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info@marketpublishers.com

Austria Business Forecast Report Q2 2014

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Abstracts

Core Views

The government's final decision on how to address the wind down of nationalised lender Hypo Alpe Adria (HAA) will have a significant impact on the country's economic outlook over the coming years. We expect the government to establish a 'bad bank' to deal with HAA's toxic assets (totalling over EUR17bn), in a move that will improve confidence in the banking sector, but curtail the government's ability to increase current spending. However, we believe this effect will be mitigated by an uptick in private consumption, on the back of low interest rates, rising house prices and a recovery in consumer lending, as well as an improving export outlook driven by a revival in the wider eurozone economy.

We believe the main opposition nationalist Freedom Party of Austria will take first place in the country's elections to the European Parliament, to be held in May. This is on the back of increased apathy towards the governing 'grand coalition' partners (the centre-left Social Democrats and the centre-right Austrian People's Party) as well as votes gained in protest at the government's likely establishment of a publically-backed bad bank for HAA, a move that would be very unpopular among the electorate.

We expect euro strength against the dollar and on a trade-weighted basis to persist in H114. However, we continue to argue that the economic and monetary policy cycles in the eurozone are lagging further behind peers in the US and UK, which will trigger a re-pricing of the euro towards the end of 2014. Indeed, we believe that weak eurozone economic growth and lingering deflationary risks will spur the European Central Bank into loosen monetary policy further.

Major Forecast Changes

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The government's target of eliminating the budget deficit by 2016 will be rendered unfeasible if it decides to go ahead with the creation of a bad bank for HAA. We believe this option will prove more palatable, given that the other option of allowing the bank to become insolvent would send a severe shock through the wider banking sector, potentially derailing the country's nascent economic recovery. As a result of this we have revised up our forecast for the budget deficit to 3.2% and 3.4% of GDP in 2014 and 2015 respectively, from 2.2% and 1.7% previously.

Key Risks To Outlook

The government may decide to allow HAA to become insolvent, for fears of the political backlash of establishing a bad bank. In this event we would expect to see a collapse in consumer credit growth as confidence in the banking sector evaporates, suppressing private consumption and impeding real GDP growth.

If the parties of the governing grand coalition perform particularly poorly in the European Parliament elections it could presage a spate of defections to opposition parties on both the left and the right. With the government only holding a majority of seven seats in the 183-member National Council it could pose threats to government stability.

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