debt could rise above 300 percent of GDP by 2050.[5]



Source: IMF staff calculations.

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

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

Annex 2. Regulatory Reform Priorities in Austria

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

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

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

- The high level of foreign currency lending in Austria. Such loans have not been prohibited; instead, the FMA issued a recommendation in October 2008 on bank practices, which has contributed to the ending of new foreign currency loans to Austrian households. In June, the FMA announced an approach that will result in banks reducing outstanding lending year by year in line with targets agreed with the regulators. However, most of the intermediaries involved in arranging such loans will remain unregulated.

- Weaknesses in the conduct of investment business, particularly sales practices in respect of property funds and investment-linked vehicles for the repayment of bank loans ("Tilgungsträger"). Enforcement action has been taken, which has contributed to a sharp reduction in the number of licensed companies.

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

Appendix 1. Draft Public Information Notice

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/xx
FOR IMMEDIATE RELEASE
[Month, dd, yyyy]

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

IMF Executive Board Concludes 2009 Article IV Consultation with Austria

On September 9, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Austria.[1]

Background

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

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

The underlying fiscal position has deteriorated significantly as a result of policy measures. The 2009/10 budget includes a stimulus package of 1.5 percent of GDP in 2009 and an additional 0.4 percent of GDP in 2010. The stimulus and automatic stabilizers will widen the deficit to 4.2 percent of GDP in 2009 and 5.6 percent of GDP by

[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.