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REUTERS

Hypo bank woes heap pressure on Austrian coalition talks

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* Hypo bank needs more state cash quickly

* Adds urgency to coalition talks

* Two main parties at odds over fiscal policy

* Previous govt's budget forecasts look optimistic

By Michael Shields and Angelika Gruber

VIENNA, Nov 11 (Reuters) - Nationalised lender Hypo Alpe Adria's urgent need for more state cash is heaping pressure on Austria's two biggest parties to agree coalition terms and tackle stretched state finances.

As the Social Democrats (SPO) and the conservative People's Party (OVP) try to form a new government, a hole in state finances exposes policy differences between the SPO - which campaigned to protect public pensions and introduce a wealth tax on millionaires - and the OVP, which wants to cut state spending and has ruled out new taxes.

News at the weekend that Hypo will undershoot minimum capital requirements by the end of this month without at least 1 billion euros ($1.33 billion) more in state funds adds urgency to talks between the two parties to decide on the proper mix of tax hikes and spending cuts.

"The situation is very serious and I expect the SPO to recognise this," senior OVP negotiator Josef Puehringer, the governor of Upper Austria province, told the Oberoesterreichische Nachrichten paper on Monday.

Opposition leaders have claimed that the two parties - who made up the previous coalition and now run a caretaker government after being badly weakened in September's election - hid how much the financing gap could widen.

The prior coalition forecast a 2013 budget deficit of 6.3 billion euros - 2.3 percent of gross domestic product - narrowing to zero by 2016, but that now looks ambitious.

Puehringer said he expects a budget hole of up to 34 billion euros over five years, even excluding aid to ailing banks, primarily Hypo, which the government was forced to take over in 2009 after an unbridled expansion drive pushed it to the brink of insolvency.

Hypo said at the weekend that it needed extra capital this month. It did not say how much, but one source familiar with the bank's situation said 1 billion to 1.3 billion euros was "realistic".

The caretaker government could authorise a fresh capital injection for Hypo, but political wrangling is holding up agreement on how to handle the bank in the long run.

Finance Minister Maria Fekter has opposed creating a state-run "bad bank" to absorb its toxic assets, which would relieve pressure on Hypo but could boost state debt by as much as 5 percentage points to nearly 80 percent of GDP, the head of the agency overseeing aid to banks has said.

Instead, Fekter favours a "creative" approach that would put billions of Hypo assets into an Irish-style bad bank owned by the private sector so that its debts are kept off state books.

But details of the plan are still unclear, Fekter might not be reappointed in the next government, and efforts to badger healthier Austrian banks into taking part are on hold.

"No one can or wants to move on this before the next finance minister is fixed. That is the serious problem," one regulatory source said.

POLICY DIFFERENCES

Hypo has already received around 3.8 billion euros in state aid, including 700 million to fill a hole in its balance sheet caused by writedowns that led to an 860 million euro loss for the first half of this year.

Selling off Hypo could cost taxpayers up to 5.4 billion euros in fresh **capital** by 2017 - 1.9 billion to 3 billion this year alone - under a plan approved by the European Commission in September but not reflected in state budgets.

The SPO and OVP aim to reach an agreement on a new coalition by the Christmas holidays in late December but have been taciturn about progress in the talks, which need to bridge differences over education and social policy as well.

Puehringer, who has given the negotiations a 50-50 chance, dismissed speculation that the OVP may ready a secret approach to other parties on forming a centre-right government.

"That would be the unfairest thing of all," he said, adding it was premature to speak of talks with the SPO failing. ($1 = 0.7491 euros) (Editing by Susan Fenton)

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