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Discussion on „budget gap“ in Austria

Much ado about nothing

November 2013

Summary

- Over the past few days, media attention has been focusing on the need for medium-term consolidation of Austria's national budget. We think that the intensive discussion on the size of the "budget gap" has not been helpful and has caused considerable uncertainty also among international investors.
- The amounts mentioned in the discussion – ranging from EUR 18.4 billion (according to the government) to EUR 40 billion or more – reflect new budgeting rules and are to be seen as cumulative figures over the entire term of the federal government's financial framework, which covers the period from 2014 to and including 2018.
- In our opinion, the current structural budget deficit of 1.8 per cent of GDP should be used as a base for determining the actual consolidation requirement. This deficit – less than EUR 6 billion (based on GDP for 2013, which is expected to be close to EUR 315 billion) – needs to be covered by 2017, the year in which the "debt brake" will become effective. Keeping the deficit to 0.45 per cent of GDP, the minimum requirement under the debt brake, would give an amount of only about EUR 4 billion.
- The current budget situation does not differ significantly from what is envisaged for 2013 in the budget plan of the consolidation package which was prepared in February 2012 (see our analysis "The reform package of 2012 – belt-tightening in Austria"). The intermediate target for the structural budget deficit was 1.9 per cent of GDP for 2013. Since 2011, the structural budget deficit has been reduced by about ½ per cent of GDP. But as we pointed out already in the past year, concrete measures to further reduce the deficit are yet to be defined or involve significant uncertainty (e.g. the financial transaction tax). Basically, the current discussion is not about filling new gaps – the point is to make concrete proposals for the second part of the package put together in the past year.
- We think that Austria's general government budget deficit, and especially the part of it which reflects economic trends, is not in need of any significant correction. On the basis of data available so far, we assume that the budget deficit in 2013, officially planned to reach 2.3 per cent of GDP, will not be exceeded. We expect that public debt will reach a level of 74.9 per cent of GDP by the end of 2013. If there is no deviation from the planned budget path, public debt will then decline to about 70 per cent of GDP by the end of 2016. However, this figure does not include any potential impact from the resolution of Hypo Group Alpe Adria (HGAA) and other banks.
- In this context we think that a bad-bank (SPV) solution will be found which will not fully impact the budget deficit. Nevertheless, this could lead to an increase in total public debt. If the total amount of EUR 5.8 billion to support banks must be included in the calculation, public debt would rise to a level of more than 75 per cent of GDP.
- Overall, the consolidation requirement of EUR 18.4 billion (cumulative) which has now been announced by the government for the period to 2018 (plus EUR 5.8 billion to support banks) seems plausible. We take the view that this amount is at the lower end of the range of possible scenarios. The government now needs to present a credible and transparent plan to reduce the structural deficit to nil while at the same time resolving HGAA. Then these figures will probably not give investors any reason to see Austria's credit standing in a less favourable light than before the parliamentary election.

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The current discussion on the size of the "budget gap" in Austria

Austria budget figures have a high degree of creditability, a fact which has repeatedly been confirmed by various rating agencies.

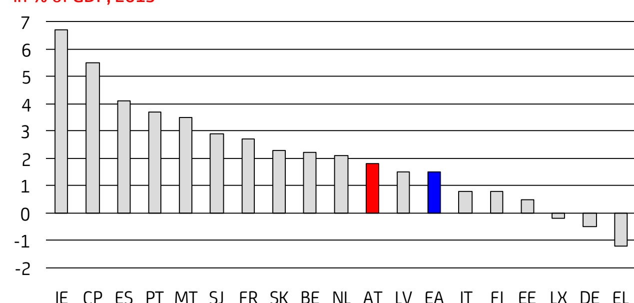
We also think that the consolidation package announced in February 2012, and the "debt brake" presented in the period since then, are based on reliable data. With the consolidation path described in these plans (see the Bank Austria analysis entitled "The reform package of 2012 – belt-tightening in Austria"), the Austrian government aims to significantly reduce the structural budget deficit, i.e. that part of the deficit which is not dependent on economic trends, to 0.6 per cent of GDP in 2016. The debt brake introduced by law will become effective in 2017: while providing for a balanced structural budget, it permits a maximum deficit of 0.45 per cent of GDP (Republic of Austria up to 0.35 per cent of GDP, regional governments up to 0.10 per cent of GDP).

Based on an expected structural deficit of 3.1 per cent of GDP in 2011, the consolidation package adopted in early 2012 included measures totalling about 2.5 per cent of GDP. Only about one-third of the total amount, in our view, related to measures set out in specific terms and easy to implement at that time. Two-thirds of the measures were yet to be defined in concrete terms or their implementation was based on uncertain assumptions. As part of the multi-year plan, the government aimed to reduce the structural budget deficit to 1.9 per cent of GDP by the end of 2013. In its recent presentation, the Ministry of Finance assumes that the structural budget deficit for Austria will be 1.8 per cent of GDP, a figure that is slightly lower than the intermediate target. Over the past two years, the structural budget deficit has been reduced by about ½ per cent of GDP; all of the reduction was achieved in 2012.

AUSTRIA'S STRUCTURAL DEFICIT JUST OVER EURO AREA'S AVERAGE

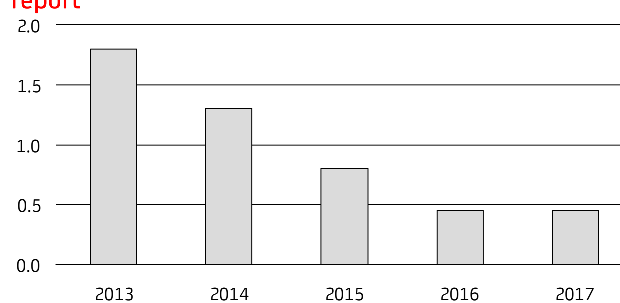
Structural budget deficit in Euro area

in % of GDP, 2013



Source: EU Commission, Ministry of Finance, Bank Austria Economics & Market Analysis Austria

Structural budget deficit acc. to budget strategy report



Source: EU Commission, Ministry of Finance, Bank Austria Economics & Market Analysis Austria

Basically, the structural budget deficit of 1.8 per cent of GDP assumed by the Ministry of Finance also represents the consolidation requirement for reaching a balanced structural budget by 2017. In absolute terms, with nominal GDP estimated to be close to EUR 315 billion in 2013, the structural budget deficit is lower than EUR 6 billion. Projecting this amount for the period to the budget for 2018 gives a total of about EUR 24 billion (or up to EUR 30 billion if 2018 is included). The difference compared with the officially announced budget gap of EUR 18.4 billion results from the fact that the objective stated by the government is compliance with the "debt brake", which permits a maximum structural deficit of 0.45 per cent of GDP. On this basis, the consolidation requirement is just under 1.4 per cent of GDP or about EUR 3.8 billion. This figure, projected for the period to and including 2018, gives the total amount indicated by the government.

If Austria keeps to the budget path specified in the consolidation package of 2012, various measures still need to be taken to cut costs, including almost EUR 1 billion in the pension system (raising the effective retirement age), about EUR 0.6 billion in the health service and some EUR 0.5 billion in financial assistance schemes, i.e. a total of EUR 2 billion annually. In addition, measures totalling almost EUR 2.5 billion which were mentioned in the consolidation package of 2012 need to be defined in concrete terms. Overall, these measures will reduce public expenditure by more than EUR 4 billion. Measures on the revenue side include EUR 0.5 billion planned to come from a European financial transaction tax starting in 2014; the introduction of such a tax will, however, take place at a later date. Other measures have already been adopted, with revenue totalling more than EUR 1 billion; but some of them, such as the real estate income tax, will produce tangible results with some delay. The consolidation package of 2012 thus provides for expenditure cuts of over EUR 4 billion and additional revenue of over EUR 1 billion; the total of at least EUR 5 billion to EUR 6 billion is more or less equal to the amount required to fully cover the current structural budget deficit. However, not all of the measures may be regarded as certain (e.g. the financial transaction tax) and the effect and extent of some measures (e.g. in the pension system) are uncertain.

We took a critical view of these factors last year (see the Bank Austria analysis entitled “The reform package of 2012 – it´s time to “save” in Austria”). At any rate, the Austrian budget gap is not wider than was previously known. But the measures needed to close have not yet been defined in really concrete terms and/or they involve some degree of uncertainty. So, now is the time to think about more concrete, and possibly alternative, measures. There is no scope for tax reductions or additional expenditure, and this was clear even before the parliamentary elections in September 2013.

We think that there is hardly any need for ad-hoc correction of the general government budget deficit – especially with regard to the part which reflects economic trends; in addition to economic developments, the overall deficit is also influenced by ad-hoc events, including costs associated with the resolution of Hypo Alpe Adria in particular. Available data concerning revenue trends suggest that the budget deficit for 2013, officially planned to reach 2.3 per cent of GDP, will be met. The assumptions for growth and the GDP deflator for 2014 and subsequent years hardly differ from our estimates. We think that the official budget path is credible in this respect.

We expect that public debt will be 74.9 per cent of GDP at the end of 2013. If there is no deviation from the planned budget path, public debt will decline to about 70 per cent of GDP by year-end 2016.

These figures do not yet include any potential impacts from the resolution of HGAA. Financial assistance provided to HGAA up to the end of 2012 totalled EUR 3.1 billion. According to information released by the Ministry of Finance, the bank will need additional capital of between EUR 2.6 billion (base scenario) and EUR 5.4 billion in the period from 2013 to 2017. In September, HGAA received EUR 0.7 billion to close the equity capital gap resulting from the first six months; this capital injection was included in the budget. An additional EUR 1.2 billion to EUR 2.3 billion could become necessary for the capitalisation of HGAA in the current year.

Effects of HGAA

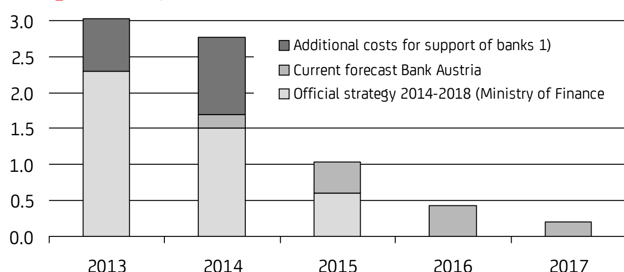
No details on the HGAA solution are available at this time, so all our calculations should be taken with a pinch of salt. At the best of our knowledge we assume a further EUR 2.3 billion in 2013, increasing the deficit 2013 to EUR 9.5 billion or 3 per cent of GDP. In 2014 we assume a further EUR 3.5 billion for the deficit leading to a budget deficit of 2.8 per cent of GDP (instead of 1.7 per cent of GDP without support of banks).

We further assume that the government will make a decision on the structure of a bad bank (SPV) with assets of about EUR 18 billion in this December, with no further effects on the debt level. So in total the higher deficit in 2013 and 2014 (in total EUR 5.8 billion) will lead to total public debt of more than 76 per cent of GDP in 2014 (instead of 74.4 per cent without HGAA) and Austria´s debt will fall to 69.4 per cent in 2017 (instead of 67.8 per cent without HGAA).

BUDGET- AND DEBT SCENARIOS FOR AUSTRIA UNTIL 2017

Budget deficit

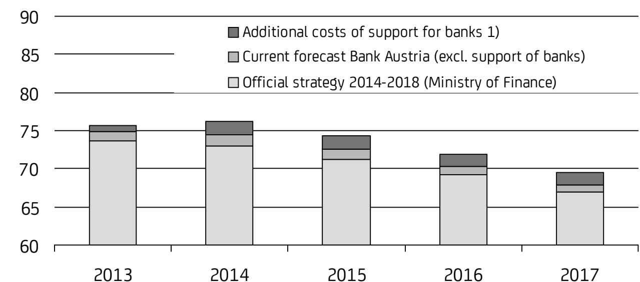
total government, in % of GDP



Source: Ministry of Finance, Bank Austria Economics & Market Research Austria
1) Assuming that EUR 2.3bn in 2013 and EUR 3.5bn in 2014 (total EUR 5.8bn for support of banks) will fully impact the budget

Total public debt

in % of GDP



Source: Ministry of Finance, Bank Austria Economic Research & Market Analysis Austria
1) Assuming that EUR 2.3bn in 2013 and EUR 3.5bn in 2014 (total EUR 5.8bn for support of banks) will fully impact the debt level. Without possilble consequences of ESA changes.

Another factor of uncertainty in assessing the public debt is the forthcoming reform of the European System of National and Regional Accounts (ESA); pursuant to the new rules, additional liabilities which are currently not reflected in the public debt – e.g. those of Austria’s Federal Real Estate Agency (Bundesimmobiliengesellschaft – BIG), ASFINAG (the company responsible for planning and financing motorways and trunk roads in Austria) and ÖBB (the Austrian National Railways) – will have to be included in the national debt. The ESA reform alone could add about 5 percentage points of GDP to Austria’s public debt.

In a worst-case scenario, if the total amount of EUR 18 billion in impaired assets of HGAA must be included in the calculation (excluding EUR 5.8 billion, which we already included in our deficit assumption), public debt would rise to a level of 80 per cent of GDP in 2014; this figure compares with just under 75 per cent of GDP without any impact from the resolution of HGAA. In this case – which we do not expect to materialise – Austria’s public debt would only decline to a level of 75 per cent of GDP by 2016.

The consolidation requirement of EUR 18.44 billion which has now been announced by the government for the public sector budget for the period to 2018 (plus EUR 5.8 billion to support banks) seems plausible. We take the view that this amount is at the lower end of the range of possible scenarios. With declining potential growth and specific demographic trends, the structural budget deficit would reach a higher level than has been assumed so far. While the total consolidation volume referred to by the government appears to be enormous, it should be noted that this reflects new budgeting rules and is to be seen as a cumulative figure over the entire term of the Austrian government’s financial framework. The actual amount required for the consolidation efforts to reach a balanced structural budget by 2017 is less than EUR 6 billion, which is more or less equal to the amount of the structural budget deficit of 1.8 per cent of GDP in 2013. This means that the average annual volume of additional adjustments in the consolidation process is about EUR 1.5 billion or 0.5 per cent of GDP in 2013, a moderate amount when compared with adjustments required in other countries of the European Union.

As soon as the government presents credible plans for reducing the structural deficit and for a transparent resolution of HGAA, these figures will probably not give investors any reason to see Austria’s credit standing in a less favourable light than before the parliamentary election. But the discussion in the past few weeks has caused uncertainty, which has slightly increased risks and restricted the government’s room for manoeuvre. This is now putting stronger pressure on the new government to deliver a clear plan.

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