February 25, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/78-1

10:00 a.m., September 10, 2018

1. Austria—2018 Article IV Consultation

Documents: SM/18/220 and Correction 1; and Supplement 1

Staff: Dorsey, EUR; Sun, SPR

Length: 31 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	B. Jappah (AE), Temporary
	O. Diakite (AF), Temporary
	J. Corvalan (AG), Temporary
	G. Preston (AP), Temporary
	P. Fachada (BR)
	S. Fan (CC), Temporary
	P. Moreno (CE)
	N. Feerick (CO), Temporary
	C. Just (EC)
	A. Castets (FF)
S. Meyer (GR)	
	H. Joshi (IN), Temporary
	F. Spadafora (IT), Temporary
	Y. Saito (JA)
	M. Daïri (MD)
	F. Al-Kohlany (MI), Temporary
	R. Doornbosch (NE)
	K. Virolainen (NO)
	S. Potapov (RU), Temporary
H. Alogeel (SA)	
	E. Villa (ST)
	P. Inderbinen (SZ)
	M. Chen (UK), Temporary
	M. Svenstrup (US), Temporary

H. Al-Atrash, Acting Secretary
J. Morco, Summing Up Officer
M. Gislen, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
European Central Bank: R. Rueffer. European Department: T. Dorsey, I. Karpowicz, M. Pradhan, J. Reinke. Finance Department: J. Hukka. Middle East and Central Asia Department: C. Purfield. Monetary and Capital Markets Department: F. Xavier Dezouzart Drummond Melo. Strategy, Policy, and Review Department: Y. Sun.

1. AUSTRIA—2018 ARTICLE IV CONSULTATION

Mr. Just submitted the following statement:

The Austrian authorities express their appreciation to the mission team for the candid discussions. They welcome staff's excellent understanding of the EU's policy frameworks and overall awareness of Europe's fiscal, financial and supervisory policy discussions which frame the internal Austrian economic policy discourse. The Austrian authorities welcome the staff's high-quality analytical work and its succinct presentation, which may be beneficial to reach a wider audience and to stimulate public debate.

Economic Policy

The Austrian authorities concur with the main messages as well as the economic outlook presented in the staff report. GDP growth is broad-based, consumer confidence and sentiment indicators show high values and order books are well-filled. Recent indicators clearly confirm that strong growth is set to continue also in 2018. This in turn will bolster the achievement of the fiscal target in 2018. Staff forecasts a moderation of growth in 2019 which is in line with Austrian expectations of a maturing cycle. Going forward, the Austrian authorities are confident that private consumption will be supported by increased family benefits coming into effect in 2019 and therefore see the external environment posing the main risks to the outlook, in particular a further increase in protectionism, legal uncertainty stemming from unilateral sanctions against trading partners, an increase in risk averseness in the wake of emerging market jitters.

The authorities concur that supply-side measures are needed to increase potential growth. Since its inauguration on December 12, 2017, Parliament has adopted 75 laws, of which 40 are directly related to improving the supply-side of the economy. As of September 1, 2018, the daily maximum working-time was increased from 10 hours to 12 hours, with longer assessment periods for compensation. SMEs were relieved from approval procedures for production sites or retail outlets, crowdfunding has been broadened and some 2,500 outdated laws were abolished. Going forward, the economic policy priorities for the Austrian authorities are to reduce the high tax burden and to further improve the flexibility of the labor market, which will be achieved by a reform of the unemployment benefit system with the clear objective to strengthen work incentives. As mentioned in the staff report, enhancing the efficiency of the public sector is another priority and first steps are being taken to merge the many health funds in Austria.

Fiscal Policy

The authorities are committed to reduce fiscal revenues towards 40 percent of GDP, while at the same time reaching a positive structural balance in the medium term. The debt-to-GDP level stood at 78.3 percent of GDP at the end of 2017 and is on a clear declining path toward the EU-agreed 60 percent by the end of the medium-term planning horizon. The current economic environment clearly contributes to improving the budget situation, but there are also considerable additional fiscal efforts underway to reduce discretionary spending with procyclical effects.

The authorities agree with staff that the current economic environment is supportive of structural reforms that will boost growth and increase efficiency in various policy areas in the medium and longer term. Most importantly, the Austrian government has put forward a plan to reduce the number of public social security entities from 21 to 5 to save administrative costs and streamline IT-expenses. Moreover, the authorities are aware of demography-related cost pressures stemming from long-term care and are currently working across all levels of government on proposals to secure long-term financing in this policy area. In the context of subsidies, further efforts to achieve better coordination between the different levels of government will help identify savings potential and pave the way for reform options for a future reorientation of fiscal federal relations.

Financial Sector

Amidst a benign macroeconomic environment and historically low credit risk costs, Austrian banks recorded their highest post-crisis profits in 2017, marking a recovery to pre-crisis levels. Banks continued to benefit from their activities in Central and Eastern Europe (CESEE), where net results were high due to low provisioning needs as well as the buoyant macroeconomic development. Furthermore, Austrian banks increased their capitalization in 2017, although some momentum was lost compared to previous years due to—among other factors—an increase in dividend payments.

Despite these benign developments, the supervisors have repeatedly recommended especially to significant financial institutions to reinvigorate efforts to increase their capitalization above regulatory limits as the current buoyant economic activity in Austria and CESEE may show signs of excessive credit growth. Furthermore, banks need to improve structural

efficiency to foster the sustainability of profits, as a significant part of the recent rise in profits stems from one-off factors, especially reduced risk provisioning. While initially expenses could rise as investments in IT as well as staff reductions are costly, these measures should increase efficiency and reduce the cost-income ratio in the medium term and provide banks with enough room for manoeuvre in potential future downturns.

The Austrian authorities agree with staff that real estate-related risks to financial stability are contained at present, but that caution is warranted. Currently, the authorities see limited risks arising from residential real estate lending, mainly due to the high risk-bearing capacity of both lenders and borrowers. In addition, residential real estate prices and loan growth rates have stabilized. Nonperforming loan ratios have remained low as lending standards have mostly been sustained. However, some challenges for financial stability lie ahead as the share of housing loans in banks` balance sheets is increasing. Thus, the authorities are vigilant to prevent a deterioration of lending standards. The supervisors not only monitor comprehensively lending standards but also engage in a continued dialogue with banks if mortgage lending practices appear to be riskier than deemed appropriate.

The Austrian authorities see a strong and effective Anti-Money Laundering / Combating the Financing of Terrorism (AML/CFT) framework as quintessential to safeguard Austria's role as a regional financial center. Several measures, such as increasing supervisory resources and establishing a register of beneficial ownership, have recently been taken. This resulted in an improvement in several of Austria's ratings in the 2017 follow-up report of the FATF. The implementation of the European Union's 5th AML will further improve Austria's AML/CFT framework.

Mr. Meyer submitted the following statement:

We thank staff for their insightful report in the context of Austria's Article IV consultation. We also thank Mr. Just for his helpful buff statement.

The positive readings of macroeconomic indicators show that the Austrian economy is robust and performing well. Its financial sector has become more resilient as risks related to non-performing loans and exposures to foreign markets were reduced. In this benign context, the authorities are well advised by staff to set their sight on the longer term. They should steadfastly implement their ambitious fiscal plans and augment them by deeper structural reforms that also address outstanding public sector inefficiencies. Durably boosting employment and tackling ageing-related costs

would be needed to maintain growth and safeguard long-term fiscal sustainability. Finally, monitoring developments in the real-estate market is warranted and the authorities should stand ready to enact further macroprudential measures if needed.

Macroeconomic Developments

We welcome Austria's robust growth performance and solid fundamentals. Economic growth has reached 3 percent in 2017, considerably above the euro area average of 2.4 percent, on account of strong investment and exports growth. This positive performance is expected to continue in the short term, underpinned by private consumption, and then to gradually converge to its medium term potential growth rate. Moreover, the unemployment rate has dropped below 5 percent by April this year, significantly lower than the euro area average. Overall, the Austrian economy boasts solid fundamentals, annual CPI inflation is forecast to remain at around 2 percent and the current account balance is assessed to be in line with fundamentals. We agree with staff that risks to the outlook are largely external and that the impact should be rather limited.

Fiscal Policies

The government's planned fiscal adjustment is ambitious but needs to be fully specified. On the back of strong growth and savings on interest payments, the 2017 budgetary outcome was better than expected. This provides a good basis for the welcome objective of achieving an overall balance by 2019 and reaching the medium-term objective (MTO) of -0.5 percent of GDP by the same year. The authorities are planning a comprehensive tax reform for 2020 and a faster debt reduction path to approach the 60 percent of GDP threshold in five years. These are welcome but ambitious initiatives that rest upon a restrictive expenditure path, which is not yet fully specified and seems challenging to achieve in the short term. Moreover, in the absence of fiscal structural reforms, staff projects the structural deficit to widen again in the medium- to long-term, as demography-related spending picks up gradually.

We agree with staff that deeper fiscal structural reforms are needed to buttress fiscal sustainability. Increasing fiscal costs related to population ageing and a rather complex fiscal governance system are two important issues that the authorities will need to tackle to ensure long-term fiscal sustainability. Efficiency-enhancing structural reforms in health care and containing pension-related expenditure are key in this respect. While the staff

report refrains from providing concrete recommendations with regards to the pension system, we would encourage the authorities to consider increasing the statutory retirement age and restricting early retirement. As for the health care system, potential savings hinge on a more thorough reform of the intergovernmental fiscal relations. Austria's fiscal framework is characterized by a complex system of tax sharing and grants which dilute accountability and provide weak incentives for budgetary discipline at subnational level.

Financial Market Policies

Austrian banks are well capitalized and their asset quality has improved. The consolidated non-performing loans ratio of Austrian banks dropped further to 3.8 percent by end 2017. Notwithstanding the positive developments, we share staff's view that banks need to work on their profitability, which remain under pressure in the current low interest rate environment. While several credit institutions have implemented cost-cutting measures in the domestic market, banks continue maintaining a expensive network of branches.

Risks in the real estate market are limited but warrant continued monitoring. While we agree that real estate-related risks to financial stability are currently contained, we note the continued increases in residential prices, signs of overvaluation and banks' growing exposure to mortgage lending. Therefore, we welcome the continued efforts of authorities to enhance the monitoring of lending standards and the new legal basis for borrower-based measures.

Structural Policies

Further efforts, in particular in terms of labor market policies and mismatches, will be needed to support economic potential by addressing structural unemployment and countering the projected gradual decline in labor force growth. Therefore, we agree with staff about the need to increase demand for labor, further boost employment and also encourage labor force participation Measures addressing the specific hurdles faced by immigrants, such as lack of language skills or acquiring qualifications, would foster their integration into the labor market. Moreover, we see merit in targeted active labor market policies that could reduce the unemployment rate of elderly workers and incentivize the participation of women who are also more likely to be employed only part-time and face in Austria a larger-than-average gender and pension gap. On the labor demand side, positive impulses could be obtained by strengthening innovation and competition, by reducing the high

tax burden on labor and shifting taxes to less distorting revenue sources and by higher public investment.

Mr. Saito and Mr. Ozaki submitted the following statement:

We thank staff for the comprehensive and informative papers and Mr. Just for his helpful buff statement. We welcome that Austrian economy is robust, and its economic foundations are strong. It is welcoming that growth has picked up markedly, unemployment has begun to decline recently, and the financial system is stronger and better capitalized than in recent years. In this favorable environment, the key challenge is to improve the potential growth, while preserving strong fundamentals. In this regard, we note that staff's estimation as for the potential growth rate is lower than the authorities' one. Could you elaborate on the background of the divergence, and the view on how the Austrian economy boosts the potential growth? As we broadly agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy and Reforms

We commend the authorities' Stability Program, which includes faster reduction of public debt than previously envisaged and a reduction of the tax and contributions burden. As the Stability Program is ambitious, it should be carefully planned and sequenced in implementation. We concur with staff's view that the authorities' medium-term plans are difficult to achieve without deeper structural reforms. We encourage authorities to facilitate structural fiscal reforms with the concerted effort of the federal government and states, including the improvement of the efficiency in the healthcare area.

We observe staff indicate that in designing reforms, including a tax reform, equity considerations will need to be taken into account. In this respect, in the revenue side, do staff imply more progressive measures for high-income earners is imperative to improve equity, as the Stability Program already includes helpful measures for low-income group, including a reduction of unemployment insurance and tax burden for low-income earners?

Unemployment

While we commend the authorities for taking several measures to reduce unemployment, tackling unemployment remains a challenge. When it comes to improving education to tackle the unemployment, lengthening the duration of compulsory schooling and training guarantees will lead to the right

direction. However, as these measures take relatively long time to bear fruit, it seems not so easy to contain the recent increase of unemployment with only compulsory schooling in the short term. Could staff share their view to identify the measures to reduce unemployment with only compulsory schooling if any?

Another challenge is elderly workers. We see that the government decided to discontinue targeted support through secondary labor market for over 50-year-old long-term unemployed. We agree with authorities' view that supporting continuous training and education for workers are more effective, but it will take time. In order to minimize the likely adverse effects on this age group, could staff tell which measures are the most effective?

Financial Sector

We concur with staff's view that Austria's banking system as a whole is well-capitalized, but additional buffers would be welcome as insurance against large adverse events. In order to strengthen bank's business model, we encourage banks to make efforts to reduce structural costs, as net interest income remains constrained in the low interest rate environment.

We observe the Austrian housing market has shown a strong trend rise in valuations over the last decade, mainly driven by price increases in Vienna. While we also take note of staff's view that real estate related financial stability risks are contained, we have some concerns that there are signs of some easing in banks' lending standards. We welcome that the legal basis for using targeted real-estate macroprudential tools has been established. We urge the authorities to closely monitor the situation in order to avoid another new "bubble".

Mr. Gokarn and Mr. Joshi submitted the following statement:

We thank staff for the report and Mr. Just for the informative buff statement.

The upswing in the growth in Austria in 2017 has sustained through the first quarter of 2018 and created favorable conditions for further strengthening of potential growth and economic resilience. While improving growth momentum has reduced unemployment, inflationary risks have increased but are expected to remain contained in the medium term. Going forward staff considers that economic growth may recede slowly from its current level to reach a lower potential rate of expansion. External threats of

retreat from cross-border integration, protectionism, disruption in trade due to sanctions on trading partners, increased risk averseness and global growth slowdown could also affect growth prospects adversely. Ensuring macroeconomic and financial resilience would mitigate risks and reduce the impact of any negative spillover effects on the economy. We welcome the several legislative measures taken by the authorities to strengthen the supply side of the economy.

The fiscal sector has endured gradual consolidation fostered by higher growth and interest savings resulting in marked reduction in public debt in 2017. The medium-term plan to achieve structural surplus under the Stability Program and the 2018/19 budget plan to achieve overall balance in 2019 would both serve to pare public debt going forward. Staff however considers that meeting these fiscal objectives would be difficult in the absence of deeper structural reforms that are required to generate larger savings such as from healthcare reforms and reduction in subsidies, tax rationalization and reorientation of fiscal federal relations that improve cost savings. At the same time, we welcome the steps planned by the authorities to reduce discretionary spending. Ageing related risks would also strain fiscal finances and would necessitate preemptive policy actions to fortify fiscal defenses. We are encouraged by the authorities' intention to accelerate reduction in debt to sixty percent in line with the Maastricht treaty. Could staff suggest the likely medium-term impact of demographic related spending on deficit and debt on the projections presented by them in the report?

The financial system is stable and large banks are vested with adequate core and risk capital buffers. While NPLs have declined and bank's portfolio risks have abated, yet targeted measures are needed to improve cost efficiency to enhance the effectiveness of financial intermediation and raise profitability. We are encouraged to note that the regulatory and supervisory frameworks have been strengthened further and that efforts are on way to reinforce the business models of internationally active banks. Although real estate related risks have remained contained so far, the establishment of legal basis for macroprudential tools to de-risk real estate exposures and the assessment of their links with the financial sector as well as the identification of impairments in household balance sheets would enable the authorities to take timely measures to prevent risks to financial stability. In this context, we are encouraged to note the ongoing process of continuous supervisory engagement with banks to assess the riskiness of mortgage exposures. While the authorities have taken significant efforts to bolster AML/CFT framework by legislating suitable provisions yet there is a need to sharpen financial intelligence and processes related to investigation and prosecution. The

implementation of the 5th EU AML Directive will further enhance credibility of Austria's AML/CFT framework. The authorities' commitment to strengthening the AML/CFT framework is welcome as also the recent efforts to enhance supervisory resources and establish the register of beneficial ownership.

High living standards and low inequality and poverty are exceptionally positive features of the Austrian economy borne out of consistent and focused policy efforts. Yet structural reforms are required to boost the employment rate sustainably above its pre-crisis level. Strengthening education and skills, integrating foreign refugees, increasing employment opportunities for elderly workforce, greater flexibility in working hours, shifting the tax mix away from labor income including supportive policies to encourage investments, innovations and entrepreneurship would spur potential growth and foster employment. Could staff comment on how refugee integration initiatives suggested by them that depend on increased expenditures be taken forward at a time when social benefit expenditures are being curtailed by the authorities?

We wish the authorities the very best and all success in future endeavors.

Mr. Daïri and Mr. Nadali submitted the following statement:

Strong economic foundations and sound policies have helped Austria preserve macroeconomic and financial stability after the global financial crisis (GFC) and experience robust growth over the past two years. In 2018, growth continues to be strong and broad based; inflation has decelerated slightly to close to the ECB objective, despite the output gap turning mildly positive; and unemployment has dropped further, although it remains above pre-GFC levels. The fiscal deficit continues to narrow; the external current account remains in surplus; and public debt continues on a declining path. The financial system is also stronger and better capitalized. While the near-term outlook, despite global risk factors, is favorable, low potential growth and population ageing present key challenges over the medium term. The authorities should therefore use the current benign macroeconomic environment to consolidate public finances, further strengthen the financial sector, and advance structural reforms. We concur with the thrust of staff appraisal.

Fiscal consolidation remains necessary to rebuild buffers, accelerate debt reduction toward the Maastricht target of 60 percent of GDP, and ensure long-run fiscal sustainability in the face of rising demographic spending

pressures. The 2019 budget appropriately aims at an overall balance, and we welcome the authorities' intention to achieve a structural surplus over the medium term. Work should continue to enhance spending efficiency in healthcare and subsidies, including through additional reforms in fiscal federal relations, and further reform the pension system. Strengthened tax administration should help compensate for income tax cuts. We see merit in further steps to lower the tax wedge on low incomes, and wonder if the authorities are receptive to higher taxation of environmental pollution and wealth. What is being done to address outdated property tax valuations? Moreover, how will the tax burden on corporates be reduced from 2020 onward? Staff comments are appreciated.

The banking system is stable and liquid. Large banks have narrowed the gap in their capital levels with peers and met targets under the 2012 bank sustainability package. Declining NPLs have reduced risk provisioning needs and helped the recent rise in profits. However, cost reduction is progressing slowly, and net interest income remains constrained in the low interest rate environment. Banks need to further improve capitalization to bolster cushions above regulatory limits, increase fee-based activities, and strengthen business models by rationalization, cost cutting, and IT investments. While real estate-related risks to financial stability are contained at present, caution is warranted in view of increasing share of housing loans in banks' balance sheets. We welcome the establishment of the legal basis for using targeted real estate macroprudential tools as well as efforts to better analyze the real estate market and its interaction with the financial system. We are also reassured by Mr. Just in his helpful buff statement that the authorities are vigilant to prevent a deterioration of lending standards and engage in a continued dialogue with banks where mortgage lending practices appear to be riskier than deemed appropriate.

Higher productivity and potential growth and lower unemployment require strengthening innovation and competition, improving education outcomes, increased integration of foreigners into the labor market, and targeted active labor market policies. Raising the age of compulsory schooling to 18, offering training guarantees for people under 25, and providing language classes and a program to identify skills for accepted asylum seekers are steps in the right direction. We also welcome ongoing and planned measures to better support start-ups, increase spending on R&D, provide investment incentives for SMEs, and enhance flexibility in working hours.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

Austria's economic fundamentals are sound. Growth is robust and broad-based, driven by favorable external conditions, fiscal policy, and a recovery in private investment. Unemployment has declined, although is still above pre-crisis levels, the financial sector has strengthened, and key risks are largely contained. We agree with staff's assessment that the authorities should use this favorable window to advance measures aimed at boosting growth potential and improving resilience of the financial sector.

The authorities' Stability Program envisions ambitious fiscal measures designed to boost growth through tax reform and increase the efficiency of public expenditures. While we agree that improving fiscal sustainability is important given Austria's demographics, we would have liked to see more detail on the estimated impact of fiscal reforms on consumption and growth. In particular, the authorities are planning a substantial consolidation of expenditures—2.4 percentage points of GDP over five years—although it is unclear how much of the planned adjustment is due to favorable growth projections versus cuts to expenditures. Could staff provide more detail on the assumptions underlying the numerator and denominator in the revenue and expenditure lines in the authorities' plan versus staff projections (per the table on page 7)?

Further, we agree with staff that structural measures will be necessary to complement the authorities' fiscal strategy, and to boost growth potential and private investment. We appreciate Mr. Just's description of the supply-side measures the authorities have taken recently, but we think that staff could have been more specific on their recommendations in this regard. For example, staff expect a declining contribution of private investment to GDP growth this year and that private investment as a percent of GDP will decline after 2019. Could staff discuss why the investment contribution to GDP is declining and what are their recommendations for attracting new investment beyond the labor market policies described in the report?

We welcome the improvements to the financial sector, including stronger bank capital buffers and updated regulatory and supervisory frameworks. However, the housing market's relatively high exposure to foreign exchange denominated loans and variable rate mortgages exposes the sector to interest rate and exchange rate risks. We agree that the authorities should continue to monitor this sector closely, especially in the context of any further loosening of credit standards.

Finally, we note that the Risk Assessment Matrix may be using old language under the "Policy Uncertainty" heading, as it still refers to elections in several large economies.

Mr. Lopetegui and Mr. Corvalan Mendoza submitted the following statement:

We thank the staff for the report and Mr. Just for his insightful buff statement. Supply-side economic measures were launched by the authorities to boost potential growth. Policy actions took place to fortify the economy's foundation from the risky environment, posed by the external sector. We are encouraged by the Austrian authorities will to improve the flexibility of the labor market, strengthen work incentives, and the efficiency of the public sector to deliver public goods. The country is characterized as a strong welfare state, with low inequality and poverty rates.

The authorities are aware of demographic dynamics and its potential impact on the fiscal accounts in the future. The country's public finances do not present a risk in the short term, and the policy makers' willingness to tackle this long-term challenge simultaneously, from the revenue and expenditure sides, is encouraging. On the expenditure side, the authorities believe that savings needed to repair its balance sheet will automatically be reached, thanks to high output growth that reduces the expenditure-to-GDP ratio. On the other hand, the staff sees that savings could be substantial (2.5 – 3 percent of GDP) if more ambitious reforms were put into motion. We would appreciate further clarification from the staff on what path to follow to help the country rebuild its fiscal buffers, without risking economic growth.

We applaud the government's clear message to accelerate debt reduction toward the Maastricht target of 60 percent of GDP for the medium term. Last year, debt-to-GDP ratio was around 78 percent. The increase of the public debt level during the global financial crisis, owing to the government's bank rescue measures—for its exposure to Central, Eastern, and Southeastern Europe— today is on a clear downward trend. We would appreciate further clarification from the staff on positive effects of the deal with the creditors of HETA, as stated in Annex III, which may bring gross public debt down to 61 percent of GDP by 2023.

Austrian banks have been strengthened further, and its role as a regional financial center is well maintained. As much as the level of direct exposure of these institutions to Central, Eastern, and Southeastern Europe were reduced, the process did not create a negative spill over effect on credit dynamics in the region. The financial institutions moved away form wholesale

to deposit base funding. Capital infusion was introduced, and tighter regulation and supervision was imposed. We concur with the authorities' view that the initial costs to the industry on IT and staff reductions would result in efficiency gains that would give banks greater flexibility to face possible downturns in the future. To transform banks' business model will take time and a constant surveillance from the supervisors. (OeNB 2017 stress tests, clearly states that reinvestment risks will be high in the coming three years).

With these comments, we would like to wish Austria and its people all the best in their future endeavors.

Mr. de Villeroché, Mr. Castets and Ms. Sanchez submitted the following statement:

We thank staff for their concise report on Austria and Mr. Just for his insightful buff statement. We salute the robustness of the Austrian economy, including its low inequality and poverty levels. We also concur with staff that the acceleration of growth in 2017/2018 provides an opportunity to implement reforms addressing long term challenges, related to potential growth and fiscal trajectory, while pursuing the strengthening of the financial system. We associate ourselves with Mr. Meyer's statement and would like to make the following points for emphasis.

Like staff, we consider that risks to the outlook are largely external and pertain to a retreat in cross-border integration, weak growth in trading partners and unsuccessful integration of immigrants. We take note that the authorities also mention the increasing environmental risks arising from climate change, with impact on the tourism industry and agriculture. We would appreciate staff view on this. More generally, addressing climate change requires going beyond the case of the most vulnerable states and we invite staff to continue to assess the macro criticality of risks related to climate change for all member countries.

The reduction of public debt and fiscal deficit is noticeable, and we welcome the ambitious medium-term fiscal plans set out by the new government. We note that divergences between the authorities and staff in assessing potential growth and the impact of fiscal measures lead to a significant gap in structural fiscal balance. In particular, staff considers that the measures embedded in the Stability Program may not be specified enough to achieve the program's target. In addition, in the context, common to the majority of AEs, of aging population, fiscal policy needs to be able to absorb rising spending needs. In this context, we concur that implementing efficiency-enhancing structural reforms is desirable, even if, in the case of

Austria, public debt is not projected to increase before 2040 and high uncertainty surrounds public debt projections beyond that date. Such reforms entail the identification of savings potential, notably in healthcare, adjustments in fiscal relations between the federal and subnational governments and measures (recently implemented) to restrict expenditure growth. Additionally, increasing workforce participation and productivity appear also warranted to deal with the aging phenomenon. We also agree that fiscal reforms should take equity considerations into account and preserve Austria's strong welfare state.

Finally, in spite of a low unemployment level, we encourage he authorities to press ahead with structural reforms that address or prevent risks arising from labor market mismatches. The set of measures proposed in the staff report is adequate in order to upgrade the skills and accompany the employability of specific segments of the population. However, we are missing a more in-depth analysis of the recent measures that could have an impact on the labor market, particularly for women. We would be interested in having staff's view on the expected impact of the introduction of a family bonus in 2019 and the new regulations for flexible working, in effect since September 1st.

Mr. Leipold and Mr. Spadafora submitted the following statement:

We thank staff for an informative report and Mr. Just for his candid buff statement. We associate ourselves with Mr. Meyer's statement and offer some additional comments for emphasis.

Austria's economic growth is gathering speed and is expected to remain strong in the near term. Fundamentals are improving further, with lower unemployment, accelerating consumption and net export growth, and a lower-than-expected 2017 headline fiscal balance. Over the medium term, growth is projected to decline gradually toward its medium-term potential of around 2 percent, which has been revised upward on account of faster TFP growth and higher labor force participation. Risks are mainly of an external nature, given Austria's high degree of openness.

We agree with the staff's overarching message that the current favorable cyclical upswing provides the opportunity to make progress, through structural reforms, toward preserving longer-term fiscal sustainability and bolstering potential growth.

As noted by staff, the authorities' medium-term fiscal plans are difficult to achieve without deeper structural reforms, needed to preserve and expand fiscal space and ensure the long-term sustainability of public finances. The authorities' objective of reducing fiscal revenues (including social security contributions) toward 40 percent of GDP (from the current 48 percent), while simultaneously reaching a positive structural balance in the medium term, is ambitious given rising age-related spending needs.

Concrete measures will need to be specified by focusing on efficiency-enhancing expenditure reforms in the health care sector and the pension system; complementary changes in the fiscal relations between the federal and the subnational governments would also strengthen fiscal discipline.

Although projected above-potential growth would help lower unemployment further, reducing it to pre-GFC levels requires further measures along the lines suggested by staff in paragraph 21 of the report, including efforts to better integrate foreign workers and refugees. We welcome the authorities' focus on improving employability and strengthening work incentives, as underscored in Mr. Just's statement, as part of the efforts to counter the projected gradual decline in the labor force growth.

Austrian banks display robust capital and liquidity positions and improving asset quality. Banks' profitability is also rising, although bolstered by one-off factors such as reduced provisioning. Against this background, we support the staff's call on the need to further reduce operating costs to support sustained profitability in a low interest rate environment. Continued monitoring of risks in the housing market are warranted, also to prevent a deterioration of lending standards.

Mr. Sembene, Mr. Alle, Mr. Mkwezalamba and Mr. Jappah submitted the following joint statement:

We thank staff for a concise report and Mr. Just for his insightful buff statement.

Despite several years of slow growth, economic activity in Austria has rebounded, strongly contributing to high living standards and low inequality and poverty levels. We commend the authorities for the sound policy measures that have culminated in low inflation, falling unemployment, and declining public debt. Going forward, we encourage the authorities to take advantage of this favorable environment to press ahead with structural

reforms. In this vein, efforts should emphasize fiscal reforms to further reduce public debt, measures to boost employment, and further enhancing financial stability. We support the authorities' endeavors, and offer a few comments.

We welcome the authorities' ambitious medium-term fiscal plans aimed at reducing public debt at a rapid pace. In this regard, we take good note of the mix of expenditure cuts and reductions in the tax and contributions burden as envisaged under the Stability Program. Further, we see merit in the emphasis placed on enhancing efficiency gains in the public administration and streamlining social benefits, while increasing spending on IT infrastructure and research and development (R&D). Fiscal space should also be created to accommodate expenditures relating to an aging population. Further, we urge the authorities to take the necessary steps for these measures to bear fruit. In particular, all stakeholders from the federal government to states should be involved in the process of implementing the fiscal plans. Regarding the revenue side, while acknowledging the key goal of reducing the tax and contributions burden on households and corporates, we are concerned about the potential impact on the on-going fiscal consolidation efforts. Is there any sequencing plan for the reform measures envisaged by the authorities on both the revenue and expenditure sides to meet their fiscal balance objectives? Staff comments would be welcome.

We take good note of the adequate capital level of banks and support on-going efforts for further strengthening the financial system. In this regard, we welcome the reassuring developments in the financial sector, particularly, banks compliance with prudential requirements and the progress made by the largest banks in aligning their capital levels with those of regional peers. Exposure to foreign banks is also low, thus minimizing spillovers risks. We appreciate the fact that the soundness of the banking system has translated into an acceleration of credit, both to non-financial corporations and households. Going forward, we encourage the authorities to make further progress in strengthening the regulatory and supervisory framework, and constantly monitor real estate-related financial risks. In addition, we call on the authorities to continue strengthening the AML/CFT framework, in line with the 2016 FATF recommendations to sustain Austria's position as a financial center.

Finally, we encourage the authorities to continue their current efforts in reducing unemployment by addressing the related challenges. The recent acceleration in employment growth has combined with the rising labor supply from migration and higher labor force participation. Maintaining this pace will require efforts to improve education outcomes to address skill mismatches and

facilitate the integration of immigrants into the labor market. Moreover, addressing hurdles to the integration of immigrants into the labor market and boosting labor through policies to strengthen innovation and competition by lowering barriers to entrepreneurship, would contribute to boosting employment.

Mr. Inderbinen and Mr. Heim submitted the following statement:

We thank staff for the comprehensive report and Mr. Just for his informative buff statement.

We welcome the solid performance of Austria's economy. Growth has remained high in 2018 and is well above the Euro area average. Robust domestic demand and a favorable external environment have been the main drivers of growth. Risks to the outlook are mainly related to the external front and stem from a possible retreat from cross-border integration and slower growth of external trading partners. We share the view that the current environment provides a window of opportunity to advance reforms to address long-term fiscal sustainability challenges, to further reduce unemployment and to increase buffers in the financial system.

We commend the authorities for their continued efforts to rebuild fiscal buffers and to put public debt on a clear downward path. The authorities' Stability Program to accelerate the reduction of public debt toward the Maastricht target is welcome. At the same time, we share staff's view that the medium-term fiscal consolidation plan is ambitious and that there is a need for deeper structural reform. Particularly on the expenditure side there is room for further consolidation, with a focus on increasing the efficiency of health expenditures, reforming pensions and cutting subsidies. One of the critical challenges for the timely implementation of the Stability Program is the need to coordinate between the federal and subnational levels of government.

Unemployment has decreased over the last years, but remains above pre-crisis levels. Although the unemployment rate is expected to further decrease, more proactive policies would support a durable reduction of unemployment to levels seen before the financial crisis. We support the set of measures proposed by staff that include i) improvements in the education system, ii) efforts to better integrate foreign nationals into the labor market, as well as iii) structural measures to strengthen labor demand, e.g., by shifting taxation away from labor. At the same time, we take good note of the various initiatives in the education sector and efforts to further increase labor market

flexibility. As mentioned in the staff report, reforms can build on the solid foundations of Austria's singularly well-developed vocational training system.

The strengthening of the financial system and the improvements in supervision are welcome. Banks have increased capitalization, they have ample liquidity, and profitability has risen. Also, the Austrian banking sector has reduced its exposure to CESEE countries, and non-performing loans have been reduced. Nonetheless, there is room to further improve resilience. Banks should use the benign macroeconomic environment to strengthen profitability through higher cost efficiency and enhanced internal capital-generating. This is of particular importance, as the low-interest environment and increasing competition from the fintech sector are putting pressure on the banking sector's profits. Finally, we take good note of progress in strengthening the AML/CFT framework. This is welcome, given Austria's role as a financial center and a gateway to the CESEE countries.

Mr. Moreno and Mr. Montero submitted the following statement:

We thank staff for its report and Mr. Just for his buff statement. We broadly share staff's appraisal and associate ourselves with Mr. Meyer's statement. We would like to add the following comments.

We note that economic growth has picked up markedly and has been broad-based, supported by strong domestic demand and a favorable external environment. This benign environment has supported a positive fiscal performance and an improvement in the health of the financial system. Despite this, the level of potential growth remains constrained and age-related challenges loom on the horizon, even though most crisis legacies have been addressed

We concur with staff that the current strong economic environment offers an opportunity to build fiscal buffers and to boost the economy's growth potential, while preserving the achievements in terms of income inequality and poverty. We welcome the authorities' medium-term fiscal plans, which are ambitious, but agree with staff that they will be difficult to achieve without deeper structural measures involving both the federal government and the states which aim to enhance the efficiency of public expenditure and fiscal corresponsibility at a subnational level. Additionally, the current window of opportunity could be used to implement efficiency-raising reforms and to tackle age-related costs, which are expected to rise over time.

We notice that the unemployment rate is currently hovering close to the long-term average (4.9 percent for the period 1994–2017). Thus, further reductions in unemployment can only be achieved on a sustainable basis by tackling remaining challenges in the labor market. There is certain evidence of underutilization of female labor, persistent skill mismatches and difficulties in integrating some foreign residents into the labor market. We welcome recent steps to improve education—by increasing to 18 years of age compulsory schooling or training or the training guarantee for people under 25. Additional efforts to foster female participation, integrate foreigners and to boost labor demand would also be desirable.

Banks' capitalization has improved and its dependence on wholesale funding has diminished. At the same time, portfolio risks have been reduced, as the shares of foreign currency loans and variable rate loans have declined significantly. We welcome the fact that Austrian banks' retrenchment from CESEE countries has not had significant negative spillovers. In this context, we share the view that the focus needs to shift to strengthening the business models of major banks. This includes stepping up efforts to reduce structural costs and withdrawing from non-profitable and high-risk activities and locations. Finally, we concur with staff that real estate related risks are contained at present, but we also consider that providing clear guidance to banks on sustainable lending standards is important at this stage of the real estate cycle.

Mr. Beblawi and Mr. Al-Kohlany submitted the following statement:

We thank staff for their report, and Mr. Just for his helpful buff statement. We concur with the staff assessment and policy recommendations and limit our comments to the following points.

Austria's economy continues to perform well. Growth is strong, income inequality and poverty are low, and living standards are high. The outlook shows favorable growth prospects over the short term and growth is projected to converge back to its potential over the medium term. We welcome staff's focus on the various measures needed to boost Austria's potential growth. These include easing long-term fiscal pressures and preserving fiscal sustainability, improving labor force participation, and safeguarding the financial sector.

We commend the authorities for their prudent fiscal policy, and for maintaining the debt-to-GDP ratio on a downward path. We agree that efficiency gains in public spending would create the needed fiscal space to

meet the rising costs of an aging population, and to ensure the continued decline of public debt to the EU-agreed 60 percent. The reduction in the number of public social security entities from 21 to 5 and plans to better coordinate subsidy spending between the different levels of government are steps in the right direction.

Unemployment levels in Austria are low compared to peer countries but are high in historical terms. Bringing unemployment down to the pre-global-financial-crisis levels requires measures to reduce skill mismatch, better integrate Austrian residents—who are foreign born—into the labor market, and boost labor demand. To this end, we welcome the recent training guarantee for people under the age of 25, which aims to address the high unemployment among those with only compulsory schooling. We also recognize the efforts to ensure the education system is keeping up with the labor market needs and avert further widening of the skills mismatch gap.

The banking sector is sound. Banks are well capitalized and liquid, and nonperforming loans have declined. However, profitability is low, reflecting low-interest rates and the slow progress in cost reduction. We concur with staff that ensuring sustainable profitability and capital-generating capacity should be key priorities for the banking sector. We also welcome the steps taken to reduce risks to the banking sector, including by reducing the share of Swiss franc loans in total household loans, and by strengthening the regulatory and supervisory framework and the development of recovery and resolution plans.

Risks from the real estate market warrant continued monitoring. The housing market is showing signs of overvaluation, and the share of variable rate loans in new household loans remains over 50 percent. Could staff provide further information on the potential risks to the financial sector arising from the high share of variable rate loans? We welcome the newly established legal basis for using targeted real estate macroprudential tools (i.e., loan to value caps and debt-service to income limits). The updated macroprudential toolkit, together with improved analysis of the real estate market development, and early identification of household balance sheet strains will improve the authorities' mitigation, recognition, and response to real estate market risks.

Ms. Villa and Mr. Ismail submitted the following statement:

We thank staff for the comprehensive report and Mr. Just for his insightful buff statement. Underpinned by supportive macroeconomic policies, the Austrian economy has exhibited strong performance in the recent

period, contributing further to the downward trend in the public debt to GDP ratio, drop in the unemployment rate and improved consumer confidence. Meanwhile, the overall health of Austria's banking sector continues to improve. With the risks to the outlook assessed to be largely external and policies to mitigate these in place, the impact of these risks will be limited, if they were to materialize. Measures to increase potential growth will be key to further strengthening Austria's macroeconomic and financial resilience. We broadly agree with the thrust of staff's appraisal and policy recommendations and limit our comments to the following points for emphasis.

Authorities should take advantage of this favorable economic environment to implement key structural reforms that would raise potential economic growth, durably reduce unemployment and ensure fiscal sustainability.

The authorities' focus to undertake supply-side reforms is encouraging. In particular, measures to increase labor employability, address skill mismatches through improvements in education, and continued support to integrate the increasing share of foreigners into the labor market should remain priorities. We invite staff's assessment on the key aspects of recently adopted laws that are linked to this endeavor and their immediate impact to growth. We also invite staff's views on the scaling back of some labor market measures.

Expenditure efficiency is critical. The planned fiscal program is ambitious. Providing specificity would engender greater confidence towards the authorities' stability program. Moreover, the expeditious implementation of cost savings measures will be critical to the program's success. In addition, there is a need to address long-term fiscal sustainability risk due to an ageing population. The authorities should now gear towards enhancing expenditure efficiency especially in the areas of healthcare and subsidies to accommodate spending needs, particularly those arising from demographic challenges. Allied to this, the authorities ought to elicit further adjustments, where necessary, between the federal and subnational governments. We also agree that fiscal reforms envisaged by the authorities should preserve Austria's social achievements of low income inequality and poverty rates. As such, we welcome the reduction in social security contributions for low-income earners and urge the authorities to lower the tax wedge on low incomes.

The authorities should remain steadfast in ensuring that banks follow through with their adjustment plans to ensure sustainable profitability and capital-generating capacity through improved operational efficiencies and

agile business models. We also positively note that banks are now adequately capitalized and better shielded from risks; profitability has risen; and credit extension has recovered from post-crisis lows. Though real estate-related risks to financial stability are contained and do not necessitate the use of formal macroprudential tools, we welcome the authorities' vigilance and preparedness for preemptive actions to ward off any buildup of stability risk. We concur that a strong and effective AML/CFT framework will be essential to safeguard Austria's role as a regional financial center.

Mr. Fachada and Mr. Fuentes submitted the following statement:

We thank staff for the report and Mr. Just for his insightful statement. The macroeconomic fundamentals of Austria remain sound, with the economy performing well under a strong policy framework. Economic activity has accelerated in 2017-2018 on the back of stronger domestic demand and solid export activity. Private investment is expected to remain a strong driver of growth over the medium-term. The broad-based growth performance has led to a sustained drop in unemployment, in a context of rising labor force participation.

Austria should create additional fiscal space to face demographic challenges. While the country does not have short-term fiscal sustainability risks, the new government aims to achieve a significant reduction in expenditure and revenue as a share of GDP, and implement a comprehensive tax reform to strengthen Austria's long-term fiscal position. The authorities' strategy seeks to generate the necessary structural surplus to prompt a significant reduction in the debt-to-GDP ratio. This strategy should also provide the savings to meet demographic-related expenses, like higher social security and healthcare spending, to satisfy the increasing demand for public resources as population ages.

Deeper structural reforms are needed to raise potential output. Despite rapid growth in recent years, potential growth in Austria has weakened since the early 2000s and is expected by staff to remain around 1¾ percent into the medium-term. Higher potential output growth is required to strengthen both fiscal sustainability and social cohesion. Hence, active policies aimed at improving education and training, especially among women and foreigners, are critical to boost productivity. Similarly, actions directed to expand credit and foster innovation among SMEs, particularly start-ups, would be welcome to boost labor demand and maintain high levels of private investment.

Austrian banks are healthier and better positioned. The banking system has benefited from the favorable economic conditions, exhibiting improved capitalization, adequate liquidity and rising profitability, while non-performing loans (NPLs) continue to decline. At the same time, Austrian banks' exposure to Central, Eastern and Southeastern Europe has declined, and the macroprudential toolkit has been established. Despite the solid performance, we agree with staff that banks should take advantage of the current benign macroeconomic environment to strengthen profitability and the capacity to generate capital organically.

Mr. Virolainen and Mr. Bernatavicius submitted the following statement:

We thank staff for their well-written report and Mr. Just for the informative buff statement. The Austrian economy is robust with low income inequality, high living standards, and stable financial system. Strong economic growth is expected to gradually moderate before settling at its potential. The short-term fiscal outlook is favorable, but in the medium to long-term reforms will be necessary to control age-related spending. Risks in the real estate market are currently contained, but early signs of easing in banks' lending standards warrant continued monitoring. We associate ourselves with Mr. Meyer's statement. We are in broad agreement with staff's appraisal and offer the following remarks for emphasis.

The Austrian banking system is stable and well-capitalized, risks to banks' portfolios have been reduced and credit growth recovered. On the other hand, the significant increase in real-estate prices over the last decade, high share of variable interest rate mortgages and rising share of relatively high loan-to-value, debt service-to-income, and debt-to-income ratios in new housing loans to households call for close monitoring. We welcome the authorities' decision to establish the legal basis for real-estate specific macroprudential tools. We agree with staff that, so far, financial stability risks are contained, but clearer guidance to banks on sustainable lending standards may be useful. The authorities should stand ready to implement macroprudential measures if needed.

While the overall unemployment rate in Austria is decreasing, there is significant heterogeneity between different labor force segments. Additional efforts are needed to better integrate immigrants by addressing their lack of language skills and qualifications. Moreover, the unemployment rate among those with only compulsory schooling is high and has been increasing steadily since 2011. The recent increase in the age of compulsory schooling or training

and introduction of the training guarantee for people under 25 are steps in right direction, seeking to boost skills and reduce youth unemployment.

Austrian potential economic growth is relatively low. This calls for increased attention to policies which could strengthen innovation and competition. We welcome the recent decision to increase spending on IT infrastructure and R&D. On the other hand, the authorities' projections imply that public investment will remain broadly constant as a share of GDP. While safeguarding long-term fiscal sustainability we urge the authorities to be mindful of the need to maintain adequate level of public investment, which could increase productivity and potential growth.

The short-term fiscal outlook is favorable, fiscal consolidation has resumed and public debt is on a declining path, but fiscal structural reforms are needed in the medium to longer-run, especially in containing age-related spending. The current economic environment provides a good window of opportunity to proceed with further reform of the pension system.

Mr. Alogeel and Mr. Keshava submitted the following statement:

We thank staff for the focused report and Mr. Just for his helpful buff statement. We broadly agree with staff's analysis and policy recommendations and would like to emphasize the following points.

We welcome the strong and broad-based growth, solid fundamentals, and favorable economic outlook. We are also pleased that the debt ratio has continued to fall, unemployment has declined, and consumer and business confidence indicators are at high levels. These positive developments provide an opportunity to further implement reforms to raise growth potential, reduce unemployment further, and ensure long-term fiscal sustainability against the backdrop of an aging population. The authorities also face many challenges in successfully integrating immigrants into the labor market and sustained efforts in this regard will be essential.

We are encouraged by the improved debt outlook with debt expected to fall from around 84 percent of GDP at end-2016 to 61 percent of GDP by end-2023. At the same time, further reforms of fiscal federal relations have rightly been underlined to achieve greater spending efficiency and help achieve the authorities' medium-term plans. We also note in the DSA that, without additional policy measures, aging cost pressures and higher interest rates would reverse the debt path in the longer term. To this end, additional reforms to the pension system are essential to ease future fiscal pressures. In

this regard, staff elaboration on possible reform options would be welcome. Is linking the statutory retirement age to changes in life expectancy under consideration to help improve long-term fiscal sustainability?

We take positive note of staff's assessment that the financial system is stronger and better capitalized than in recent years. In this regard, we agree with the recommendation to create further buffers as an insurance against large adverse events. While real estate-related risks are contained at present, continued vigilance is needed. Here, we welcome the agreement on real-estate macroprudential instruments, which can be deployed if needed, and the ongoing efforts to improve the analysis of the real estate market. On the AML/CFT framework, we are reassured by the authorities' strong commitment to further strengthen it.

Finally, the authorities should duly consider the useful recommendations made by staff to further reduce unemployment. On the authorities' response to past policy advice (Annex IV), we missed any reference to the authorities' actions regarding the previous advice to "strengthen competition and further reduce firms' administrative burden". We would especially welcome staff elaboration on the steps taken by the authorities to reduce regulatory barriers in Austria's business service sector, given its importance to the economy.

With these remarks, we wish the authorities continued success.

Mr. Doornbosch and Mr. Hanson submitted the following statement:

We thank staff for the report and Mr. Just for his informative buff statement. We agree with staff that Austria is experiencing robust and broad-based growth. We associate ourselves with Mr. Meyer's statement and would like to add the following comments.

The benign economic outlook provides an opportunity to address long-term fiscal pressures. Staff projects that demography-related expenditures will result in an increase in public debt over the medium term. We agree with staff that structural fiscal reforms to enhance the efficiency of public expenditure and the sustainability of the pension system are key to ensure long-term sustainability. However, we would have welcomed more specific guidance on recommended policies. In particular, increasing the statutory pension age and restricting early retirement are important to contain pension-related expenditures.

We would have welcomed a reference to risks related to climate change. Staff writes that the authorities pointed to increasing environmental risks arising from climate change. According to the authorities, climate change already impacts tourism and agriculture. Given the size of the Austrian tourism sector, climate change could potentially have a significant effect on the Austrian economy. We note that the risk assessment matrix does not include any long-term risks. We wonder whether Staff considered including climate related risks in the risk assessment matrix? Like Mr. De Villeroché we invite staff to continue to assess the macro criticality of risks related to climate change for all member countries.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for the insightful report and Mr. Just for his informative buff statement. The Austrian economy is growing robustly, supported by strong private consumption and investment. Growth has accelerated to 3 percent in 2017, and it is expected to remain sound this year. Positive developments include the strengthening of public finances, falling unemployment, and improved resilience of the banking sector. Strong economic environment bodes well for bolstering potential growth and reducing future vulnerabilities. We note that staff and the authorities mostly share the assessment of the outlook and risks, and broadly agree on policy recommendations.

While there is some difference between staff's and the authorities' fiscal projections, the ongoing adjustment is rightly designed to significantly reduce public debt over the medium term. We welcome the authorities' efforts aimed at streamlining public spending and improving efficiency of public expenditures, while reducing the country's sizeable tax burden. Clear identification of necessary cost-saving measures would be key in this context. We note that continued robust growth will contribute to further narrowing of the deficit in the coming years. Public debt as a percentage of GDP is projected to decline gradually, from 78.5 percent in 2017 to 62.8 percent in 2022. The low interest rate environment and Austria's relatively strong fundamentals keep the funding risks at a low level.

Addressing rising spending needs associated with population aging would require additional deep fiscal reforms, including in the pension system, the healthcare sector, and subsidies. It is also paramount to further strengthen the fiscal relations between the federal and subnational governments. We agree with staff that equity considerations should be taken into account in designing reforms in these areas.

We welcome the significant progress in strengthening and revamping the regulatory framework in the banking sector. Capitalization of large banks has been improved, profits have risen, and nonperforming loans (NPLs) have declined. Moreover, risks arising from exposure to CESEE have been mitigated. At the same time, further efforts are needed to buttress profitability, reduce operational costs, and create additional buffers against potential adverse events. Strengthening the AML/CFT framework also remains one of the key priorities. We note that staff feel that, at this juncture, the risks from considerable house prices growth are contained.

In the medium term, the important challenge for the authorities is to foster higher potential growth. To this end, we welcome the authorities' efforts aimed at promoting the labor market and education reforms in order to further reduce unemployment and reap productivity gains. Absorbing the additional labor supply in the labor market, including integration of migrants, remains one of the key challenges. Given the government's decision to discontinue targeted support for unemployed older workers through secondary labor market, what specific measures would staff recommend in terms of mitigating risks for this age group? We would also appreciate staff's comments on how the authorities can address the high gender pay gap in Austria.

Ms. McKiernan and Mr. Feerick submitted the following statement:

We thank staff for their report and Mr. Just for his helpful buff statement. The Austrian economy continues to be generally well managed. As such, staff's advice rightly focuses on incremental improvements in the short term coupled with more fundamental structural reforms to ensure longer-term sustainability. We broadly agree with the staff assessment and offer the following comments for emphasis.

The short-term fiscal outlook is reasonably robust with an ambitious plan laid out by the authorities. However, this will need to be further expanded to improve credibility. While the debt ratio is estimated to converge toward the 60 percent of GDP threshold over the medium term, we note that this reflects more a reliance on revenue buoyancy and overall growth to reduce the debt ratio, this could usefully be supplemented with discrete adjustment measures. Coupled with the substantial demographic challenges, deeper fiscal structural reforms will be necessary to buttress long-term fiscal sustainability. This is made clear in the DSA, where ageing cost pressures and higher interest rates would reverse the downward path for debt, unless

additional policy measures are taken. In this regard, we agree with staff's assessment that efficiency-enhancing reforms in health care and containing pension-related expenditure are key. More generally, we would like to acknowledge the efforts of the Austrian authorities in maintaining low levels of income inequality and poverty and would encourage that future reforms preserve these important social gains.

The banking sector is well capitalized and liquid but there are concerns around longer-term profitability prospects. Analogous to the fiscal position, we agree that banks should take advantage of the present upturn to aim to build profitability, including through cost-cutting or limiting the payment of dividends. We would like to acknowledge the significant reduction in NPLs over recent years which has played a key role in improving the balance sheets of the banking sector. We welcome the strengthening of the regulatory and supervisory framework and the fact that the authorities are now collecting data to enhance the analysis of the interaction of the real estate sector and the financial system. While changes to the macroprudential toolkit do not appear warranted at this time, the authorities should stand ready to act if signs of imbalance emerge.

Looking to the longer term and measures to support increased potential growth, further efforts will be needed to mitigate the gradual demographic decline in the labor force. As with many European countries, Austria is facing a demographic challenge due to an ageing population. As such, it will be crucial that the authorities put in place concrete steps in the medium term to both bolster participation rates and human capital. Annex V makes clear that there is much stronger demand for labor for those with higher educational attainment and skillsets, a trend likely to continue into the future. As such, the suite of recommendations from staff, such as additional well-targeted ALMPs and improving educational outcomes, appear sensible and we encourage the authorities to be proactive therewith.

Mr. Jin and Mr. Fan submitted the following statement:

We thank staff for the comprehensive paper and Mr. Just for the informative buff statement. We commend the Austrian authorities for the strong economic performance and the timely implementation of reform measures to secure sustainable growth. We broadly agree with the thrust of staff's appraisal and would limit our comments to the following for emphasis.

Concrete reforms are warranted to maintain fiscal sustainability and keep public debt in a downward path. It is noteworthy that the fiscal outturn

performed better than expected in 2017. However, to prepare for potential external risks and maintain a credible debt reduction plan, we agree with staff that fiscal consolidation is needed, especially under the current favorable window of opportunity. We thus commend authorities for their plan to achieve a structural surplus over the medium term by significantly reducing both revenue and expenditure. Since social benefits account for nearly half of fiscal expenditure, we welcome staff's comments on the scale and timetable of the reform in the pension system. We noted the large room in healthcare and subsidies for cost cutting through efficiency enhancing, but the room is conditioned to the adjustment of the fiscal relation between the federal and subnational government. We welcome staff's further elaboration on the main obstacles resulted by this relationship and the policy options to address these issues.

Adjustment plans for banks are needed to consolidate financial stability. Austria has achieved progress in the financial sector by including stronger capitalization, rising profitability, and strengthened the supervisory framework. We commend the banks' measures to further cut cost and rationalize their business models to create additional buffers for future uncertainties. Although still under control, the potential risk in housing market warrants close monitoring. We commend the authorities' action to establish the legal basis for using targeted real-estate macroprudential tools and see merit in remaining vigilant and prepare to take preemptive action if necessary.

The representative from the European Central Bank submitted the following statement:

We would like to thank Staff for their informative report and Mr. Just for his clear buff statement. We associate ourselves with the statement by Mr. Meyer.

We broadly agree with the Staff outlook of strong economic growth this year and a gradual slowdown toward potential next year. Staff estimate potential growth over the next few years to be around 1.7-1.8 percent. Achieving higher sustainable growth rates will be challenging in the context of a possible slowing in the investment cycle, recently decreasing net inward migration, and a sizeable population cohort moving closer to retirement age over the next years. The projected slowing in labor force growth by Staff underscores the need for labor market policies to address labor market mismatches and structural unemployment in particular by improving employment outcomes for immigrants, elderly workers and women.

We share the Staff view that the short-term fiscal outlook is favorable, but long-term sustainability requires fiscal structural reforms. In particular, the planned fiscal consolidation for the period 2018-22, which foresees Austria to meet its Medium-Term Objective by 2019, is welcome. Looking at the medium- to long-run challenges, priority should be given to reforms that enhance the efficiency of public expenditure and the sustainability of age-related expenditures. Notably, there is scope for reforms in the areas of social protection, pensions and healthcare, given that the expenditure ratio in these areas is among the largest in the euro area and expected to rise further going forward. Increasing the statutory retirement age and restricting early retirement would contribute to pension sustainability in an ageing demographic context. Moreover, further gains could be achieved from streamlining healthcare expenditure. We also share the Staff view that reforms require adjustments in fiscal relations between the federal and subnational governments. Despite recent reforms (e.g. the 2017 Financial Equalization Law), the fiscal framework may be suboptimal since a significant mismatch between expenditure- and revenue-raising responsibilities persists, providing weak incentives for budgetary discipline at subnational level.

With respect to structural policies, we welcome the focus on unemployment and broadly share the recommendations outlined but consider the issue of framework conditions more generally also to be important. Labor market policy recommendations include an improvement in education outcomes, better integration of foreigners into the labor market, targeted ALMP and structural measures to raise labor demand. The latter include fiscal measures (shifting taxes away from labor, higher public investment, inter alia in R&D), which we see as beneficial. The report also mentions important measures taken for younger people, such as the training guarantee. As in other European countries, the issue of youth employment is important as the recent overall decrease in the unemployment rate does not appear to have benefitted the young as much as other cohorts. With respect to framework conditions there is a particular need to reduce regulatory barriers in the services sector, such as entry restrictions to regulated professions and administrative burdens.

We agree with Staff that risks in the real estate market are currently limited but warrant continued monitoring. Against the backdrop of continued residential price increases, some signs of overvaluation and growing mortgage lending, monitoring the quality of new lending is crucial to prevent the build-up of risks. Therefore, we welcome the continued efforts of authorities to enhance the monitoring of lending standards. We also consider that providing clear guidance to banks on sustainable lending standards is important at this stage of the real estate cycle. Finally, we welcome the new

legal basis for borrower-based measures. Nevertheless, only the future use of the framework will show whether it is sufficiently flexible to enable the authorities to act early in the cycle in order to prevent the build-up of risks. With respect to Austrian banks' exposure to CESEE countries, while the report rightly notes the recent reduction, it nevertheless remains significant and still accounts for a significant share of the total exposure of Austrian banks.

Mr. Meyer made the following statement:

I thank the staff for their insightful report and Mr. Just for his informative buff statement.

The Austrian economy is robust and is performing well, with growth considerably above and unemployment well below the euro area average. The financial sector has also become more resilient. At the same time, such positive news should not make us lose sight of longer-term challenges, such as increased demography-related spending that is expected to gradually pick up. Therefore, we consider that efficiency-enhancing reforms in health care and containing pension-related expenditures are key in this regard.

Against this background, we encourage the authorities to push ahead with deeper fiscal structural reforms, including a thorough reform of intergovernmental fiscal relations. In the same vein, further labor market reforms should help to further lower unemployment and counter the projected gradual decline in labor force growth.

In the financial sector, Austrian banks have become more resilient as their capitalization and asset quality have improved. However, we share the staff's view that banks still need to work on their profitability.

Finally, even though real estate-related risks to financial stability are currently contained, we welcome the authorities' continued efforts to enhance the monitoring of lending standards and the new legal basis for borrower-based measures.

With this, I wish the authorities all the best.

Ms. Preston made the following statement:

We thank the staff for the informative set of papers and Mr. Just for his helpful buff statement. We did not issue a gray statement, but we broadly

agree with the staff's assessment and wish to make the following remarks for emphasis.

Austria has experienced robust, broad-based growth, supported by strong institutional settings and a well-educated population. Low poverty and income inequality have contributed to strong social cohesion. The outlook for growth is positive, and risks, which are mainly external, are assessed as having a limited impact. Things are looking pretty good, but can they be great?

In his buff statement, Mr. Just noted that the succinct presentation of the staff's high-quality analytical work may be beneficial to a wider audience and could stimulate the public debate. We hope so.

We see the risk of complacency as the biggest challenges for Austria—the lack of a burning platform to catalyze structural reforms that are not urgent but important, complex, and necessary to increase potential growth and keep debt on a sustainable trajectory in the longer term. We acknowledge that such reforms are difficult to implement and we do not underestimate the political challenges associated with such reforms but urge the authorities to push on.

We are encouraged by the recently legislated reforms to expand the supply side of the economy and support the authorities in their plans to improve labor market flexibility, incentives to work, and increase public sector efficiency. But we strongly support the staff's recommendation that deeper reforms are needed. We note that many of the priority reforms involve negotiations with the subnational government, and we would be interested in whether the staff spoke with these bodies.

We welcome the Austrian authorities' efforts to deliver on their fiscal target, taking advantage of the uptick in growth momentum and cutting back on discretionary spending to help build fiscal buffers. Debt, at 78.3 percent of GDP, remains elevated; and therefore, we support efforts to bring debt down toward EU-agreed levels of 60 percent by the end of the medium term.

We note that the staff and the authorities have a difference in view on the path of consolidation, owing to the quantification of a number of savings measures. Despite this, debt metrics are projected to end up at relatively similar levels in 2022. We would be more interested in the staff's view on the relative priority of implementing the authorities' proposed measures. Are they

the most important measures or just necessary but not sufficient to underpin Austria's long-term sustainability?

Finally, we recognize the health of the financial sector, with strong, well-capitalized banks; but we strongly encourage the authorities to fully comply with the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) requirements, given their available resources.

Mr. Inderbinen made the following statement:

We thank the staff for the good documents and Mr. Just for his concise buff statement.

We welcome the solid economic performance of Austria over the surveillance cycle, building on robust domestic demand and a favorable external environment. Austria remains a wealthy and stable economy, with a high quality of life for its citizens. This is also demonstrated by the fact that Vienna has recently been named again the world's best city to live in for the ninth consecutive year, and we note, once again, ahead of Geneva and Zurich.

Apart from this, we take good note of the further structural reforms that have been initiated by the current government and that they are already paying off in terms of investment and in terms of slightly higher total factor productivity (TFP) growth, although we do note the slight difference between the authorities and the staff with regard to the outlook for potential growth.

With debt at still high levels, as emphasized by Ms. Preston, and slightly above the Maastricht criterion, efforts at further fiscal consolidation are warranted. We commend the authorities for their continued efforts to rebuild buffers and to keep public debt on a clear downward path.

We also take good note of the measures already set in train; for instance, on the expenditure side, including social security, health care, and others, as enumerated in Mr. Just's buff statement.

The staff does make the point that further structural reforms will be needed to meet the authorities' stability program objectives. These could include certain adjustments in the relations between the federal government and the lender at the provincial level. Such adjustments in a federal system are, by their very nature, challenging tasks. We do encourage the authorities to specify the necessary action early on, also to enable them to benefit from the

current momentum in terms of growth and the overall environment for reforms.

Like Mr. Meyer and others, we also agree that further efforts would be warranted to address labor market mismatches. We are of the view that Austria's strong and institutionally deep-rooted dual education and apprenticeship system is well placed to boost skills. In this context, we did note that there has been an increase in the number in attendance at technical colleges and universities of applied sciences in Austria. This is encouraging. There has also been progress to more flexibility and more permeability between the higher levels of education and vocational tracks, but more could be done in this area. We encourage the authorities to contemplate increasing part-time study programs at the technical colleges.

Finally, like Mr. Virolainen, we also see room to further strengthen innovation and competition, and we welcome the recent decision to increase spending on IT infrastructure and R&D. I would like to note that Austria has been lagging its peers in the transition toward digitalization. In particular, there is a need to further strengthen the digitalization of Austria's banking sector, also in terms of bringing the costs of operation down in the sector.

Ms. Villa made the following statement:

We join Directors in thanking the staff for the report and their responses to technical questions. I also thank Mr. Just for his informative buff statement. We have issued a gray statement, so I will confine myself to a few remarks for emphasis.

First, we join Directors in saying that the favorable economic outlook presents the authorities with an opportunity to implement key structural reforms. More specifically, to look toward the medium-, and long-term horizon in order to cement Austria's macroeconomic and financial resilience while preserving gains in raising social well-being. We note that the authorities have an ambitious medium-term plan that could rapidly reduce public debt and keep it on a downward trend. However, we wish to reiterate what we mentioned in our gray statement and echo other Directors' call that, to heighten policy credibility, there is a need to fully specify this medium-term plan, clearly communicate it, carefully sequence measures, and appropriately follow through on implementation, including coordination at all levels of government. In this regard, we look forward to their efforts to raise efficiency gains in public spending and contain pension expenditures, which

are key areas to meet the rising costs of an aging population and ensure a sustainable fiscal position.

We also welcome that appropriate measures have been initiated to foster higher potential growth through innovation and incentives to the private sector. At the same time, we urge the authorities to nurture the growing labor force through the active promotion of the labor market and education reforms to durably reduce unemployment.

Finally, we welcome that banks are now on a stronger footing and that vulnerabilities in the banking sector have receded. Supervision has also strengthened. Going forward, to preserve financial stability and Austria's position as a financial center, we urge the authorities to remain on top of the banks' cost-cutting exercises, to remain vigilant to developments in the real estate market, and to continue to bolster their AML/CFT framework.

With these remarks, we wish the Austrian authorities continued success.

Mr. Spadafora expressed dissatisfaction with the fact that paragraph 10 of the staff report specifically referred to Italy. He remarked that the reference was not warranted and asked the staff to provide the analytical basis for its decision.

Mr. Moreno made the following statement:

We have issued a gray statement, and we agree with the staff appraisal and with Mr. Meyer's gray statement. I will only introduce a few issues on the structural side for emphasis.

The first is the importance of targeted labor market policies. The staff has already identified the relevant groups: immigrants and elderly workers. I wonder if the staff could elaborate on the decision to discontinue the targeted support to elderly workers in the labor market and the participation of women and the gender gap. I also wonder if the staff could elaborate on one of the recommendations provided in the written responses on reducing the length of paid maternity leave, rather than just increasing paternity leave.

Second, I would also stress the importance of fiscal responsibility and accountability at the subnational level. Like Mr. Spadafora, I would inquire if the staff has had conversations with the local and regional authorities and if the staff could elaborate on them.

The staff representative from the European Department (Mr. Dorsey), in response to questions and comments from Executive Directors, made the following statement:[1]

We tried to address most of Directors' questions in the written answers, but there are a few policy-oriented issues that I want to address now. There were questions and observations on the fiscal path, including about what the authorities should do to rebuild their fiscal buffers without risking economic growth. The envisaged fiscal path cuts both revenue and expenditure in roughly equal measures. Therefore, the fiscal impulse over the projection horizon would be very low in either direction. This should not undercut economic growth.

We do not have specifics as to the revenue and expenditure measures underpinning the revenue and expenditure path, given that these are still being worked out. This is a relatively new government. However, lowering the tax wedge on labor would help growth and generate more revenues.

Expenditure efficiency gains could be achieved by rationalizing subsidies, reforming government compensation, and through further reforms in the health sector. All of these are planned by the authorities. However, there is not yet sufficient detail for the staff to be able to present a detailed assessment.

There were some questions and comments on refugee and other immigrant integration, including how integration initiatives suggested by the authorities that depend on increased expenditures be taken forward at a time when social benefit expenditures are being cut. The arrival of refugees has slowed dramatically since 2015 and the initiatives focus on stepping up the integration of existing refugees and processing applications, rather than on addressing the immediate needs of the newly arrived.

Austria's social safety net is ample and poverty and income inequality are low. The envisioned savings on social benefits and the authorities' program will focus mainly on transfers to families abroad and should not affect growth or income distribution in Austria. However, the savings effect is small.

However, barriers to integration can be large for certain groups in terms of the language and other skills. Therefore, programs for German

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

language training of refugees and other immigrants, and the identification and recognition of skills will remain and be partially expanded. The expansion of preschool and late secondary education should promote integration, even though these measures are not specifically targeted to immigrants.

Some Directors take note that the authorities also mention increased environmental risks arising from climate change, with impacts on the tourism industry and agriculture. There are large uncertainties associated with climate change, and different parts of the globe are being affected differently. However, the general pattern of increased temperatures, higher volatility, and larger extremes appears to apply to Austria thus far. Climate change is already affecting the tourism industry, especially ski resorts, although the extent of the change and its pace are difficult to predict. It is expected that the long-term effect will be negative in terms of both shorter seasons and the need to retreat to higher altitudes.

For agriculture, the impact has been positive thus far, with a larger share of land available for cultivation and a longer growing seasons. However, this could change in the future, as temperatures rise even further and precipitation patterns are altered.

Mr. Just made the following statement:

It is great to be back at the Board for an Article IV discussion of Austria after last year's lapse-of-time hiatus. The comments, concerns, and advice in Directors' gray statements and also expressed today suggest that there is still some interest in how a small, advanced Central European economy is charting its policy course through increasingly disruptive waters. I will relay Directors' helpful comments to my authorities in Vienna.

Life in Austria continues to be very good. The hills are alive with the sound of a humming economy. The new government has outlined a comprehensive reform program which, supported by a continuing benign macro environment and a new reform spirit, should increase Austria's resilience and strengthen its policy space, thereby safeguarding our high living standards and the social cohesion. I personally appreciate that the staff has come out strong in support of Austria's welfare state. We often take its existence and the extent of its benefits too much for granted and forget that we are very fortunate, as this is not a global norm. Therefore, I also welcome the message to my authorities to approach certain reforms with care.

I would like to make one general observation. We occasionally discuss the effectiveness of surveillance, traction, and whether the Article IV process is a bit anachronistic, and adds much value. I am of two minds on this. But when my authorities received the concluding statement and the staff's assessment of the fiscal reform plans, it did not go down well with the finance ministry. While we could eventually agree on a compromise, this was still a great surveillance moment. The staff had done their homework. Their fiscal projections, incorporating my authorities' fiscal objectives, made it clear that, without additional specific fiscal measures, we will have a problem. The staff's strong stance, backed by the authorities' analysis, drove back home the message that we need to up our structural fiscal reform game. In the meantime, an expert task force has been convened to develop a coherent and consistent set of fiscal measures, and the minister has announced a comprehensive fiscal legislative reform package for mid-next year.

In the buff statement, I commended the staff for their understanding of the EU's economic governance framework. I was, thus, a bit surprised how our request for a small correction in the draft press release was handled. The euro area has a well-known average primary objective, which is for the euro area as a whole, but does not translate into a 2 percent inflation target for individual euro area members.

I also share the spirit of Mr. Spadafora's point on the appropriateness of singling out other euro area members. The paragraph is factually correct, and it reflects the views of the Governors. It is also in the context of June this year, when the concerns about Italy were fairly high. However, the presentation in the report should be more neutral.

Turning to the labor market, Austria experienced a significant labor supply shock in 2011 when we liberalized labor market access for several Central, Eastern, and Southeastern Europe (CESEE) countries. The unemployment rate skyrocketed until 2015. This dominated the public debate. It resulted in calls by the trade union, the social democrats, but also the far right, to restrict access of foreign workers to Austria's labor market. Leaving aside the EU's freedom of movement, this would have been a blow to our economic relationships with the CESEE region, and it would have been a cost to Austria. Today, it is increasingly clear that we gained significantly from this labor shock. It increased the talent pool, lowered our recruitment costs, and helped moderate wages. The competitiveness of Austrian companies improved, so that we were able to benefit from the economic upswing, which first took place in our neighboring countries, which then spread to Austria. Today we have a significantly larger competitive labor force, but

unemployment is converging again toward pre-crisis levels. This is quite a remarkable achievement.

Regardless of these positive developments, Austria needs to upgrade its overall skills level, as rightly observed by Directors. Skills mismatches and the lack of skills are affecting the high-tech industry but also the services and tourism sectors. How to address the low skills of the young is a pressing and broader societal challenge, as the future prospects not only of young refugees but also of young Austrians—with or without a migration background—could be curtailed. Some incremental steps to reform the education system have been taken. Industry is working together with the authorities on Education 4.0. Most recently, the government agreed on a digitalization of education master plan to revamp teaching methods, develop new sets of skills, and reassess the contents of teaching.

Climate change is a topic dear to my heart. I was positively surprised when my minister pointed out the risks from climate change to staff. I also thank Mr. de Villeroché and Mr. Doornbosch for picking up on this and for their suggestions for possible further Fund engagements. To be clear, in Austria, the damage from climate change is not macro-critical. We also have the necessary resources to invest in adaptation, mitigation, and resilience. But still, there is a role for Fund advice on how to make the economy greener, how to reduce the carbon footprint with specific tax and regulatory changes. There is also increasingly the question of financial risk. I personally would welcome further discussions on how the Fund could add value in those areas.

I will be brief on the financial sector, as we are gearing up for our 2019 Financial Sector Assessment Program (FSAP). The supervisor still remembers vividly how the Fund was instrumental in bringing global attention to the risks from foreign exchange mortgage lending in Austria. This practice has long stopped. The volume of outstanding foreign exchange loans has been significantly reduced. As a legacy, the supervisor is more vigilant on lending practices to households by banks. Earlier this year, the Financial Market Authority (FMA) publicly expressed concerns about the rise in consumer lending, especially to lower-income households, and it is in the process of analyzing lending practices. The FMA has also warned about the risks of variable interest rates, which has led to a market shift to fixed interest rate products. We are also looking at how banks apply prudential standards on mortgage lending in view of the anecdotal evidence of a softening of underwriting standards.

The real estate sector has been a common thread in the gray statements. Mr. Inderbinen rightly observed that Vienna is among the most livable cities in the world. This also translates into an increased demand for our real estate. Still, my authorities see the European Systemic Risk Board (ESRB) warning we received a few years ago as not fully justified; but I believe it was ultimately useful. Macroprudential tools are now part of the supervisory toolkits, and considerable effort is being made to improve the availability, accuracy, comprehensiveness, and comparability of data from the real estate sector. My authorities would still like to use the forthcoming FSAP as an opportunity for the Fund to delve much deeper into Austria's real estate sector. Complementing this would be an assessment of the existing macroprudential framework. Equally, we would like to see the FSAP as an opportunity to assess the progress achieved in bringing Austria's AML/CFT framework close to or in line with best practices, which would be incomplete without looking at the effectiveness of the revised AML/CFT framework.

To conclude, last year's lapse-of-time meeting also deprived me of the opportunity to bid farewell to Mr. Gueorguiev, our previous mission chief. The transition to Mr. Tom Dorsey has been very smooth. Mr. Dorsey's intimate knowledge of the policies of many of our peer countries, where he served as mission chief, and his understanding of the idiosyncrasies of small advanced European economies, will serve us well. Mr. Pitt, who completed his assignment as our senior desk economist, came well prepared by our Australian colleagues on how to probe and challenge conceived wisdom. He has passed the baton to Ms. Karpowicz, who is quite similar to Mr. Pitt in certain Fund ways, but also very different. She brings from her previous assignment on Brazil some fresh thinking, especially how she approaches our rich country problems. I would like to thank the Finance Department for giving Mr. Hukka the opportunity to join this mission. I apologize to Mr. Hukka for not giving him a sufficient heads-up on the peculiarities of our real estate sector. Let me not forget Mr. Yehoue, who moved to the Strategy, Policy, and Review Department after a short stint as our financial sector expert. My appreciation and gratitude to all of them.

The Acting Chair (Mr. Furusawa) noted that Austria is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Austria's robust and broad-based economic growth on the back of sound domestic policies and a favorable external environment. Together with

strong business confidence, this has contributed to job creation and a decline in unemployment. Looking ahead, Directors encouraged the authorities to take advantage of the favorable position to step up structural reforms to raise growth potential through inclusive policies. This will help preserve Austria's important achievements in income equality and social cohesion.

Directors commended the authorities for persevering with fiscal consolidation and maintaining public debt on a downward path. They observed that, while the short-term fiscal outlook is favorable, long-term sustainability will require further structural reforms. With spending pressures likely to rise from population aging, it will be important to specify and prioritize reforms that enhance the sustainability of the pension system and generate cost savings in healthcare and subsidies spending. Adjustments in fiscal relations between federal and subnational governments could be necessary to ensure the success of such reforms. Directors emphasized that the authorities' envisaged fiscal consolidation should aim to remain equitable and growth-friendly.

Directors welcomed the progress in reducing banking system vulnerabilities through improved capitalization and asset quality, as well as a further strengthening of Austrian banks' foreign subsidiaries' funding base. While risks have subsided, Directors recommended remaining vigilant and further increasing banks' capital buffers. They also underlined the need to continue efforts to improve cost efficiency to enhance long-term profitability, in particular of smaller banks.

Directors agreed that real estate related risks to financial stability remain contained at present, but urged the authorities to continue to closely monitor house price developments and variable rate and foreign currency denominated housing loan exposures, in order to identify early any household balance sheet strains. They welcomed the recently established legal basis for targeted real estate specific macroprudential tools. While the use of the new macroprudential instruments does not appear necessary at this time, Directors underscored the need to continue to provide clear guidance to banks to maintain sustainable lending standards. It will also be important to continue to bolster the AML/CFT framework.

Directors welcomed the supply-side measures that the authorities are undertaking. They underlined that raising potential growth and lowering structural unemployment require strengthening competition and implementing proactive policies to enhance education outcomes, address skills mismatches, promote labor participation of women and the elderly, and integrate foreign

nationals into the labor market. Directors noted that structural and fiscal measures could raise labor demand, including by shifting the tax mix away from labor and ensuring an adequate level of public investment.

It is expected that the next Article IV consultation with Austria will be held on the standard 12-month cycle.

APPROVAL: March 3, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook

1. Could you elaborate on the background of the divergence between staff's and authorities' potential growth estimates, and the view on how the Austrian economy boosts the potential growth?

- The difference in potential growth estimates stems largely from different estimates of total factor productivity, and to a smaller extent, on labor input to be expected in the future. Staff's view on TFP growth is a somewhat more cautious, based on recent experience, and on the labor input as well, given that labor force participation has already risen significantly, and further increases will be harder and harder to generate. Austria can boost its potential growth by implementing structural reforms outlined in the 2017 Article IV selected issues IMF Country Report No. 17/27. These include further liberalization of professional services, lowering costs for start-ups, and FDI promotion to increase productivity. Regarding fiscal measures, a shift in the tax and expenditure structure to less distortionary taxes and pro-growth spending on public investment in a budget-neutral manner can boost long-run output and private consumption.

2. Could staff discuss why the investment contribution to GDP is declining and what are their recommendations for attracting new investment beyond the labor market policies described in the report?

- Austria is growing above potential and the contribution of investment was above trend in 2016-18. As growth converges to its medium-term potential investment growth will slow to historical levels and remain constant in percent of GDP. In any case, Austria's investment rate is already relatively high.

Labor Market

3. Could staff share their view to identify the measures to reduce unemployment with only compulsory schooling if any?

- The proposed measures aim at lowering structural unemployment and will take time to bear fruit. Although it is still higher than the level observed before the GFC unemployment has declined recently. We think that as growth will be above potential for the next few years employment growth will outpace the labor force growth and

lower unemployment further. The reform to the education system should aim to improve outcomes and producing higher skills to match the increasing demand from the high-tech sector.

4. We see that the government decided to discontinue targeted support through secondary labor market for over 50-year-old long-term unemployed. In order to minimize the likely adverse effects on this age group, could staff tell which measures are the most effective?

- The employment measures targeted to the elderly population through temporary job creation have increased their employability. As the economy is growing strongly and generating jobs the reason to continues this program has become less compelling.

5. We would also appreciate staff's comments on how the authorities can address the high gender pay gap in Austria.

- Gender pay gap is not a priority on the authorities' reform agenda. However, while the gender pay gap appears large according to some indicators it drops once controlling for professional experience and education. The gap is partly due to the very generous maternity benefits (two years of paid leave) during which women's salaries increase with seniority but not due to performance. Many mothers also chose to work part-time upon return to work which affects their salaries significantly. Moreover, women often work in smaller companies, below their skill levels and in traditionally female occupations (social, administration, retail). Some obvious measures to address the pay gap would thus be reducing the length of paid maternity leave and increasing paternity leave, and increasing the availability of affordable day care, especially in rural areas.

6. We would be interested in having staff's view on the expected impact of the introduction of a family bonus in 2019 and the new regulations for flexible working, in effect since September 1st. We invite staff's assessment on the key aspects of recently adopted laws that are linked to this endeavor and their immediate impact to growth.

- We have no quantitative estimate of the effect of these reforms on growth and labor market participation. The family bonus will strengthen the finances of middle-class families and thereby likely consumption. With regard to more flexible working hours, this can help companies to react more flexibly to changes in demand. Employees may also profit gain from greater flexibility. However, care needs to be taken that this does not lead to a weakening of worker protection. The increase in female labor force participation has been strong in Austria and follows a general trend across European

countries. It is relatively strong in the age group of 50 to 64 years suggesting a catching-up process with other European countries.

Fiscal Policy

7. In the revenue side, do staff imply more progressive measures for high-income earners is imperative to improve equity, as the Stability Program already includes helpful measures for low-income group, including a reduction of unemployment insurance and tax burden for low-income earners?

- Staff implies that any further tax reform aiming at reducing the tax ratio contemplated by authorities and not specified should be mindful of the possible effects on income inequality. Higher taxation of higher incomes would, ceteris paribus, improve equity. However, this can also be achieved by other means.

8. What is being done to address outdated property tax valuations? Moreover, how will the tax burden on corporates be reduced from 2020 onward? Is there any sequencing plan for the reform measures envisaged by the authorities on both the revenue and expenditure sides to meet their fiscal balance objectives?

- Updating property tax values is not one of the government's priorities, however, the tax reform planned for 2020 may include this measure. As there is no proposal in place yet, we do not have details on the planned reduction in corporate taxation or other measures. Higher taxation of wealth, including real estate, as well as of gasoline or carbon dioxide emission, are likely politically difficult. We understand that the authorities are working on a package of reforms that will come into force broadly simultaneously. However, more detailed discussions will likely only begin only after the Austrian presidency of the EU ends in December.

9. Could staff suggest the likely medium-term impact of demographic related spending on deficit and debt on the projections presented by them in the report? Staff elaboration on possible pension reform options would be welcome. Is linking the statutory retirement age to changes in life expectancy under consideration to help improve long-term fiscal sustainability?

- Demography-related spending is already built into the staff's projections. The impact in the earlier years (2022-23) is small; only beyond the projection horizon will the impact be significant. Austria's public expenditure on pensions is among the highest in the OECD. Reforms to the pension system have already been legislated (including an increase in the retirement age for women, and a tightening of eligibility for early retirement). Labor force participation among the elderly has already increased and is likely to rise further in the long term as already legislated reforms gradually take

effect after 2024. However, bringing forward this increase, further tightening early retirement options, and indexing the pension age to life expectancy would generate further and faster savings. Without additional measures, strong pressures arising from an increase in the share of pensioners in the population (and higher healthcare and long-term care costs) would drive up spending by some 3 percentage points of GDP, widen the budget deficit accordingly, and push public debt above 100 percent of GDP by 2060.

10. The authorities are planning a substantial consolidation of expenditures—2.4 percentage points of GDP over five years—although it is unclear how much of the planned adjustment is due to favorable growth projections versus cuts to expenditures. Could staff provide more detail on the assumptions underlying the numerator and denominator in the revenue and expenditure lines in the authorities' plan versus staff projections?

- The main difference is that the authorities' assumptions include the effects of a planned tax reform on both revenue and expenditure, whereas staff's don't (as the measures have not been specified yet, and the package not passed). Furthermore, there are also some small differences in the projections of nominal growth and its impact on revenue and expenditure, as well as in potential growth and hence the output gap, which has repercussions on the structural balance. However, as growth is projected to slow down over the medium term compared to 2017-18, most of the effect will come from cuts in expenditures.

Financial sector

11. Could staff provide further information on the potential risks to the financial sector arising from the high share of variable rate loans?

- The share of variable rate housing loans in Austria is high be international comparison, although their share in new lending has declined to around 50 percent at end-2017, from above 85 percent three years earlier. This implies considerable mortgage holder exposure to interest rates over the medium term that warrants close monitoring alongside bank lending standards and remaining stock of foreign currency loans. However, risks to the financial sector are significantly mitigated by the Austrian banks' comparatively modest real estate exposures and the strong debt-servicing capacity of majority of Austrian mortgage holders.

12. We would appreciate further clarification from the staff on positive effects of the deal with the creditors of HETA, as stated in Annex III, which may bring gross public debt down to 61 percent of GDP by 2023.

- HETA Asset Resolution is a state-owned wind-down company managing a portion of assets from Hypo Alde Adria that was put into resolution in 2014. In 2016, a large majority of HETA creditors representing nearly 99 percent of the claims accepted a debt buyback offer to orderly restructure liabilities that exceed the financial capacity of the debts' guarantors. The removal of the legal uncertainty allowing for the disposition of the assets will partially compensate for the rise in debt incurred by the government as part of the resolution process, reducing projected 2021 debt to GDP ratio by 1.6 percentage points. The repayment flows are included in the staff's DSA.

Miscellaneous

13. On the authorities' response to past policy advice (Annex IV), we missed any reference to the authorities' actions regarding the previous advice to "strengthen competition and further reduce firms' administrative burden". We would especially welcome staff elaboration on the steps taken by the authorities to reduce regulatory barriers in Austria's business service sector, given its importance to the economy.

- To our knowledge there was no major progress in this area. However, Austria ranks above the OECD high income country average and just behind Germany in the Doing Business composite indicator with a relatively weaker score on time needed to start a business.