

Xplicit Austria

**” Has Austria taken
on too much? “**

April
2009

Author: Stefan Bruckbauer
Imprint
Published by UniCredit Bank Austria AG
Economics & Market Analysis
Hohenstaufengasse 6
1010 Vienna
Telephone +43 (0)50505-41951
Fax +43 (0)50505-41050
E-Mail: economic.research@unicreditgroup.at
20 April 2009

Has Austria taken on too much?

Austria is currently being criticised for its proximity to Eastern Europe and its commitments in CEE, which were previously celebrated as a success. The criticism sometimes creates the impression that it is Austria's banks and their commitment in Central and Eastern Europe rather than the US mortgage market and asset securitisation which are at the heart of the financial market crisis.

Unfortunately, this not only damages Austria's self-esteem but increasingly also leads to real economic problems. For example, the CDS rate¹ for Austria rose from a modest 10 basis points at the end of summer 2008 to a peak level of 273 basis points at the beginning of March 2009. While nearly all credit spreads increased, the increase for Austria was particularly high. The gap to Germany widened to 182 basis points from a level of zero six months ago. Although the difference has meanwhile narrowed to just under 100 basis points and CDS rates generally tend to be exaggerated, the interest rates payable by Austria are well above those of other countries with an AAA rating. Interest rates for Austrian government bonds with a maturity of 10 years are today much lower than in summer 2008 as a result of the general decline in interest rates, but the gap to Germany has widened to over 100 basis points (and peaked at 134 points).

Amongst the AAA rated countries in the eurozone, Austria is currently paying the highest interest rate after Ireland; higher than that paid by Finland, France and the Netherlands, and much higher than the interest rate paid by Germany. The interest rate for Austria is even higher than that for Belgium and Spain, which have an AA+ rating, and almost as high as that for Portugal and Italy, both rated A+, which (according to S&P) is four rating categories below Austria.

Eastern European risk, bank support measures and the country's small size

The higher risk spread for Austria is of course also a result of the "flight" to "safe" investments, which are primarily considered to be government bonds of large countries such as the US or Germany. But this only explains part of the rise; the Eastern European risk would also appear to be responsible for the increase. Is this justified?

Austria is without doubt the no. 1 country in Central and Eastern Europe amongst the "old" EU member states, at least in terms of the CEE's relative significance for Austria. We have frequently drawn attention to Austria's achievements in CEE. Austria's banks are the leading financial institutions in CEE and the region now accounts for 25 % of our exports. Central and Eastern Europe has consequently made an important contribution to Austria's current

account surplus, it has permanently increased our income by about 6%, and it has created over 100,000 jobs. Was the cost too high?

About 25 % of the CEE's foreign obligations constitute claims by Austria's banks² against western banks, i.e. about € 300 bn of a total € 1,200 bn. In terms of GDP, both absolute and in per cent, Austria therefore accounts for the highest proportion of claims. However, the CEE's total foreign obligations of € 1,200 bn also include all local obligations of the banking subsidiaries in the region. About 60 % of the € 1,200 bn are local claims, in Austria's case the figure probably even exceeds 60 %. In other words, Austria's direct claims against CEE amount to up to € 120 bn, while the remaining amount of about € 180 bn represents loans extended by banking subsidiaries in CEE to their customers. The figure compares with customer deposits of no less than € 130 bn. This puts the volume into a very different perspective. About 70 % of the claims of Austrian banks against CEE are moreover against countries which are already EU member states, first and foremost the Czech Republic.

Even if the € 1,200 bn representing obligations of the CEE countries to western banks (39 % of the CEE's GDP) is a large amount, this accounts for only 5 % of the claims of all western banks against other countries, which total € 24,000 bn. Claims against Ireland alone currently amount to € 745 bn or 366 % of Ireland's GDP, much higher than the 39 % for CEE. Claims against Spain total about € 850 bn, those against the UK almost € 3,000 bn, and claims against the US amount to € 4,700 bn

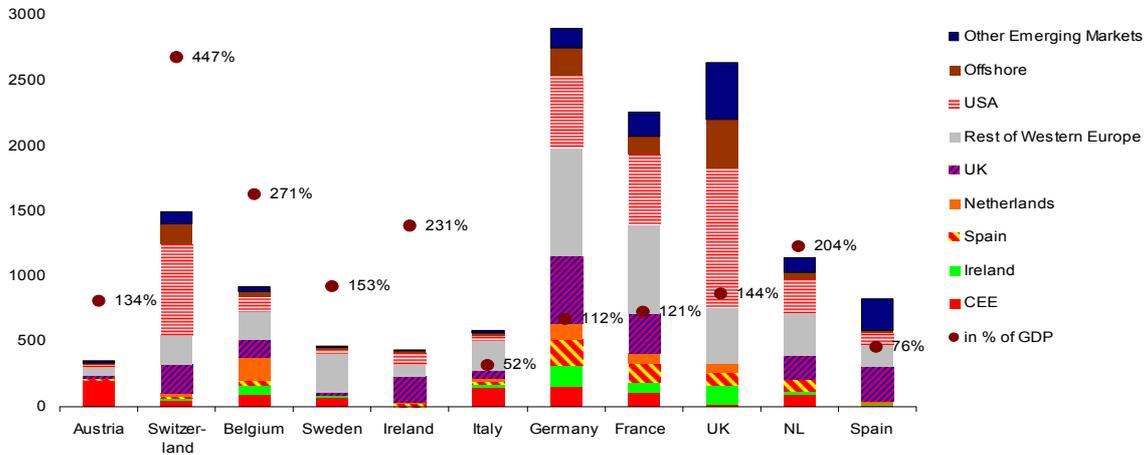
Claims against CEE are therefore not the only foreign claims held by western banks. Even if it is often said that no country has as many claims against CEE as Austria, the foreign claims of Austria's banks amount to no more than 134 % of GDP (of which CEE accounts for one half); the claims of banks in other countries account for a much higher percentage. Switzerland's claims amount to 447 % of GDP, in Belgium 263 %, in Sweden 153 %. The figure is also very high in the case of large countries: in Germany 112 %, France 121 %, the Netherlands 202 %.

The large volume of foreign claims held by many countries is partly the downside of the high current account surpluses achieved by these countries in the past. Conversely, the debtor countries are mostly those which have had current account deficits. Austria has translated a high proportion of its surpluses into loans to CEE. Many other countries such as Switzerland, Germany, or even France and the Netherlands have claims especially against the UK, the US, Spain or Ireland. The claims of German banks against

¹ Credit default swaps indicate the cost to protect against a specific risk.

² Including Austrian banks that are majority foreign owned, which are assigned to the owner country in the statistics.

Foreign claims of western banks located in ...
(by creditor country, € bn, Sept. 2008)



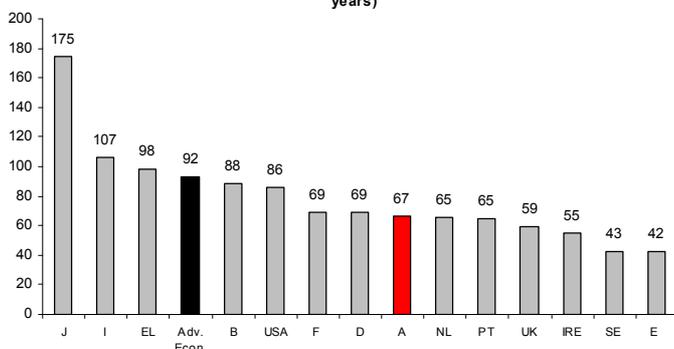
Source BIS: Direct claims and claims of own banking subsidiaries, Bank Austria Economics and Market Analysis

Ireland and Spain are in each case higher than those against CEE. Austria's banks have very few claims against Ireland, Spain, the UK or the US. It is questionable whether the financial sector in Germany, Switzerland or the Netherlands is more stable than that of Austria simply because the absolute amount of claims against CEE is smaller, while the absolute amount of claims and especially the amount of claims as a percentage of GDP against countries which are already severely affected by the credit crisis (primarily the US, Ireland, Spain), is much higher. An analysis of the risk position of the banks in individual countries would help to put into better perspective the ratios which are currently being interpreted disadvantageously for Austria.

Austria adopts substantial bank support measures which are transparent, and stability not jeopardised in case of risk

The risk in CEE of course remains high even if it is relativised by an evaluation of the overall situation. But Austria's bank support measures appear to be very sensible also in the face of the very uncertain global economic situation. Here too, however, a fragmented consideration of the issue could give the wrong impression. The bank support measures amount to about 35 % of GDP, of which about 5 % is for strengthening equity capital (only the latter prompts an increase of gross government debt until the funds are repaid by the banks). In an estimate in which the IMF examined all announced bank programmes and computed how they could lead to a medium-term increase of government debt for a very pessimistic risk scenario (the increase does not include income from interest payments or repayments; the actual costs are therefore likely to be lower, also in case of risk), the figure for Austria was about 7.4 % of GDP. This corresponds to the average for all western nations, even if this may be higher than the percentage for Germany. The funds made available to banks in Germany could still increase, however. But Austria's government debt would rise to only 67 % of GDP even under these pessimistic and for Austria overly negative assumptions, a level which is today still below the figure (without bank support measures) for Germany or the eurozone average. In a comparison of Austria's 67 % with other countries including the possible costs of the bank support measures, Austria's government debt would remain well below the average for western nations (92 %), and below the percentage for Germany, France and the US, all countries with an AAA rating. Austria would therefore rank among the most stable countries also in a pessimistic scenario; the markets' negative appraisal therefore seems to be exaggerated.

Government debt in % of GDP
(2008, incl. theoretical fiscal costs for bank supporting programmes for 5 years)



Sources: EU Commission, IMF, Bank Austria Economics & Market Analysis

We invite you to visit the economic analyses on Bank Austria's website: www.bankaustria.at under "Analyses & Research" in the section "Economic Research" or directly at <http://economicresearch-e.bankaustria.at>.

If you would like to receive information on our most recent publications by e-mail, please subscribe to the newsletter Bank Austria EconomicNews on the website.

If you have further questions, please send us an e-mail to economic.research@unicreditgroup.at

Disclaimer of liability

The opinions of the authors do not necessarily reflect those of Bank Austria and those of the companies which have engaged the services of the authors. The information contained in this publication is not to be interpreted as an offer or invitation for the sale or purchase of securities of any kind. We reserve the right to modify the views expressed in this publication at any time without prior notification.