PUBLIC FINANCE REPORT 2023-2028 FOR AUSTRIA (DECEMBER 2024): EXECUTIVE SUMMARY AND MAIN RESULTS FROM THE FISCAL ADVISORY COUNCIL

EXECUTIVE SUMMARY

- The Fiscal Advisory Council forecasts high budget deficits and a steep increase in the debt ratio over the entire forecast horizon. The positive budget effects of the past few years' high inflation are giving way to its negative fallout from 2024 on: expenditure is rising sharply, while revenue growth is losing momentum. In addition, costly stimulus and support measures launched in the past and the bad economic situation are weighing on public finances. The 2024 and 2025 budget deficits will rise to 3.9% and 4.1% of GDP, respectively. Over the medium term, crisis support, economic stimulus and climate measures will continue to expire, while expenditure under the new fiscal sharing regime between central government and the provinces will increase. By 2028, these factors, in combination with an economic recovery, will result in a slight decline in the budget deficit, to 3.5% of GDP.

- High primary deficits will lead to a significant increase in gross debt. This effect will be reinforced by a rise in interest expenditure, whose impact will remain limited, however. Unlike in previous years, nominal GDP growth will not suffice to avoid an increase in the debt ratio, which will be climbing continuously to reach 85.0% in 2028, a level 14.0 percentage points above the pre-crisis ratio recorded in 2019.

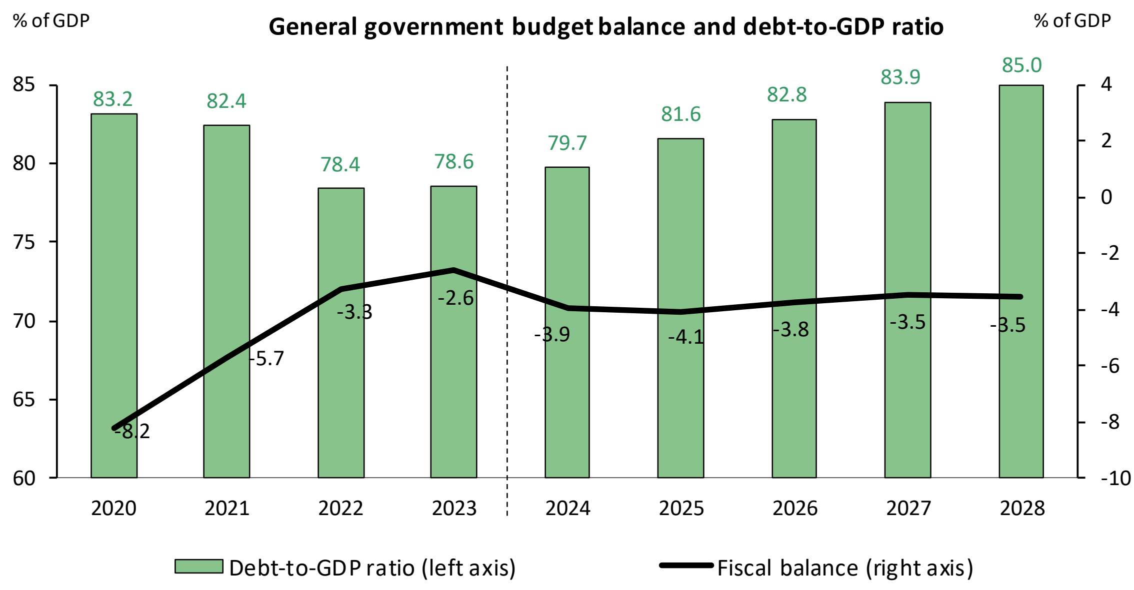
- Slow economic activity alone would account for budget deficits in the order of 0.8% and 0.6% in 2024 and 2025, respectively. Hence, the largest part of the budget deficit cannot be attributed to current economic conditions. The structural deficit will amount to 3.1% and 3.5% in 2024 and 2025, respectively, and will remain at a high level also in the medium term. The high structural deficits, which will be clearly exceeding pre-crisis levels, are mostly the result of economic policy measures, whose budgetary impact will be EUR 12.2 billion higher in 2028 than it was in 2019. Moreover, demographic change leads to a sharp increase in expenditure related to health care, long-term care and pensions. Finally, we are now beginning to see the full negative budgetary effects of the high-inflation period (Holler and Reiss, 2023).

- Significant hikes in pensions and public-sector salaries will drive up government expenditure sharply in 2024 and 2025. This is primarily due to the lagged budgetary impact of the high-inflation period. From 2026 on, expenditure growth will decelerate on account of the decreasing reference inflation rate used for the indexation of social benefits, pension payments and public-sector salaries.

- If Austria wants to avoid being put under an excessive deficit procedure (EDP), it must not exceed the deficit threshold of 3% of GDP. This means that, in a first step, Austria must report to the European Commission, by mid-January 2025, credible corrective measures worth EUR 6.3 billion for 2025. This amount of corrective action needed is based on the European Commission's deficit forecast of 3.7% of GDP for 2025 and a fiscal multiplier of 0.75 for macroeconomic feedback effects. Should the European Commission arrive at a more pessimistic assessment of the 2025 deficit in its next forecasts, the measures needed to avoid an EDP would be correspondingly more costly.

- Austria will have to take substantial corrective action to comply with the EU fiscal rules, according to the Fiscal Advisory Council's forecast. Our calculations show that if the European Commission opens an EDP, Austria will have to consolidate its budget by EUR 3.1 billion in 2025; by 2028, this amount will grow to EUR 8.9 billion (compared to 2024). In the absence of an EDP, the debt sustainability safeguard will be the most relevant criterion. In this scenario, the corrective measures needed would increase to EUR 15.8 billion in 2028 (compared to 2024). To qualify for this regime, i.e. to cut the deficit to below 3% of GDP, Austria would have to achieve budget savings worth EUR 7.4 billion already in 2025. This amount is derived from the 2025 deficit as forecast by the Fiscal Advisory Council (4.1% of GDP) and takes into account macroeconomic feedback effects (fiscal multiplier of 0.4).

- An extension of the fiscal adjustment period to seven years would reduce both the annual and the total amount of corrective action needed. However, this would require additional investment and reforms that cause additional costs until fully implemented, and these costs also need to be taken into account.



Source: Statistics Austria, FISK autumn forecasst 2024.

Decision-making: Fiscal Advisory Council, December 6, 2024.

MAIN RESULTS

Austria's public finances have been characterized by strong fiscal expansion and high budget deficits, with the latter having been lower for a brief period because of the positive budgetary short-term impact of high inflation. Government finances have deteriorated markedly as a result of exceptional pension hikes and changes in the pension law as well as a large number of climate-, environment- and tax-related measures in combination with crisis support measures and the revenue-reducing effects of tax reforms. The fact that crisis support has put such a strain on the budget is attributable not only to the severity of the crises but also to the – in part – inefficient design of the implemented measures; in particular, it was due to lacking information and data (e.g. on household incomes) that support often took the form of untargeted lump sum payments. Economic forecasts suggest that the decline in economic activity caused by the energy crisis in 2023 is becoming increasingly entrenched in the medium term and contributing to a marked deterioration in the budget situation. A large part of the stimulus measures and support packages are of a permanent nature, thereby continuing to weigh on the government budget in the medium term. In addition, the lagged effect of inflation has started to drive up government expenditure. This means that the past period of high inflation will be contributing to a significant deterioration in the budget situation in the medium term.

Unfunded economic policy measures and inflation make for high budget deficits

The following factors will take the 2024 and 2025 budget deficits to a high 3.9% and 4.1% of GDP, respectively: past economic policy measures, the inflation-induced strong increase in social spending and public-sector salaries (lagged inflation effect), additional climate protection measures and the budgetary impact of the recession and sluggish economic growth. It has to be pointed out that since 2020, none of the stimulus and support measures with an impact on the budget balance has been adopted with any specific funding. The impact of current economic activity on the fiscal balance amounts to -0.8% and -0.6% of GDP in 2024 and 2025, respectively. This shows that economic conditions are an additional, but not the most important driver of high budget deficits over the forecast horizon. In the medium term, the expected modest recovery and the absence of stimulus measures (no policy-change assumption) lead to a small improvement in the budget balance, which, however, will be weakened by a notable increase in military expenditure. The high budget deficits will drive up the debt ratio to 85% of GDP until 2028, a figure 14 percentage points higher than the pre-crisis level of 2019. Table 1 provides an overview of the main indicators of the forecasts prepared by the Fiscal Advisory Council, the Federal Ministry of Finance and the European Commission.

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Table 1: Main results of the FISK autumn forecast

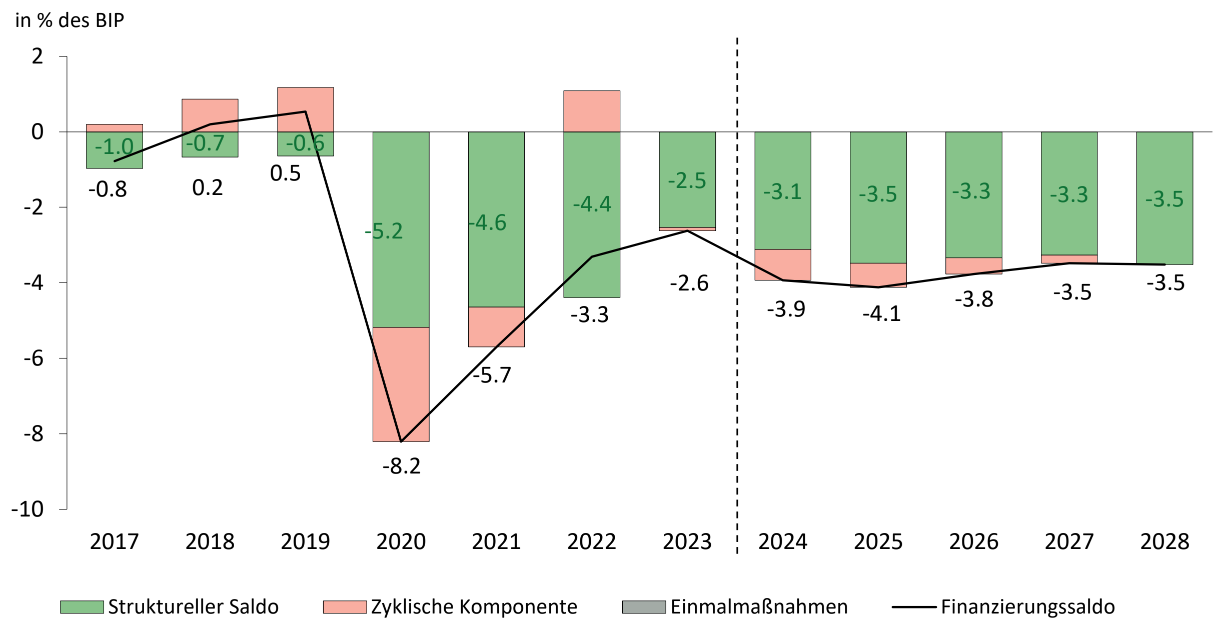
			FISK autumn forecast 2024				
% of GDP	2022	2023	2024	2025	2026	2027	2028
Fiscal balance	**-3.3**	**-2.6**	**-3.9**	**-4.1**	**-3.8**	**-3.5**	**-3.5**
Cyclical budget component	1.1	-0.1	-0.8	-0.6	-0.4	-0.2	0.0
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural budget balance	**-4.4**	**-2.5**	**-3.1**	**-3.5**	**-3.3**	**-3.3**	**-3.5**
Real GDP (%, year on year)	5.3	-1.0	-0.6	1.0	1.5	1.5	1.4
Potential output (%, year on year)	1.4	1.1	0.7	0.7	0.8	0.8	0.9
Output gap	1.9	-0.2	-1.4	-1.1	-0.8	-0.4	0.0
General government debt	**78.4**	**78.6**	**79.7**	**81.6**	**82.8**	**83.9**	**85.0**
Memo: Fiscal balance (MoF)	***-3.3***	***-2.6***	***-3.3***	.	.	.	.
Memo: General government debt (MoF)	***78.4***	***78.6***	***79.3***	.	.	.	.
Memo: Fiscal balance (MoF)	***-3.3***	***-2.6***	***-3.6***	***-3.7***	***-3.5***	.	.
Memo: General government debt (MoF)	***78.4***	***78.6***	***79.5***	***80.8***	***81.8***	.	.

Source: FISK autumn forecast 2024, MOF-notification autumn 2024, EC autumn forecast, WIFO and Statistics Austria.

Fiscal Advisory Council forecasts high structural budget deficits

The Fiscal Advisory Council forecasts high structural budget deficits over the entire forecast horizon. Due to the recession, the output gap will be negative from 2023 on, and will be closing by 2028.[1] While the fiscal balance will be improving somewhat in the medium term, the structural balance is expected to deteriorate from -3.1% in 2024 to -3.5% in 2028, despite the absence of significant economic stimulus.

Chart 1: Austria's structural balance and its components from 2017 to 2028



Quellen: Statistik Austria und FISK-Herbstprognose 2024.

1 According to assumptions of the European Commission, the output gap will be closing over the medium term.

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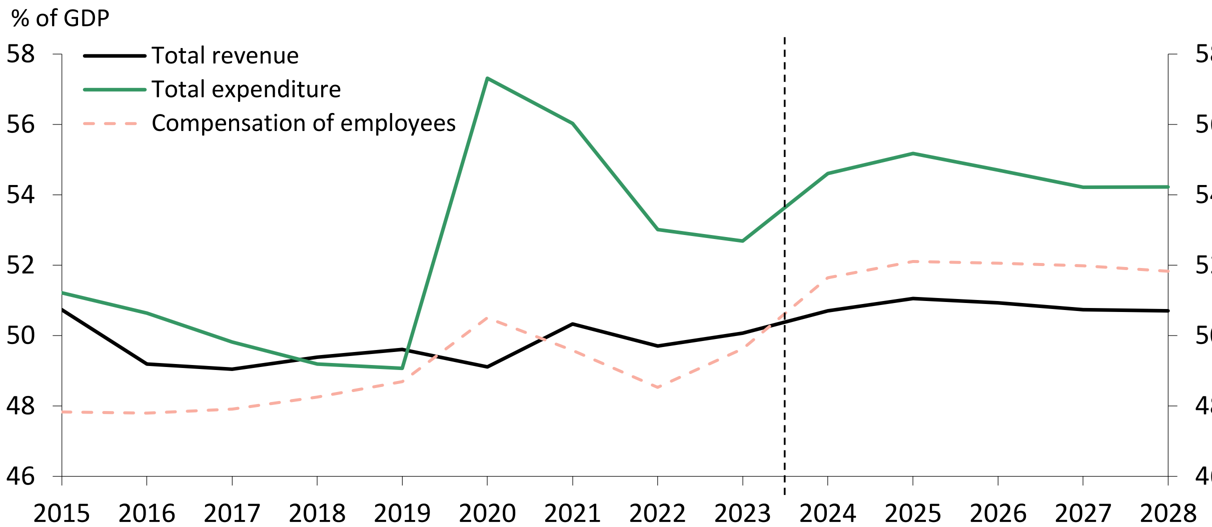
Robust labor market supports fiscal path despite ongoing recession

Contrary to expectations in the spring forecasts, the Austrian economy will continue to shrink in 2024 (-0.6% instead of +0.2%). Hopes that accelerating private consumption on the back of rising real incomes would provide a strong impetus will not materialize in 2024 (real private consumption: +0.1%). Additionally, WIFO's fall forecast sees a much weaker upswing in 2025 than projected in spring 2024 (real GDP: +1.0% instead of +1.8%), so that government revenues will grow less than previously expected. At the same time, inflation and interest rates are falling faster than projected in spring, thereby holding back revenue growth even more. That said, these developments will also slow down government expenditure growth in the years to come.

Labor market developments are crucially helping to keep the economic downturn from harming the government budget balance even more. Like in 2023, compensation of employees will increase more strongly than nominal GDP in 2024 and 2025 (+7.9% and +4.1%, respectively, after +8.0% in 2023 compared to +3.7% and +3.1%, after +5.6% in 2023). This is thanks to high nominal wage growth and despite moderate employment growth. As a result, the wage ratio will climb to almost 52% in the medium term, from just below 50% in 2023 (Chart 2).

Revenues from social security contributions, wage tax and payroll taxes are hence expected to grow briskly, which will be the main contributing factor to the revenue ratio rising to 51.1% in 2024. On the expenditure side, the lagged effects of the past few years' high inflation will fully materialize, with the adjustment factors used in the indexation of social benefits amounting to 9.7% (2024) and 4.6% (2025). Expenditure growth will reach +7.5% and +4.2%, respectively, clearly surpassing nominal GDP growth (table), which will result in the expenditure ratio rising by almost 2 percentage points to 54.6% in 2024 and to 55.1% in 2025.

Chart 2: Revenues, expenditure and compensation of employees to GDP from 2015 to 2028



Source: Statistics Austria, WIFO and FISK autumn forecast 2024.

Table 2: Main results of the FISK-autumn forecast

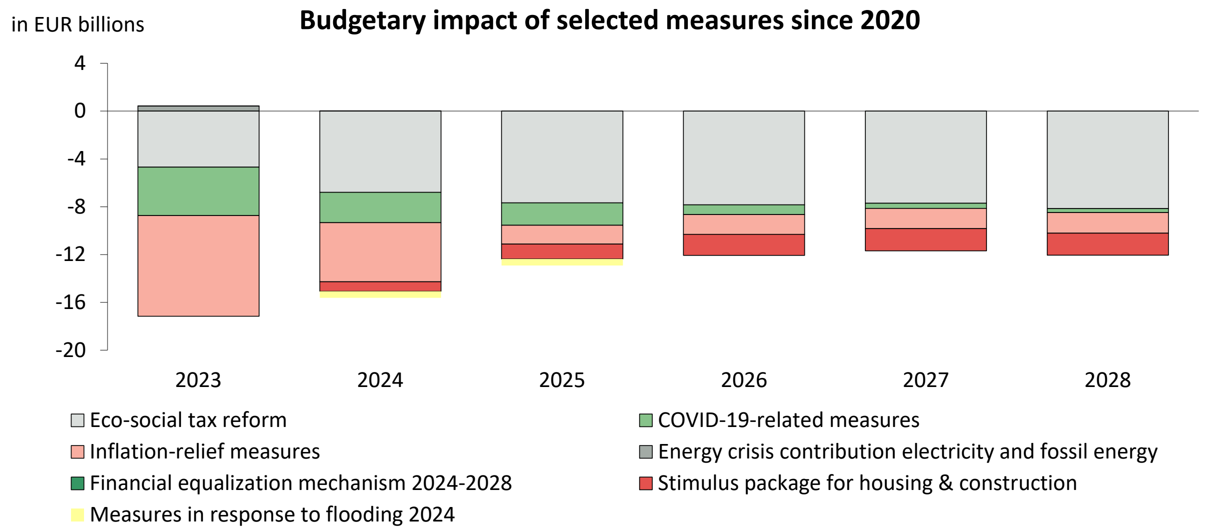
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
							in bn Euro							
Total revenue	173.6	174.9	180.1	189.3	196.3	186.8	204.5	222.7	237.0	248.8	258.4	266.8	274.7	283.9
Growth rate	4.2%	0.8%	3.0%	5.1%	3.7%	-4.9%	9.5%	8.9%	6.4%	5.0%	3.8%	3.3%	3.0%	3.3%
Total expenditure	175.2	180.1	183.0	188.5	194.2	218.0	227.6	237.5	249.3	268.0	279.2	286.6	293.6	303.6
Growth rate	1.3%	2.8%	1.6%	3.0%	3.0%	12.2%	4.4%	4.3%	5.0%	7.5%	4.2%	2.6%	2.5%	3.4%
Nominal GDP	342.1	355.7	367.3	383.2	395.7	380.3	406.2	448.0	473.2	490.7	506.0	523.8	541.5	559.9
Growth rate	3.6%	4.0%	3.3%	4.3%	3.3%	-3.9%	6.8%	10.3%	5.6%	3.7%	3.1%	3.5%	3.4%	3.4%

Source: Statistics Austria, WIFO and FISK autumn forecast 2024.

Costly economic policy measures adopted without funding plan

The temporary measures of the crisis support packages will fully expire by 2026. However, the budget balance will reflect additional expenditure attributable, in particular, to the new fiscal sharing arrangement, more climate-related and environmental measures, an increase in "climate bonus" payments, which are, in fact, an over-compensation of CO2 pricing, (residential) construction stimulus measures and the coming into effect of the last part of the so-called "eco-social tax reform," which cuts the corporate income tax rate to 23%. Expenditure on measures that have been reflected in the budget from 2020 on will decrease to EUR 11.9 billion in 2026, from EUR 17.0 billion in 2023. A large part of the budget burden that will persist in the medium term is attributable to the income tax reform under the eco-social tax reform, which can be interpreted as a compensation of taxpayers for bracket creep since the 2016 tax reform (Fiscal Advisory Council, 2022). Furthermore, the budget is and will be strained by the long-term effects of increases in expenditure on pensions, climate and environmental protection measures, the military and due to the new fiscal sharing framework. While the COVID-19-related support measures will no longer be reflected in the budget in the long term (with the exception of the corona bonus for pensioners in the amount of EUR 0.3 billion), the inflation relief measures represent a permanent burden on the budget in the amount of EUR 1.7 billion (especially pension hikes, cuts in accident insurance and contributions to the Family Burden Equalization Fund). None of the measures with a budgetary impact from 2020 on was adopted with a funding plan.

Chart 3: Budgetary impact of economic policy measures



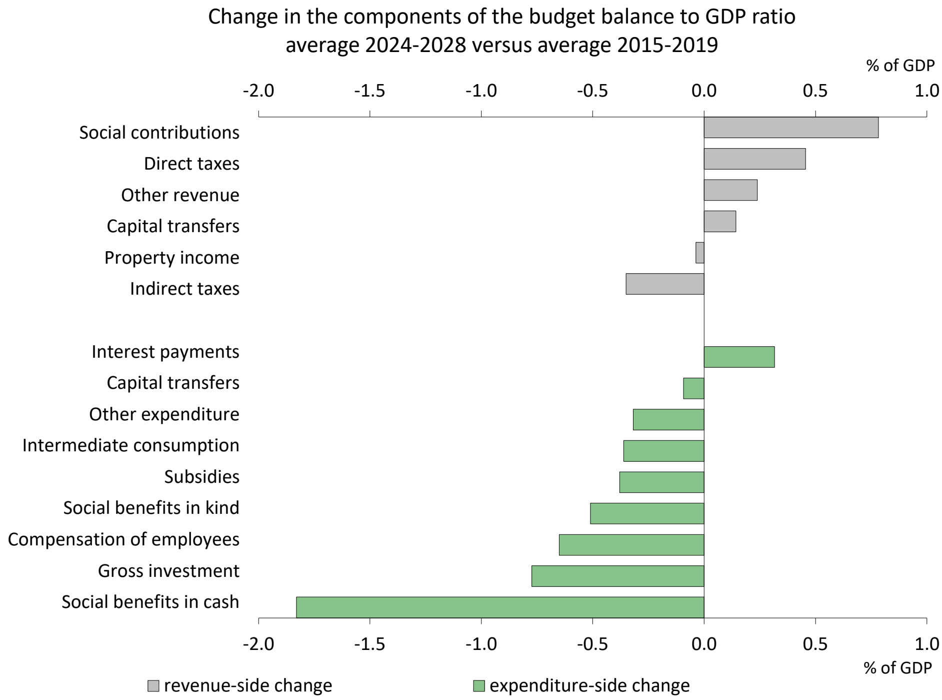
Source: FISK autumn forecast.

Change in revenue and expenditure structure leads to deterioration in fiscal situation

The Fiscal Advisory Council expects the 2024 to 2028 average budget balance to deteriorate to -3.8% of GDP. By comparison, the pre-crisis 2015 to 2019 budget balance averaged -0.4% of GDP. This deterioration will be driven by significant changes in the structure of revenues and expenditure triggered, above all, by the permanent effects of economic policy measures (with crisis support measures playing a minor role in this context), the budgetary impact of the high inflation period and the slump in GDP growth (Chart 4). Government expenditure as a percentage of GDP will be rising in all categories, except interest expenditure. Monetary social transfers (especially expenditure on pensions) will increase particularly strongly, accounting for a large part of the deterioration in the budget balance. Interest expenditure will rise less than GDP, despite the significant increase in market rates, which will offset some of the deterioration in the budget balance ratio.

Social security contributions and payroll taxes, which are both determined by the wage level, will grow more strongly than GDP, and – together with direct taxes increasing at a rate higher than GDP growth (especially because of revenues from corporate income tax) – will offset some of the deterioration in the budget balance ratio. Wage and income tax ratios will remain steady as ongoing inflation-related hikes in the average tax rate have been mostly abolished through the indexation of tax brackets. Revenues from indirect taxes as a percentage of GDP will drop, mostly because of revenues from non-indexed specific taxes (especially the petroleum tax), thereby more than canceling out the increase in revenues from value-added tax as a percentage of GDP. In sum, the average increase in expenditure exceeds the average increase in revenues by 3.4% of GDP.

Chart 4: Decomposition of the change in the fiscal balance over the medium term

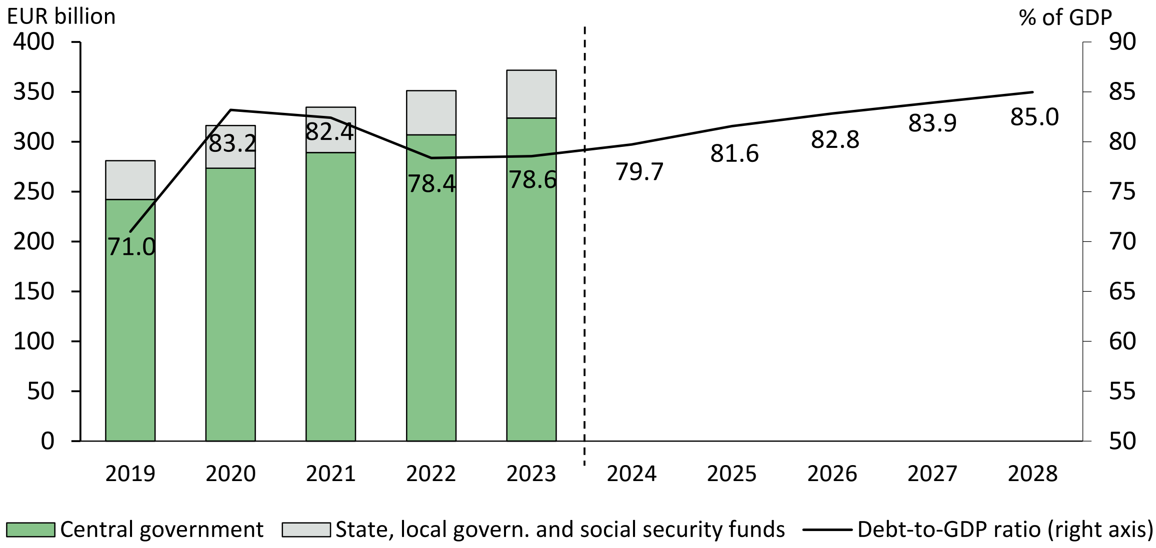


Source: Statistics Austria and FISK autumn forecast 2024.

Debt ratio remains well above pre-crisis level in the medium term

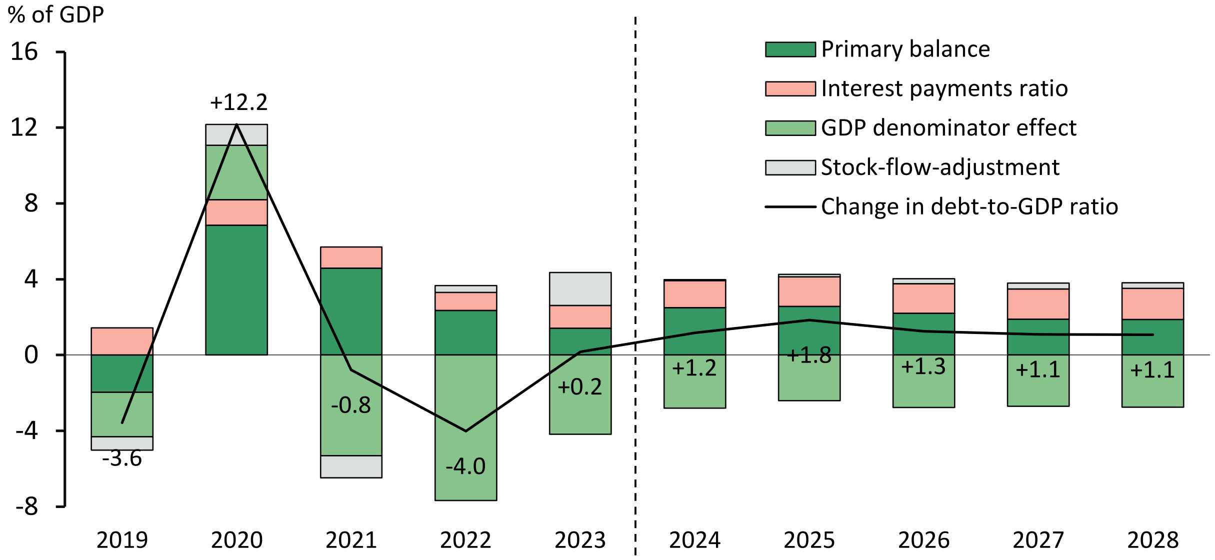
Austria's general government debt (gross) will grow to EUR 391.1 billion and EUR 412.8 billion, respectively, in 2024 and 2025, as a result of the high primary deficits in these years (EUR 12.3 billion and EUR 13.0 billion, respectively) and a further rise in interest expenditure. Despite the latter, interest payments relative to GDP will remain at a historically low level. Contrary to previous years, nominal GDP growth will be too low in 2024 and 2025 to offset the impact of high budget deficits on the debt ratio (Chart 6). In fact, the debt ratio will climb to 79.7% and 81.6%, respectively, in 2024 and 2025, according to the forecast of the Fiscal Advisory Council (Chart 5). Continuously high budget deficits will push up the debt ratio to 85% by 2028, a level 14 percentage points above the pre-crisis ratio recorded in 2019.

Chart 5: Austria's public debt (Maastricht definition) from 2019 to 2028



Source: Statistics Austria, FISK autumn forecast 2024 and Draft Budgetary Plan 2025.

Chart 6: Decomposition if Austria's debt-to-GDP ratio dynamics*) from 2019 to 2028



*) - = reduction (+ = increase) of debt-to-GDP ratio.
Source: Statistics Austria, WIFO and FISK autumn forecast 2024.

Fiscal Advisory Council forecast far more pessimistic than Ministry of Finance assessment

According to its notification of September 2024, the Federal Ministry of Finance expects a 2024 deficit of 3.3% of GDP, which is above the Maastricht threshold of 3% but significantly below the Fiscal Advisory Council's deficit forecast. The Federal Ministry of Finance did not publish a budget plan in fall 2024, with exploratory talks about the formation of a coalition government following the general elections in October still ongoing; as a result, there is no fiscal forecast for the next few years available from the Ministry of Finance. Since the current forecast for 2024 does not provide a full breakdown, we are unable to quantify the reasons for the differences between the Ministry of Finance's and the Fiscal Advisory Council's forecasts. In its autumn forecast, the European Commission put the Austrian deficit ratios to 3.6% (2024), 3.7% (2025) and 3.5% (2026), respectively. The European Commission's 2024 figure is right between the Ministry of Finance's and the Fiscal Advisory Council's forecast. At 81.6%, the European Commission sees the 2026 debt ratio around 1 percentage point below the Fiscal Advisory Council's forecast.

Compliance with new EU fiscal framework requires substantial structural consolidation efforts from 2025 to 2028

The Fiscal Advisory Council sees an excessive deficit in 2024 as Austria is – clearly and not only temporarily – in breach of the 3% of GDP criterion. The European Commission confirmed this assessment in late November 2024. Whether an EDP will be opened critically depends on a new Austrian government being able to adopt and submit, by mid-January 2025, a detailed package of corrective measures that ensures a reduction of the deficit to under 3% as early as 2025. The European Commission will take this as the basis for its decision in mid-January whether it will recommend to the Ecofin Council that an EDP be opened against Austria. The Ecofin Council could adopt a final decision as early as January 21, 2025. This decision will determine the requirements Austria will need to fulfill under the new EU fiscal regime.

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According to the European Commission forecast, Austria needs consolidation effort worth EUR 6.3 billion to avert the opening of an EDP in January 2025; the Fiscal Advisory Council sees a need for consolidation effort worth EUR 7.4 billion. Should the European Commission arrive at a more pessimistic assessment of the 2025 deficit in the course of the year, the measures needed to avoid an EDP would become correspondingly more costly. If Austria is not put under an EDP, it will be obliged, from 2025 on, to apply a reference path consistent with the debt sustainability safeguard, which is the strictest – and binding – criterion in this scenario. In 2028, the corrective action needed will amount to EUR 15.8 billion (on the basis of 2024). Member states may deviate from the reference path by up to 0.3% of GDP p.a. or by up to 0.6% of GDP cumulatively over several years. This reduces the need for correction in 2028 to EUR 12.4 billion (0.6% of GDP equal EUR 3.4 billion), if Austria remains outside an EDP.

If, however, Austria is put under an EDP, it will be obliged to fulfill requirements that do not take into account the debt sustainability safeguard. This would significantly reduce the amount of corrective action needed, which, in this scenario, will be EUR 3.1 billion in 2025 and rising continuously. In 2028, the corrective action needed will amount to EUR 8.9 billion (with respect to 2024). But regardless of the scenario that eventually will be relevant, Austria will need to take substantial consolidation effort to fulfill the EU fiscal rules. A 7-year adjustment path means that less corrective action needs to be taken, both annually and over the entire consolidation period, than if a 4-year adjustment path applies. However, an extension of the adjustment period is contingent on additional investment and reforms, and the costs that they cause also need to be taken into account.