PRESS RELEASE

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# DBRS Morningstar Confirms Republic of Austria at AAA, Stable Trend

SOVEREIGNS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the Republic of Austria's Long-Term Foreign and Local Currency – Issuer Ratings at AAA. At the same time, DBRS Morningstar confirmed the Republic of Austria's Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trend on all ratings remains Stable.

KEY RATING CONSIDERATIONS

The confirmation of the Stable trend reflects DBRS Morningstar's view that the risks to the ratings are limited. Although untested, the new government coalition comprising the People's Party (ÖVP) and the Greens is expected to remain committed to a conservative fiscal strategy. The recent improvement in Austria's fiscal position is projected to accommodate the expansionary measures announced by the government to counteract slower economic growth. Real GDP growth could bottom out this year at 1.1% because of an external environment that remains weak but the public debt-to-GDP ratio continues to be on a downward trajectory. Despite slower growth, a further decline in interest costs alongside a continuation in the disposal of nationalised financial institutions' assets, although more gradual, will contribute to the fall in the public debt ratio to around 63% of GDP in 2022, compared with an estimate of 70% last year.

The ratings are underpinned by Austria's prosperous, diversified, and stable economy, reflecting a real GDP per capita that is nearly 27% higher than the European Union (EU) average, and the country's solid and credible institutions. Moreover, Austria's conservative fiscal policy, favourable debt profile, and moderate private debt contribute to offsetting some vulnerabilities stemming from the banking sector and costs of an ageing population.

RATING DRIVERS

Austria's ratings could come under downward pressure if fiscal policy departs significantly from its current trajectory, leading to materially higher-than-expected deficits and rapidly worsening debt metrics. In addition, downward pressure on Austria's ratings could emerge if macroeconomic prospects materially worsen and financial stability deteriorates, placing the public debt ratio on a rapid upward trajectory.

RATING RATIONALE

An Untested Coalition is Expected to Provide Policy Continuity

Last September, elections saw the formation of an unprecedented government in Austria with the centre-right conservative ÖVP party and the Greens, the coalition's junior partner, agreeing on an agenda comprising tax reform, environmental sustainability initiatives, and increasing border controls. The government's stability might depend on the successful implementation of its new policy agenda and could potentially be subject to diverging views, especially on immigration. Nevertheless, DBRS Morningstar believes that the country will continue to benefit from its good track record of consensus-oriented policies, strong and credible institutions, and a prudent fiscal framework.

A conservative fiscal policy and advantageous cyclical conditions have improved Austria's budgetary position over the last few years. For the first time since 1974 the government recorded a surplus of 0.2% of GDP in 2018, also as result of declining interest costs along with robust revenues reflecting solid wage growth. A further improvement to an estimated 0.3% surplus last year bodes well for Austria's fiscal position, leaving the government with some fiscal space to counteract the economic slowdown without substantially de-railing the downward trajectory of the public debt-to-GDP ratio.

The new government's agenda is likely to result in a modest deterioration of Austria's fiscal position. After enacting several fiscal stimulus measures that will become effective in 2020 and in 2021, including tax relief for low-income earners and higher expenditures for pensioners, the government aims to implement further income tax cuts and to become carbon neutral by 2040. Although there are no details yet on all the compensating measures, the government remains committed to a balanced budget.

The country's main fiscal vulnerabilities remain more medium to long-term because of the rising cost of pension-related and long-term health care spending. According to the latest Österreichisches Institut für Wirtschaftsforschung (WIFO) estimates, public spending on pensions, projected at about 13.5% of GDP in 2020, is among the highest in Europe and is expected to continue to rise going forward because of the country's ageing population. Similarly, long-term health care could increase by 0.4 percentage points to 2.1% of GDP by 2030 from 1.7% in 2015.

## The Improving Debt Profile Supports Debt Affordability

Austria's public debt-to-GDP ratio is on a visibly downward path since it peaked at 84.9% in 2015 and it is projected to drop to around 63% in 2022. Sound nominal growth, prudent budget balance and the gradual wind-down of nationalised financial institutions have resulted in public debt-to-GDP to decline by almost 15 percentage points. In DBRS Morningstar's view, these drivers should also remain in place in the forecast horizon reducing risks to debt sustainability. This led to a positive qualitative assessment of the "Debt and Liquidity" building block.

At the same time Austria's liquidity position is sound, with funding costs expected to further decline going forward. This is due to both the improvement in Austria's fiscal position and the still accommodative monetary policy of the European Central Bank (ECB). Around 77% of total outstanding government bonds are now trading in negative territory and total interest costs on the federal debt are expected to fall to around 1.0% of GDP this year, around one percentage point below that registered in 2014. Moreover, Austria's average debt maturity profile is sound at around ten years, as is its debt structure, with about 94% of total outstanding bonds at fixed rates. This reduces rollover risk, mitigating the potential effect of abrupt interest rate increases.

## Resilient Domestic Demand Set to Weather External Headwinds

After a period of solid growth, Austria's economic activity is cooling towards more moderate growth rates, mainly because of a weaker external environment, as well as the manufacturing sector contraction and lower investment. Following two years of sound annual average growth of 2.4%, the country's economic growth rate is expected to decelerate to 1.3% on average in the 2020-2021 period, after the estimated 1.6% recorded last year. This is a growth rate more in line with potential, but still above the euro area average projected by the European Commission (EC) at 1.2%. Domestic demand will likely be the main driver of growth while the net export contribution is set to be weak. Private consumption will likely benefit from the sound labour market, government expansionary measures, and limited inflation. At the same time, investment sustained by the still healthy conditions in the construction sector will also remain supportive, although lower than in 2019.

Risks to economic growth are tilted to the downside and are mainly external. Beyond a further weakening of the eurozone's growth momentum, in the short-term an intensification of inward trade measures and the impact of the UK's future relationship with the EU might still cloud Austria's economic outlook. At the same time, the indirect impact of a slowdown in China including potential disruption in global value chains might hamper Austria's growth rate. By contrast, in the medium term, economic prospects remain in part constrained by restrictive regulation in the services markets, low labour participation among women and foreign nationals, and the high tax wedge which constrains potential GDP.

## Households' Moderate Debt Level Mitigates Risks Stemming from the Banking System

Improving credit quality and increasing capitalisation have strengthened Austria's banking sector. Banks have made progress in restructuring themselves both in Austria and abroad, and the nonperforming loan ratio is trending downwards. According to the Oesterreichische Nationalbank (OeNB), it is well below pre-crisis levels at about 2.3% as of Q2 2019, whereas it remains slightly more elevated for Austrian banks' subsidiaries in central south-eastern European (CESEE) countries at 2.8%. The latter number, however, has declined significantly since the 11.5% registered in 2015. At the same time, according to the ECB, Austrian banks have improved their level of capitalisation with the common equity tier 1 ratio at 15.5% as of Q2 2019 compared with 12.6% as of end-2015. This, in combination with the level of coverage ratio of about 54% (versus the EU average of 46%), mitigates risks to financial stability.

Banking system vulnerabilities have receded in recent years, but concerns related to the housing market remain noteworthy. Austrian banks' exposure to CESEE countries has slightly increased recently, but the de-risking process that has taken place in the past few years has led to a significant reduction in their exposure, especially in foreign currency. Although some uncertainty remains related to the outcome of some legal rulings on mortgage foreign currency conversion, especially in Poland, according to the OeNB, foreign currency loans do not represent a systemic risk. At the same time, in Austria, the share of foreign currency loans to Austrian households has declined significantly to around 8% of total household loans in November 2019 from around 31% registered in October 2008. However, three quarters of these foreign exchange loans are bullet payments linked to repayment vehicles and are sensitive to exchange rate movement as well as the performance of these vehicles. The latest estimate from the OeNB points to a shortfall of around 30% of the outstanding volume, equivalent to EUR 4.2 billion.

House prices have been increasing over the past decade and present a risk of correction. Low interest rates and sustained immigration have contributed to Vienna's residential property prices deviating by around 26% from their estimated fundamental values, according to the OeNB. Nationwide house price inflation remains sustained with residential property prices rising at an annual average rate of 7% over the last 12 months. In addition, the share of new variable-rate mortgage loans is high, at slightly above 41% as of November 2019, substantially above the euro area average level at 16%. To some degree, this exposes households to an abrupt increase in interest rates, in particular given that the mortgage loan growth rate remains elevated, even if the large share of social housing - 25% of the total stock - mitigates this risk.

By contrast, household resilience is supported by a moderate debt level overall that has remained broadly stable as a share of net disposable income, at around 91% over the last five years. Moreover, a relatively high net financial wealth estimated at about 129% of GDP as of Q3 2019 enables households to absorb a shock arising from financial instability. In this context, the Austrian authorities continue to monitor the development of the housing market and have both introduced legal tools to contain loan growth to risky borrowers as well as strengthening public communication on lending standards over recent years. However, the risk from the housing market and the large exposure to the CESEE countries led to a negative qualitative assessment in the "Monetary Policy and Financial Stability" building block.

## Austria Benefits from Its Solid External Position and CESEE Demand Could Cushion Lower German Imports

Austria's external position is sound and hinges on a competitive service sector as well as a diversified manufacturing base, well integrated in EU value chains. The track record of current account surpluses along with a positive net international investment position (NIIP) support the country's ratings. The tourism inflow and healthy business services receipts that compensate for the negative position in net income have resulted in a current account surplus of 2.2% of GDP on average over the last five years. At the same time, the reduction in the negative net portfolio investment position has contributed to the improvement in Austria's positive NIIP, which amounted to 7.8% of GDP in September 2019. This improvement makes the country less vulnerable to external shocks.

Global headwinds related to trade tensions and the slowdown of Germany's economy, which is the largest export partner with around 30% of market share, are weighing on Austrian export performance. Nevertheless, supportive external demand from CESEE countries, which continue to outperform euro area growth, lower Austrian import growth, and the healthy surplus from services are expected to sustain the positive current account position. The OeNB estimates Austria's surplus will slightly improve to 2.3% of GDP in 2020 from the estimated 2.2% in 2019.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments: https://www.dbrs.com/research/356612/.

EURO AREA RISK CATEGORY: LOW

Notes:
All figures are in euros unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal methodology is the Global Methodology for Rating Sovereign Governments, which can be found on the DBRS Morningstar website www.dbrs.com at http://www.dbrs.com/about/methodologies. The principal rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website at http://www.dbrs.com/ratingPolicies/list/name/rating+scales.

The sources of information used for this rating include Statistik Austria, OeNB, OeBFA, Austrian Ministry of Finance (BMF), EC, ECB, WIFO, Eurostat, IMF, World Bank, UNDP, OECD, BIS, Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

This is an unsolicited rating. This credit rating was not initiated at the request of the issuer.

This rating included participation by the rated entity or any related third party. DBRS Morningstar had no access to relevant internal documents for the rated entity or a related third party.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see:
http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

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For more information on this credit or on this industry, visit www.dbrs.com.

## Ratings

### Austria, Republic of

| Date Issued | Debt Rated | Action | Rating | Trend | Issued |
|---|---|---|---|---|---|
| 07-Feb-20 | Long-Term Foreign Currency - Issuer Rating | Confirmed | AAA | Stb | EU |
| 07-Feb-20 | Long-Term Local Currency - Issuer Rating | Confirmed | AAA | Stb | EU |
| 07-Feb-20 | Short-Term Foreign Currency - Issuer Rating | Confirmed | R-1 (high) | Stb | EU |
| 07-Feb-20 | Short-Term Local Currency - Issuer Rating | Confirmed | R-1 (high) | Stb | EU |



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