FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms Austria at 'AA+'; Outlook Negative

Fri 03 Mar, 2023 - 5:04 PM ET

Fitch Ratings - Frankfurt am Main - 03 Mar 2023: Fitch Ratings has affirmed Austria's Long-Term Foreign-Currency (LTFC) Issuer Default Rating (IDR) at 'AA+' with a Negative Outlook.

A full list of rating actions is detailed below.

## KEY RATING DRIVERS

**Credit Fundamentals, Negative Outlook:** The rating is supported by a diversified and wealthy economy, the reserve currency status of the euro, strong political and social institutions, and sound external finances. This is balanced against Austria's high level of public debt relative to peers', although refinancing risks are mitigated by long maturities and low financing costs.

The Negative Outlook reflects ongoing uncertainty around Austria's still considerable and long-term exposure to Russian gas imports, leaving it exposed to fiscal risks from an exit from long-term contracts. These risks are pronounced in the context of a high level of public debt and limited headroom at the 'AA+' rating to absorb further shocks.

**Continued Dependence on Russian Gas:** Continued dependence on Russian gas leaves Austria exposed to Russia turning off supply or domestic or international political pressures to phase out long-term contracts at a potentially substantial fiscal cost - there is a lack of transparency on the details of its contract with Gazprom. Austria is one of a few EU countries that is still importing considerable volumes of Russian pipeline gas. The government lacks a clear strategy to meet the EU and national target to end its reliance on Russian gas by 2027, including how to reconcile that with a long-term contract with Gazprom that runs until 2040.

The share of Russian gas has fallen to close to 50% of total imports (excluding transits) throughout 2022, from 80% before the war, due to higher inflows from other countries and reduced supplies from Russia. Russia is reportedly again fully compliant with meeting its contracted flows.

**Reduced Risk from Energy Rationing:** The risk of gas shortages and rationing this and next winter, as in the rest of Europe, is lower than earlier anticipated. As of end-February, Austrian gas storage was around 71% full, exceeding the EU average and significantly above 2022 levels. Around 60% of the stored gas is available for domestic use, representing 46% of annual gas consumption. Gas reserves now also include a strategic gas reserve of around 20% of annual consumption, which is intended for emergency use only.

Securing new supplies in a scenario where Russian gas is abruptly and completely cut off would be a challenge but likely to be manageable. Additional pipeline capacities through Italy and Germany for the 2022/2023 gas year have been booked (45% of annual consumption). At the same time, overall gas consumption dropped significantly in 2022 (-12% compared to the five-year historical average).

**Economic Stagnation in 2023:** We now predict that economic growth in 2023 will be close to stagnation at 0.4%, representing a moderate upward revision from our previous forecast of -0.3%. This follows a strong 5% expansion in 2022, exceeding the eurozone estimate of 3.5% and the estimated 'AA'-median of 3.1% for 2022. Our forecast revision reflects an improved economic outlook for Austria and its main trading partners, indicated by improved sentiment indicators in the manufacturing sector, amid a significant fall in energy prices and easing supply chain problems. In 2024, growth will pick up again to 1.5%, before easing to potential growth of around 1.3% in 2025.

**Inflation Peaked in January:** We expect that inflation already peaked in January (11.5% year-on-year) and forecast annual inflation of 6.2% for 2023, down from 8.6% in 2022. High energy prices have probably not yet been fully passed on to consumers, implying that lower wholesale energy prices will only translate into lower inflation with a lag. Core inflation reached 7.8% in January, up from 2.8% a year ago. We estimate that higher wage growth over the coming years will keep inflation high, reaching 3.1% in 2024.

**Fiscal Improvements:** We estimate that Austria's general government budget deficit narrowed to 3.2% of GDP in 2022 from 5.9% in 2021. A stable labour market, higher wage growth, one-off revenues from a windfall energy tax and the continued phasing out of Covid-19 measures will support fiscal consolidation until 2024. At the same time, the delayed impact from higher inflation on public expenditures and inflation-relief measures will weigh on fiscal results. More structural measures, including the introduction of inflation-indexed personal income tax brackets, will permanently reduce government revenues while permanently raising defence spending. Fitch forecasts that the fiscal deficit will further narrow to 2.8% in 2023 and 1.6% in 2024.

**Nominal GDP Drives Public Debt Reduction:** General government debt (GGD) has been on a downward trajectory since 2021, falling to an estimated 78.9% of GDP by end-2022. The reduction would have been even larger if not for a sizeable stock-flow adjustments of around 1% of GDP, primarily reflecting adjustments for the pay-out of Covid-19 grants. We project that GGD will fall to 73.2% by end-2026, close to the government's medium-term projection of 72.5%. Further fiscal loosening or lower nominal GDP growth could pose risks to the downward path of debt. We project that interest payments bottomed out in 2022 and will gradually increase again to 2.8% of revenues by 2024, converging towards the forecast 'AA' median of 2.9%.

**Banking Sector Exposure to Russia:** The Austrian banking sector's exposure towards Russia and Ukraine is overall low but still ranks as one of the highest among EU countries. Exposure primarily reflects exposures of Raiffeisen Bank International. Any losses related to their Russian subsidiaries would likely be manageable for the sector, given the banks' strong capital and liquidity buffers.

**ESG - Governance:** Austria has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary SRM. Austria has a high WBGI ranking at 90, reflecting its long record of stable and peaceful political transitions, well-established rights for participation in the political process, strong institutional capacity, effective rule of law and a low level of corruption.

## RATING SENSITIVITIES

### Factors that could, individually or collectively, lead to negative rating action/downgrade:

- **Public Finances:** Failure to reduce general government debt/GDP over the medium term, for example, due to a prolonged period of fiscal deterioration in response to the energy situation, weaker medium-term growth prospects, or crystallisation of contingent liabilities related to the phasing out of Russian energy.

- **Macro:** A large adverse macroeconomic shock, for example due to adverse energy supply or price developments or other spill-overs from the war in Ukraine, particularly if it were to lower medium-term growth potential or have negative effects on the public finances and/or the banking sector.

**Factors that could, individually or collectively, lead to positive rating action/upgrade:**

- **Public Finances/Macro:** Confidence that Austria can manage fiscal and economic risks related to energy supply and price shocks, including its long-term exposure to Russian gas contracts.

- **Public Finances:** General government debt/GDP continuing on a firm downward path over the medium to long term to significantly lower levels, for example, due to sustained fiscal consolidation.

- **Structural:** An improvement in governance standards to a level that is more line with 'AAA' rated sovereigns.

## SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Austria a score equivalent to a rating of 'AA-' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

- **Macro:** +1 notch reflecting macroeconomic performance, policies and prospects. The positive notch adjustment offsets the deterioration in the SRM output driven by volatility from the pandemic shock, including on GDP growth. The deterioration of the GDP growth volatility variable reflects a very substantial and unprecedented exogenous shock that has hit the vast majority of sovereigns, and Fitch believes that Austria has the capacity to absorb it without lasting effects on its long-term macroeconomic stability.

- **Public Finance:** +1 notch to reflect our expectation that government debt/GDP ratio will decline beyond the SRM forecast horizon, based on our fiscal and macroeconomic projections and the record of debt reduction prior to the pandemic. In addition, it reflects Austria's long average maturity of government debt.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Austria has an ESG Relevance Score of '5[+]' for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Austria has a percentile rank above 50 for the governance indicator, this has a positive impact on the credit profile.

Austria has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Austria has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Austria has an ESG Relevance Score of '4[+]'for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver. As Austria has a percentile rank above 50 for the governance indicator, this has a positive impact on the credit profile.

Austria has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Austria, as for all sovereigns. As Austria has a record of 20+ years without a restructuring of public debt, which is captured in our SRM variable, this has a positive impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| Austria | LT IDR | AA+ Rating Outlook Negative | Affirmed | AA+ Rating Outlook Negative |
| | ST IDR | F1+ | Affirmed | F1+ |
| | LC LT IDR | AA+ Rating Outlook Negative | Affirmed | AA+ Rating Outlook Negative |
| | LC ST IDR | F1+ | Affirmed | F1+ |
| | Country Ceiling | AAA | Affirmed | AAA |
| senior unsecured | LT | AA+ | Affirmed | AA+ |
| senior unsecured | ST | F1+ | Affirmed | F1+ |

**VIEW ADDITIONAL RATING DETAILS**

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## APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 11 Jul 2022) (including rating assumption sensitivity)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.3 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.13.2 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Austria | EU Issued, UK Endorsed |

## UNSOLICITED ISSUERS

**Austria (Unsolicited)**

| | |
|---|---|
| With Rated Entity or Related Third Party Participation | Yes |
| With Access to Internal Documents | Yes |
| With Access to Management | Yes |

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| ENTITY/SECURITY | ISIN/CUSIP | RATING TYPE | SOLICITATION STATUS |
|---|---|---|---|
| Austria EUR 16.6 mln 5.125% bond/note 02-Jan-2034 | XS0182592062 | Long Term Rating | Unsolicited |
| Austria EUR 4.15% Gov Bonds 15 Mar 2037 | AT0000A04967 | Long Term Rating | Unsolicited |
| Austria EUR 9.2 bln 4.85% bond/note 15-Mar-2026 | AT0000A0DXC2 | Long Term Rating | Unsolicited |
| Austria EUR 100 mln Variable bond/note 02-May- | XS0166935535 | Long Term Rating | Unsolicited |

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Sovereigns Europe Austria