FitchRatings

Fitch Affirms Austria at 'AA+'; Outlook Positive

Fitch Ratings - Frankfurt am Main - 31 May 2019: Fitch Ratings has affirmed Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA+' with a Positive Outlook.

Key Rating Drivers

Austria's 'AA+' rating is supported by a rich, diversified, open, high-value-added economy with strong political and social institutions. It benefits from low private sector indebtedness and a high household savings rate. These strengths are balanced by Austria's high level of gross general government debt (GGGD/GDP) compared with peers and an ageing population, which is set to put pressure on already high pension spending. The recent rise in political volatility raises uncertainty around the fiscal outlook and could delay reform implementation. The Positive Outlook reflects favourable fiscal developments and our expectations of a firm downward trajectory for GGGD/GDP.

Economic growth has exceeded peers in recent years, but we expect it will slow down from its cyclical peak. Real GDP grew by 2.7%, in 2018 ('AA' current median of 2.6% and eurozone average of 1.9%), on the back of a favourable external environment and the continued recovery in investment. Fitch forecasts GDP growth to ease to 1.7% in 2019 and 1.8% in 2020, with private consumption becoming the main driver of growth, fuelled by a tighter labour market and a looser fiscal policy. Net exports will remain a positive contributor to growth, but we expect their role to decrease, owing to the economic slowdown in Austria's trading partners. Downside risks to our projections would include a continued contraction in Germany's car production, given Austria's prominent role in its manufacturing supply chain.

The unemployment rate has continued falling, averaging 4.9% in 2018, below the peers' historical median of 5.0%. Fitch forecasts a gradual decline in the unemployment rate to 4.6% in 2019, before stabilising in 2020 at 4.4%. Headline inflation remained above 2% in 2018, pushed by above-trend growth, tightening labour market and rising oil prices. Increasing wage pressure and strong domestic demand should be partly offset by lower oil prices leading inflation to slowly decrease to 1.9% by 2020.

Fiscal performance improved in 2018, with the authorities estimating a general government surplus of 0.1% of GDP ('AA' historical median of -0.5%), well above the government's target of -0.4% and a 2017 deficit of 0.8%. The outperformance was driven by higher-than-expected tax collection, owing to stronger economic growth and a tighter labour market, and lower interest payments. Fitch expects a surplus of 0.4% in 2019, slightly decreasing to 0.2% by 2020, as lower economic growth and the tax reform weighs on revenue collection.

The Austrian government recently introduced a new phased-in tax reform plan, named 'Relieving Austria'. By 2022, the annual total relief, including the measures that have already come into force, will amount to EUR8.3 billion, or approximately 2% of GDP. The plan includes lower personal income tax rates, lower social security contributions, and a cut in the corporate income tax rate from the current 25% to 21% by 2023. The changes will benefit low and middle-income earners and will reduce Austria's high tax wedge on labour (47.4% for a single worker earning Austria's average wage).

Austria's debt structure and dynamics remain quite favourable. General government debt, at 73.8% of GDP at end-2018, is almost double the current 'AA' median of 39.0% but on a firm downward trend. Fitch forecasts

GGGD to decline to 69.5% of GDP in 2019 and reach a level below 60% of GDP by 2023, supported by strong primary surpluses, robust nominal GDP growth and the ongoing disposal of the assets of the state-owned bad banks. The average maturity is currently above 10 years and the average effective interest rate is close to 2%.

The Austrian parliament ousted the government led by Chancellor Sebastian Kurz through a no-confidence vote in parliament on 27 May 2019. This follows the recent political controversy (the so called "Ibiza affair") that led to the resignation of Heinz-Christian Strache, Vice Chancellor and chairman of the Freedom Party (FPÖ), the former junior partner in the coalition led by the Austrian People's Party (ÖVP). The motion was backed by representatives from the FPÖ and the Social Democratic Party of Austria (SPÖ).

So far the electoral impact of the controversy has been limited for Mr. Kurz. The ÖVP had a strong result in the European elections on 26 May, where it increased its share of the vote to 34.6%, from 27.0% in 2014 (and 31.5% in the 2017 legislative elections). The FPÖ won 17.2% of the vote, down 2.5% from previous European elections but well below 26.0% in the 2017 legislative elections.

The prospect of early elections raises uncertainty around the composition of a future coalition government. With the relationship between the ÖVP and the FPÖ compromised by recent events, coalition building is likely to prove difficult. Unless the ÖVP wins an absolute majority, the party could face the choice between a grand-coalition with the SPÖ or a minority government. The fragmented political backdrop poses risks to the outlook for fiscal policy and the implementation of the tax reform plan; as yet, no bill has been introduced in parliament.

Austria's net external debtor position continued improving in 2018, reaching 11.6% of GDP, on the back of ongoing current account surpluses and large deleveraging of the banking sector. Our forecasts point to a continued reduction in the net external debt to 9.7% of GDP in 2019. The current account surplus will widen to 2.7% in 2019 (from 2.4% in 2018) above the historical 'AA' median of 1.5%, supported by an expansion of the trade balance, contributing to solidifying the current net creditor IIP position of 3.8% of GDP.

House prices maintained their upward trend, rising by 6.7% yoy in 4Q18 in Vienna and 7.4% in Austria as a whole. The Central Bank estimates that prices are 22.1% and 13.4% above fundamentals in the respective two markets in 4Q18. However, due to the low homeownership rate and low household debt, we do not expect the housing market to pose any sizeable downside risks in the immediate future. Mortgages grew by 5.2% yoy in March 2019 a significant drop from the 8.1% yoy growth in November 2018. A pick-up in housing supply, decelerating demand with lower population growth and net immigration point towards a soft landing.

The credit fundamentals of the Austrian banking sector are improving. Profitability barely changed, with return on equity of domestic banks reaching 9.9% in 2018 and return on assets reaching 0.8%. The NPL ratio remains on a firm downward trend, edging down to 1.9% in 4Q18, from 2.4% in end-December 2017. The share of variable rate loans further decreased in 2018, as did the share of outstanding foreign-currency loans (11.2% in 4Q18) and loans to non-residents (24.1%), but they still remain a risk factor. We expect banks to retain CET1 buffers (15.6% in 2018) and a continued building of capital and liquidity buffers to comply with tightening requirements from Basel III rules. Austria's baking system scores 'bbb' on Fitch's Banking System Indicator (BSI) and 1 on Fitch's Macro-Prudential Risk Monitor (MPI).

Derivation Summary

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 committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to rated peers, as follows:

- Public Finances: +1 notch, to reflect our expectation that the downward path of Austria's GGGD will continue beyond the SRM forecast horizon.
- Structural Features: -1 notch, to reflect the recent spike in political volatility which increases uncertainty around the outlook for fiscal and economic policy.

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 Long-Term Foreign-Currency 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.

Key Assumptions

- Fitch's long-term debt sustainability analysis baseline scenario assumes a primary fiscal surplus averaging 0.9% of GDP from 2019-2028, a steady increase in marginal interest rates, trend real GDP growth of 1.6%, and a GDP deflator converging to 2.0%.
- The global economy performs in line with Fitch's March 2019 Global Economic Outlook.

RATING SENSITIVITIES

Future developments that could individually or collectively, result in positive rating action include:
- A continued decline in the GGGD/GDP ratio.
- Confidence that the new post-elections government will continue prudent fiscal policy.
- Sustained economic growth and greater confidence in medium-term growth prospects, particularly if supported by the effective implementation of structural reforms.

Future developments that could individually or collectively, result in a stabilisation of the Outlook include:
- Weaker nominal GDP growth or failure to place public debt on a downward trajectory over the medium term, for example because of significant slippage from fiscal consolidation targets.
- Crystallisation of contingent liabilities, for example from the banking sector, which worsens the government debt profile.
- Political developments negatively affecting economic and fiscal policies and/or outturns

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Austria	LT IDR AA+ ⊕ Affirmed	AA+ ⊕
	ST IDR F1+ Affirmed	F1+
	LC LT IDR AA+ ⊕ Affirmed	AA+ ⊕
	LC ST IDR F1+ Affirmed	F1+
senior unsecured	LT AA+ Affirmed	AA+

senior unsecured	ST F1+ Affirmed		F1+
	Country Ceiling AAA Affirmed		AAA

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FITCH RATINGS ANALYSTS

Primary Rating Analyst
Arvind Ramakrishnan
Director
+49 69 768076 271
Fitch Deutschland GmbH
Neue Mainzer Strasse 46 - 50
Frankfurt am Main D-60311

Secondary Rating Analyst
Michele Napolitano
Senior Director
+44 20 3530 1882

Committee Chairperson
James McCormack
Managing Director - Head of Sovereigns
+852 2263 9625

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Applicable Criteria

Country Ceilings Criteria (pub. 19 Jul 2018)
Sovereign Rating Criteria (pub. 26 May 2019)

Additional Disclosures

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Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria	-	Long Term Issuer Default Rating	Unsolicited
Austria	-	Short Term Issuer Default Rating	Unsolicited
Austria	-	Local Currency Long Term Issuer Default Rating	Unsolicited
Austria	-	Local Currency Short Term Issuer Default Rating	Unsolicited
Austria	-	Country Ceiling	Unsolicited

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria EUR 3 bln 1.95% Gov Bonds 18 Jun 2019	AT0000A0VRF9	Long Term Rating	Unsolicited
Austria EUR 50 mln Variable Rate Notes 2 Dec 2019	XS0235645487	Long Term Rating	Unsolicited
Austria EUR 200 mln Variable Rate Notes 04 Mar 2020	XS0212688013	Long Term Rating	Unsolicited
Austria EUR 70 mln Variable Rate Notes 22 Apr 2020	XS0216258763	Long Term Rating	Unsolicited
Austria EUR 50 mln Variable Rate Notes 27 Apr 2020	XS0217517829	Long Term Rating	Unsolicited
Austria EUR 100 mln Floating Rate Notes 29 Jun 2020	XS0221500571	Long Term Rating	Unsolicited
Austria EUR 3.9% Gov Bonds 15 Jul 2020	AT0000386115	Long Term Rating	Unsolicited
Austria EUR 3.5% Gov Bonds 15 Sep 2021	AT0000A001X2	Long Term Rating	Unsolicited
Austria JPY 2 bln Fixed/Floating Rate Notes 09 Nov 2021	XS0138067995	Long Term Rating	Unsolicited
Austria JPY 1 bln Fixed/Floating Rate Notes 19 Nov 2021	XS0138429229	Long Term Rating	Unsolicited
Austria EUR 5.46 bln 3.65% local currency gov bonds 20 Apr 2022	AT0000A0N9A0	Long Term Rating	Unsolicited
Austria JPY 2.1 bln 3% Currency Linked Notes 5 Aug 2022	XS0151767687	Long Term Rating	Unsolicited
Austria EUR 3 bln 3.4% Gov Bonds 22 Nov 2022	AT0000A0U3T4	Long Term Rating	Unsolicited
Austria EUR 100 mln Inflation-Linked Notes 02 May 2023	XS0166935535	Long Term Rating	Unsolicited
Austria EUR 3 bln 1.75% Gov Bonds 20 Oct 2023	AT0000A105W3	Long Term Rating	Unsolicited
Austria DEM 2 bln 6.5% Notes 10 Jan 2024	DE0004123500	Long Term Rating	Unsolicited
Austria NLG 1 bln 6.25% Notes 28 Feb 2024	NL0000133924	Long Term Rating	Unsolicited
Austria CAD 250 mln 5% Notes 20 Dec 2024	US052591AT11	Long Term Rating	Unsolicited
Austria EUR 3.09 bln 4.85% Gov Bonds 15 Mar 2026	AT0000A0DXC2	Long Term Rating	Unsolicited
Austria EUR 6.25% Gov Bonds 15 Jul 2027	AT0000383864	Long Term Rating	Unsolicited
Austria EUR 109 mln 3.56% Gov Bonds 19 Oct 2029	XS0749005186	Long Term Rating	Unsolicited
Austria EUR 21 mln 2.452% Gov Bonds 19 Oct 2029	XS0749005343	Long Term Rating	Unsolicited
Austria GBP 200 mln Step-Up Notes 19 Oct 2029	XS0102835237	Long Term Rating	Unsolicited
Austria JPY 3 bln Fixed/Floating Rate Notes 26 Nov 2031	XS0138663173	Long Term Rating	Unsolicited
Austria JPY 1 bln 5% Currency Linked Notes 24 Sep 2032	XS0154915820	Long Term Rating	Unsolicited
Austria SKK 500 mln 5.125% Notes 2 Jan 2034	XS0182592062	Long Term Rating	Unsolicited
Austria EUR 1.5 bln 2.4% Gov Bonds 23 May 2034	AT0000A10683	Long Term Rating	Unsolicited

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria CAD 300 mln 5.375% Notes 1 Dec 2034	US052591AS38	Long Term Rating	Unsolicited
Austria EUR 4.15% Gov Bonds 15 Mar 2037	AT0000A04967	Long Term Rating	Unsolicited
Austria EUR 2 bln 3.15% Gov Bonds 20 Jun 2044	AT0000A0VRQ6	Long Term Rating	Unsolicited
Austria EUR 2 bln 3.8% Gov Bonds 26 Jan 2062	AT0000A0U299	Long Term Rating	Unsolicited
Austria ECP D	-	Short Term Rating	Unsolicited
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