Rabobank

Country report **AUSTRIA**

Summary

The pace of Austria's export-led economic recovery is likely to slow down in the coming quarters thanks, in part, to the challenging external environment. The risks to this outlook are considered to be broadly balanced. The difficulties that the government could face from an outright crisis in the CEE countries have abated. That said, Austrian banks' capitalisation levels are lower than their peers and their business models continue to exhibit higher risks. With large cross-border exposures (especially to the CEE region), banks need to urgently build up high quality capital to bolster confidence and improve future loss absorption capacity. Failing to do so will be credit negative.

Things to watch:

- Medium-term fiscal consolidation measures
- The recapitalisation effort of banks
- Economic development in the CEE countries

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Austria

National facts	
Type of government	Federal republic
Capital	Vienna
Surface area (thousand sq km)	84
Population (millions)	8.4
Main languages	German (88.6%)
	Turkish (2.3%)
Main religions	Roman Catholic (73.6%)
	Protestant (4.7%)
	Muslim (4.2%)
Head of State (president)	Heinz Fischer
Head of Government (PM)	Werner Faymann
Monetary unit	Euro (EUR)

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	419	0.61
Nominal GDP at PPP	352	0.45
Export value of goods and services	243	1.11
IMF quotum (in mln SDR)	2114	0.97
Economic structure	*2011*	*5-year av.*
Real GDP growth	3.1	1.5
Agriculture (% of GDP)	2	2
Industry (% of GDP)	30	30
Services (% of GDP)	69	69
Standards of living	*USD*	*% world av.*
Nominal GDP per head	49640	460
Nominal GDP per head at PPP	41615	337
Real GDP per head	39991	492

Social and governance indicators	rank / total
Human Development Index (rank)	19 / 187
Ease of Doing Business Index (rank)	32 / 183
Index of Economic Freedom (rank)	28 / 179
Corruption Perceptions Index (rank)	16 / 183
Press Freedom Index (rank)	5 / 178
Gini index (income distribution)	29.15
Population below $1.25 per day (PPP)	n.a

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Germany	33	Germany	46
Italy	8	Switzerland	7
Switzerland	5	Italy	6
US	4	Netherlands	4
Main export products (%)			
Machinery and transport equipment			39
Chemicals and related products, n.e.s.			13
Food, drinks and tobacco			7
Mineral fuels, lubricants, and related materi			4
Main import products (%)			
Machinery and transport equipment			35
Chemicals and related products, n.e.s.			13
Mineral fuels, lubricants, and related materi			11
Food, drinks and tobacco			7
Openness of the economy			
Export value of G&S (% of GDP)			58
Import value of G&S (% of GDP)			53
Inward FDI (% of GDP)			1.9

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economy

The pace of Austria's export-led economic recovery held up remarkably well in 2011 amid growth in world trade. Over the year as a whole, GDP grew by a healthy 3.1% y-o-y, even higher than Germany (3%). To be sure, GDP growth started slowing down in 11H2 in line with decelerating world trade growth. The economy actually posted a minor contraction (-0.1% q-o-q) in the fourth quarter. Going forward, economic activity is set to remain weak as households and corporations seem to be adopting an attitude of retrenchment with regard to consumption and investment outlays. Moreover, fiscal policy will also turn contractionary as the public sector repairs its balance sheet. Finally, weaker external environment is likely to weigh on exports, which has been the key driving force of the recovery. To this end, we expect GDP growth to be around 1% both this year and next. A material improvement in labor market dynamics can pose an upside risk to this relatively downbeat forecast given that households' healthy balance sheets will allow them to spend more. Another upside risk stems from the external side, especially if domestic demand in neighboring Germany proves resilient.

Of course, there are some notable downside risks that should not be ignored. Credit conditions may tighten more than currently envisaged as Austrian banks focus on raising capital buffers and reducing risk-weighted assets. Even more important is the evolution of the eurozone crisis. So far ECB's aggressive liquidity provision has eased financial conditions in eurozone. But we cannot be certain that the worst is definitely behind us. Any escalation of the crisis can potentially knock the Austrian recovery off track.

Austria's public finances have deteriorated much like the rest of the advanced economies. The public debt-to-GDP ratio is expected to stabilise around 74%, according to the IMF. Going forward, public finances will be under pressure owing to population aging and rising health care costs. To this end, the government is taking measures to cut the deficit back to below 3% by 2013 (in compliance with the EU excessive deficit procedure) and further to around 2% in the medium term. On a less positive note, the current multiyear consolidation plan will lead to a lower deficit, but it is not enough to put the debt firmly on a downward trajectory in the medium-term. With a strong economy, low unemployment, supportive monetary policy and relatively low government bond yields, there is sufficient macroeconomic space to tighten fiscal policy further. It goes without saying that lower fiscal risks will lead to more favorable credit ratings, which will in turn maintain favorable debt dynamics (i.e. interest rate-growth differential) as investors take more comfort in purchasing the country's sovereign debt. All things considered, Austria's sound fiscal track record gives us comfort that the authorities will take the necessary measures to retain debt sustainability.

Banking Sector

The biggest worry of investors concerning Austria stems from the large contingent liabilities to which the Austrian sovereign is exposed, given the massive exposure of the banking sector to the Central and Eastern European (CEE) countries. According to the Bank for International Settlements (BIS), Austria's banks exposure to CEE region remains elevated at USD 261bn, or 61% of GDP, as of September 2011. We should note that NPL ratios are high in CEE subsidiaries, but there are notable regional differences. In specific, the substantial exposure to Hungary (8.4% of Austria's GDP), which has a volatile economy in combination with an unorthodox and unsustainable policy mix, remains a big concern.

The good news is that banks' success to date in managing their CEE balance sheets and increasing their capital buffers has reduced the risks of a renewed banking crisis. The banking system's tier-1 capital ratio increased to almost 10.3% in 11Q2, up 300bps from the low reached in 08Q3. The OeNB (Austria's central bank) conducted a stress test in the spring of 2011 and concluded that in an adverse scenario more severe than that envisaged by the 2011 EBA stress test, the core tier-1 capital ratio declines to a still comfortable 8.5% in the aggregate at the end of the 2-year projection horizon.

That said, a few banks have weaker capital positions and strong dependence on wholesale and market funding than others. Moreover, an international comparison of tier-1 capital ratios shows that the major Austrian banks are less adequately capitalized than their international peers which also have sizable CEE exposure, according to the latest Financial Stability Report of the OeNB. Against this backdrop, the OeNB and the IMF have advised banks to strengthen their capital base and increase both the quantity and quality of their capital. Reducing risk-weighted assets in the CEE region at a very quick pace is unwarranted as it may create a negative feedback loop through the impact on the economies whereby the quality of existing assets will deteriorate.

Austria

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	3.7	1.2	-3.6	2.4	3.1	0.2	0.6
Consumer prices (average % change pa)	2.2	3.2	0.4	1.7	3.5	2.1	1.9
Current account balance (% of GDP)	3.5	4.9	2.7	3.0	4.2	2.4	3.1
Economic growth							
GDP (% real change pa)	3.7	1.2	-3.6	2.4	3.1	0.2	0.6
Gross fixed investment (% real change pa)	3.1	0.0	-7.5	-0.2	4.5	0.9	1.1
Private consumption (real % change pa)	0.8	0.7	0.2	1.7	1.1	0.9	1.0
Government consumption (% real change pa)	2.6	4.0	0.6	0.2	2.2	0.8	0.9
Exports of G&S (% real change pa)	8.7	1.1	-13.7	8.3	6.3	1.7	2.9
Imports of G&S (% real change pa)	7.0	-0.9	-12.5	7.4	6.6	1.8	3.5
Economic policy							
Budget balance (% of GDP)	-1.0	-1.0	-4.2	-4.4	-3.4	-3.1	-2.6
Public debt (% of GDP)	66	62	69	72	74	76	76
Money market interest rate (%)	4.3	4.6	1.2	0.8	1.4	1.0	0.8
M2 growth (% change pa)	11	7	2	1	6	-1	2
Consumer prices (average % change pa)	2.2	3.2	0.4	1.7	3.5	2.1	1.9
Exchange rate LCU to USD (average)	3.7	3.7	3.7	3.7	3.7	n.a.	n.a.
Recorded unemployment (%)	4.4	3.8	4.8	4.4	4.1	4.6	4.5
Balance of payments (mln USD)							
Current account balance	13190	20128	10291	11461	17600	9300	11800
Trade balance	1811	-592	-3413	-4283	900	-700	-500
Export value of goods	162900	179201	135099	147711	183500	176100	185000
Import value of goods	161090	179790	138510	151990	182600	176800	185500
Services balance	15179	20834	17461	17666	18400	14200	14100
Income balance	-2197	2387	-1589	736	1100	-1500	800
Transfer balance	-1599	-2498	-2169	-2658	-2900	-2700	-2600
Net direct investment flows	-7611	-22935	-384	-5258	-1075	-2050	-1200
External position (mln USD)							
International investment position	-73410	-66570	-34430	-40120	n.a.	n.a.	n.a.
Total assets	1089040	1044770	1103480	1041080	n.a.	n.a.	n.a.
Total liabilities	1162450	1111340	1137910	1081200	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	0.5	-0.1	-0.9	-1.1	0.2	-0.2	-0.1
Current account balance (% of GDP)	3.5	4.9	2.7	3.0	4.2	2.4	3.1
Inward FDI (% of GDP)	17.0	1.6	3.0	-6.7	1.9	0.4	1.0
International investment position (% of GDP)	-19.6	-16.1	-9.0	-10.5	n.a.	n.a.	n.a.

Source: EIU