

# *The Austrian Bond Market*

*Auction Agent for Austrian Government Bonds*

*April 2010*

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# Economic Background

According to the latest economic forecast, published by the Austrian Institute of Economic Research (WIFO) in March 2010, real GDP is expected to grow by 1.3 % in 2010 compared to a shrinking economy in 2009 (-3.6 %). The recovery is mainly driven by worldwide expansionary economic policy.

Positive economic impulses from Germany, Austria's major trading partner, are vital for Austria's export. After a severe decrease of merchandise exports in 2009 by -17.7 % in volume, an increase by 5 % is projected in 2010. Domestic manufacturing is expected to expand accordingly by 4.2 % in 2010 (2009: -11.5 %).

Austria's import- as well as export-partners are still concentrated in Western European countries, followed closely by Eastern European countries. Very close ties have been established with the economy of Germany which is Austria's most important trading partner with a 31.1 % share in exports and a 40.7 % share in imports, followed by Italy, Switzerland, China (concerning imports) and the USA as Austria's major trading partners.

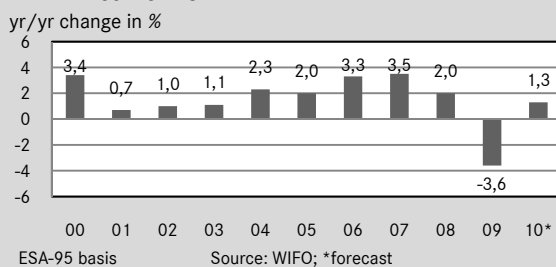
Private consumption, supported by expansionary fiscal and employment policy, contributed to steady economic activity. Private household demand is projected to increase by an inflation-adjusted rate of 0.7 % in 2010 (2009: 0.4 %).

The mentioned measures to stabilize business activity led to a slower increase in unemployment. Unemployment rate will reach 5.2 % of the total labour force in 2010 (Eurostat definition), compared to 5.0 % in 2009.

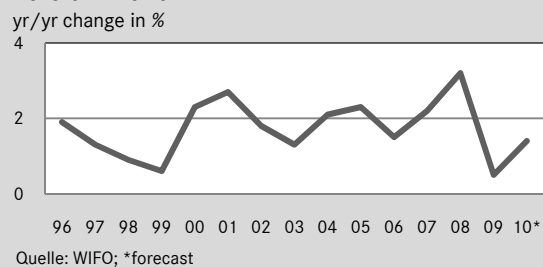
Inflation rate was nearly stable in 2009 with an increase by 0.5 %, for 2010 a growth of 1.4 % is forecast.

Decreasing government income and rising expenditures lead to a prospective widening of government deficit from 3.5 in 2009 to 4.7 % in 2010.

GDP in real terms

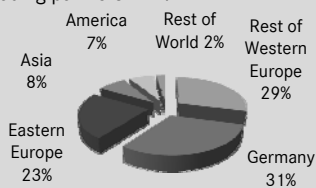


Rate of Inflation



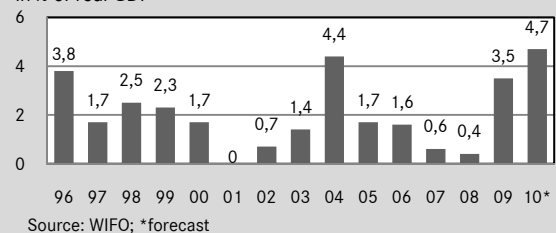
Exports of Goods

by trading partners 2009



Net Deficit of Public Sector

in % of real GDP



# The Austrian Bond Market

## Size of Market

Traditionally the national economy in Austria was mostly financed by the credit market. During the last years financing via bonds and shares has played an increasing role especially for companies. As measured by its volume, the Austrian bond market plays a bigger role than the Austrian equity market. In terms of its absolute size, the Austrian bond market belongs to the smaller European markets.

With regard to the debt securities of Austrian issuers, the total market volume outstanding amounts to Euro 475.3 billion as per end of 2009, representing a share of less than 0.8 % of the overall world bond market. Thus, it may not be compared to the markets in the US or Germany, which make up 34 % (US) and 6 % (Germany), respectively, of the total amount outstanding.

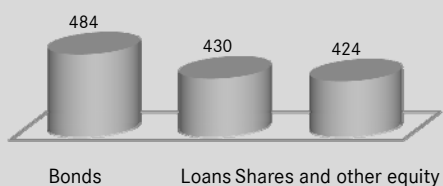
## Issuers

The most important issuer of Euro debt securities in the market is the Republic of Austria, amounting to 37.6 % of the total market volume outstanding. Austrian government bonds having a AAA-rating are representing the most liquid market issues.

Monetary financial institutions account for 52.1 % of the total market volume outstanding of Euro debt securities.

The remaining 10.2 % account for corporate bonds.

Funding of Austrian Economy 2008  
in bn Euro



Source: OeNB - Financial Assets and Liabilities

Bond Markets 2009  
Outstanding Volumes in bn Euro



Source: BIS (Bank for international Settlement)

## Types of Securities

Government bonds pay annual fixed interest rates. The bonds are in bullet form, early redemption or redemption in installments is not foreseen. The minimum denomination is Euro 1,000 (for issues before 1 January 1999, it is 1 Cent). To increase liquidity, issues have increasingly been reopened in recent years. The average outstanding volume of bonds newly issued or reopened in 2009 reached Euro 8.6 billion.

With the introduction of the European Monetary Union on 1 January 1999, all outstanding issues listed on the Vienna Stock Exchange were redenominated in Euro. The aim was to avoid market-segmentation and instantly create a market of respectable size for a range of maturities.

Federal obligations targeted to institutional investors were issued up to 1998. They were regarded as private placements with yields comparable to those of government bonds. These obligations have been supplanted by government bonds since the introduction of the auction system (see 'Government Bond Auctions').

An overwhelming majority of government bonds is issued via the auction procedure. Starting in January 1999, bonds have also been issued within the framework of the Debt Issuance Program for syndicated bonds by means of an ad-hoc banking syndicate (which has to consist of auction participants). In March 1999, the Euro-Medium-Term-Note (EMTN) Program for international issues under English law and the Austrian Treasury Bill (ATB) Program for the launch of short-term issues with maturities up to one year were established. Especially for private investors within the EU, the issuer directly offers 'Bundesschätze' with different maturities via the internet ([www.bundesschatz.at](http://www.bundesschatz.at)).

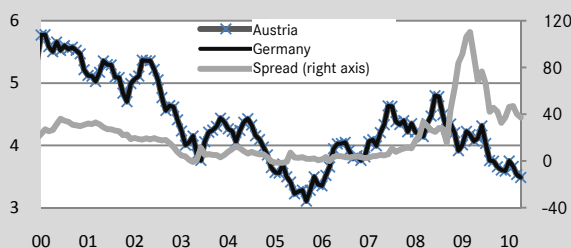
Other types of bonds include floating rate notes with the interest rate adjusted to money market rates (mainly EURIBOR). Adjustment periods vary from three months to one year. Issuers are almost exclusively banks. Furthermore, Austrian banks have issued subordinated bonds under the Austrian Banking Act 1979. Supplementary bonds (Ergänzungskapital-Anleihen) can be issued since the reform of this Act in 1987 and subordinated bonds can be issued again since its reform in 1993.

## Yield structure

Due to considerable economic interdependence, combined with the fact that the Austrian Schilling has deliberately been closely pegged to the DM, Austria had been de facto participating in a monetary union with Germany since 1970. For quite some time therefore, in the absence of outside shock effects of an economic and political nature, the yield spread of Austrian bonds to German bonds has fluctuated within a narrow margin. The introduction of the EMU therefore did not give rise to any significant change.

The widening of the spread to German government bonds peaked at 135 basis points in mid February 2010 due to the close economic relationship of Austria with Eastern Europe and the projected economic risk in Eastern Europe. The revision of published data and the development of real economy resulted in a narrowing of spreads again.

Secondary market yields in %  
Benchmark-Government-Bonds (10 years)



Source: Reuters

## Capital Markets Act

At the beginning of 1992, the new Capital Markets Act (CMA; Kapitalmarktgesetz) became effective, including the obligation to publish a prospectus for the initial public offering of debt securities or other types of securities, with the main intention to protect investors.

Oesterreichische Kontrollbank AG is entrusted with the function of the Notification Office under CMA. Upon entry into force of the Amendment to the Stock Exchange and Capital Markets Act (Federal Law Gazette I 78/2005), the functions of the Notification Office were adjusted to the requirements of the new legislation regarding prospectuses (Directive 2003/71/EG) with effect 10 August 2005.

The Notification Office acts as a depository for the prospectuses to be issued in compliance with the Capital Markets Act, the Investment Fund Act and the Real Estate Act. It publishes the New-Issue-Calendar, a calendar for planned issues of securities and investments as defined in the Capital Markets Act. The reports received on planned issues are published without stating the names of prospective issuers in a preliminary New-Issue-Calendar daily on the Internet (<http://online-meldestelle.oekb.at>) and weekly in Kontrollbank's information brochure 'Kapitalmarktservice'.

On 1 April 2002, the Austrian Financial Market Authority (FMA) was installed under the Financial Market Supervision Act (FMABG). All supervisory tasks and resources were transferred from the Federal Ministry of Finance (banking, insurance and pension funds) and the Austrian Securities Authority - Bundes-Wertpapier-Aufsicht (securities supervision) to the new supervisory body. The FMA and the Austrian Central Bank are now the statutory supervisory bodies directly responsible for banking, insurance and pension funds, securities and stock exchange supervision.

## Trading

The over-the-counter trading in the bond market takes place primarily in the interbank market and with institutional investors. Government bonds are mainly traded over the counter, only a very small portion is also traded at the Vienna Stock Exchange. Measures aimed at increasing government bond market liquidity (market maker commitments, tap issues, etc.) helped to increase total market turnover significantly.

Prices are quoted daily by the Stock Exchange and by banks, e.g. on Reuters and Bloomberg screens.

On 5 November 1999, XETRA, the electronic trading system of the German exchange, was introduced at the Vienna Stock Exchange. For over-the-counter transactions, an electronic settlement system (Direct Settlement Advanced - DS.A) has been in use since 1991. Due to the measures recently taken to increase Austrian government bond market liquidity (increase in volume, tap issues etc.) the most liquid government bonds are also eligible for trading on EuroMTS, an electronic bond trading platform for European benchmark bonds.

CCP.A, a subsidiary of Oesterreichische Kontrollbank AG, assists the Vienna Stock Exchange in processing transactions. Together with the Central Depository (Wertpapiersammelbank), which is also a part of Oesterreichische Kontrollbank AG, this office minimizes physical delivery of stock exchange transactions. For cross-border transactions, Oesterreichische Kontrollbank AG provides a service through foreign clearing organizations.

## Yield Calculations

Beginning in 1999, in compliance with the ISMA recommendation, the formula used in calculating yields for newly issued government bonds was modified to represent the actual/actual day count method. For outstanding redenominated government bonds, the changeover from the convention in use up to the end of 1998 (30/360 day count) to the new rule went into effect starting with the first coupon date in 1999 for each outstanding government bond.

The yields of all Austrian bonds are calculated daily by Oesterreichische Kontrollbank AG and published along with basic primary and secondary market data on each individual bond in the weekly 'Anleiheinformationen'. Issue parameters, stock exchange prices and other security-related information are offered via 'ProfitWeb', a financial database developed by Oesterreichische Kontrollbank AG.

The above-mentioned data form the basis for the calculation of average yields of issuer groups, such as the government, other public authorities, other domestic non-banks, etc. The group of bank bonds is subdivided into funded debentures, non-funded debentures, subordinated debentures and supplementary debentures.

Group-yields are computed by weighting each individual bond yield with the amount outstanding. Most bonds quoted on Official Market at Vienna Stock Exchange with a remaining life of more than one year and a fixed interest rate are included (with several exceptions). These figures are calculated and published on a daily basis. The monthly arithmetic mean is published at the homepage of the Austrian Central Bank (Oesterreichische Nationalbank).

These average yields play an important role in the Austrian banking sector, it being the basis for determining interest rates in many credit agreements as well as for FRNs.

Furthermore, Oesterreichische Kontrollbank AG calculates indices for selected issuer and maturity categories (API=Performance Index). These data is also published via [www.profitweb.at](http://www.profitweb.at).

## Taxation

Since 1 January 1993, a withholding tax (presently: 25 %) has been levied on any kind of interest payment. For domestic private investors, the payment of this tax on capital income (Kapitalertragsteuer) covers all personal income and inheritance taxes.

Starting from 1 July 2005, an EU-withholding tax for cross-border interest payments to private EU-residents is levied.

The turnover tax (Börseumsatzsteuer), levied on all trades transacted via the Vienna Stock Exchange as well as for over-the-counter deals, was abolished on 1 October 2000.

# Government Bond Auctions

Starting January 1989, government bonds were issued employing a price auction system. It was replaced in April 1990 by a yield auction with an 'underwritten portion', i.e. approximately half of the volume to be issued in one year was underwritten by a syndicate. In February 1991, the yield auction system was modified and is now characterized by the following specifications. Since February 2001, price auctions have been employed for tap issues according to international conventions. For new issues, yield auctions are still the norm, as the coupon is calculated on the basis of the weighted average of the accepted yields. In the last few years new issues were issued via a syndicate (see also 'Types of Securities').

## Auction Calendar

At the end of each year, the Austrian Federal Financing Agency (Österreichische Bundesfinanzierungsagentur) announces the nominal amount of the expected annual volume to be issued and the auction dates in the following year. For 2010, an issue volume of Euro 21–25 billion is planned.

Auctions of government bonds normally take place on a Tuesday, in monthly intervals. Settlement and the official listing on the stock exchange are effected three days after the auction (normally the following Friday).

## Determination of Issue Size and Maturity

One week prior to a specific auction, the issuer announces the maturity and volume with regard to the recommendations of the auction participants.

## Auction Participants

Presently, 22 banks (thereof 16 foreign banks) listed in the appendix take part in the auctions. Institutions which are not allowed to participate directly may participate via one of the 22 banks. The group of banks which participate in the auction is selected by the issuer. The decision is based on several factors including in particular sufficient capital, domestic and foreign branches, staff, size and turnover of fixed income securities in Euro and other relevant currencies.

## Bidding System

Each of the 22 participating banks is obliged to submit bids corresponding to at least 1/22 of the envisioned volume. Thus, the assurance is given that the entire volume will be bid at each issue. To avoid one institution getting a disproportionately large share of an issue, the bids of each bank must not exceed 30 % of the indicated total, unless the issue volume announced is below Euro 1 billion. Within the above mentioned maximum and minimum bid limits, multiple bids with different prices (in case of tap issues) and volumes are possible.

## Submitting Bids

Bids are submitted to Oesterreichische Kontrollbank AG, as the agent of the banks and the issuer. A web-based electronic auction system, called Austrian Direct Auction System (ADAS) is in use for this purpose (see 'Electronic Auction'). The deadline for the submission of competitive bids is 11:00 CET on the day of the auction.

The submitted bids are arranged in accordance to their prices levels in descending order. Up to that bid at which the issue amount announced by the Bund is matched (cut-off-price), any bids remaining are not considered in the further stages of the auction procedure. Bids at the lowest price accepted (cut-off price) may be subject to pro-rata curtailments to provide for a precise representation of the scheduled competitive issue volume.

## **Determination of Coupon and Official Issue Price**

In case of a new issue (where a yield auction is employed), the coupon is calculated on the basis of the weighted average of the accepted yields and an issue price which shall be as close to par as possible, after considering the maturity-dependent commission (1.05 % for 5 years, 1.50 % for 10 years).

In case of a tap issue (where a price auction is employed), the official issue price corresponds to the weighted average of the accepted prices plus the maturity-dependent sales commission.

## **Allotments**

The allotment of the accepted competitive bids is executed at the prices bid (in case of a yield auction, yields are translated into respective prices at the calculated coupon). Bids at the lowest price acceptable may be subject to pro rata curtailments.

In February 2001, a modified non-competitive bidding system was introduced as an incentive for auction participants. The total amount of non-competitive bids is limited to 15 % of the total competitive issue amount. Each bank is entitled to submit non-competitive bids at the average price of competitive allotments via ADAS until 11:00 a.m. CET one business banking day after the announcement of competitive allotments. Each bank is entitled to a certain percentage – corresponding to each bank’s market-share (i.e. the weighted average of the competitive allotments as expressed in percent) of the previous two auctions and predefined secondary market criteria - of the non-competitive issue volume.

## **Issuer’s Quota**

The issue amount of each government bond is increased by 10 % of the competitive issue amount, which is retained by the issuer and sold in the secondary market, depending on market conditions.

## **Electronic Auction – ADAS (Austrian Direct Auction System)**

Since May 1998, the auction procedure has been carried out by employing ADAS, software developed for this purpose by OeKB. Starting with June 2008 a fully web-based version of ADAS is in use. As this software has been modified frequently to accommodate changing requirements, it covers a wide range of possibilities (different auction procedures, submission of competitive and non-competitive bids, various communication- and information tools etc.). Constant communication and feedback on both sides, the issuer as well as the banks, before, during and after the auction, has enhanced the development of ADAS.

The essential advantage of the electronic auction-system may be found in its ability to respond quickly:

- The submission of bids is carried out electronically.
- The issuer confirms the issue electronically after the deadline for the submission of competitive bids has expired.
- Subsequently, the total auction results are immediately made available to the participants.
- All information (total auction results, resulting parameters in case of a new issue as well as individual allotments per bank) is communicated electronically via ADAS and can be submitted without delay via email and/or fax.

## **Parallel auctions**

Due to increasing issue sizes, two bonds were auctioned in parallel the first time in April 2009. Thus by means of parallel auctions a fast reaction to the economic situation and the accompanying borrowing requirements was possible.

## **Exchange Auctions**

Since March 2000, the possibility to exchange old, illiquid bonds into liquid benchmark bonds exists. While at the beginning exchange auctions were employed, nowadays exchange offers are carried out on a bilateral basis. By offering this exchange option, the issuer aims at concentrating the outstanding volume of government bonds on a smaller number of bonds, thereby increasing their liquidity.

## **Stripping**

In October 1996, an official strip-facility was set up by the Central Securities Depository, providing the possibility to trade the principal and the coupons of government bonds separately. Information on strippable bonds as well as on the amount stripped can be found on the OeKB-Homepage ([www.oekb.at](http://www.oekb.at)).

# Appendix

## **Participants in Government Bond Auctions**

(in alphabetical order)

Barclays Capital

BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft

BNP Paribas

Citigroup Global Markets Limited

Commerzbank AG

Crédit Agricole CIB

Credit Suisse Securities (Europe) Limited

Deutsche Bank Aktiengesellschaft

Erste Group Bank AG

Goldman Sachs International

HSBC France

J.P. Morgan Securities Ltd.

Merrill Lynch International

Morgan Stanley & Co. International plc

Nomura International plc

Oberbank AG

Österreichische Volksbanken-Aktiengesellschaft

Raiffeisenlandesbank Oberösterreich Aktiengesellschaft

Raiffeisen Zentralbank Österreich Aktiengesellschaft

Royal Bank of Scotland

Société Générale S.A.

UBS AG

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Editor:  
Oesterreichische Kontrollbank Aktiengesellschaft  
Fixed Income Securities,  
Auction Agent for Austrian Government Bonds  
Erich Weiss, Maria Kucera

1010 Vienna, Strauchgasse 1-3, Austria  
Tel. +43-1-531 27-2305  
Fax +43-1-531 27-5233  
E-Mail: [govbonds@oekb.at](mailto:govbonds@oekb.at)  
[www.oekb.at](http://www.oekb.at)

Corporate Seat Vienna  
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