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DBRS Morningstar Confirms Republic of Austria at AAA, Stable Trend

Industry Group: Public Finance – Sovereigns
Region: Europe

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 improvements in Austria's public finances up to the end of 2019 have left the country with enough room to mitigate the impact of the Coronavirus Disease (COVID-19) outbreak on its economy thus far. The government's response to the pandemic has been significant but at the expense of a large rise in public debt, likely above the peak registered in 2015 of 84.9% of GDP this year, up from the 70.5% recorded in 2019. A gradual recovery is expected to lead the government to a return to its previous conservative fiscal strategy. While a considerable degree of uncertainty remains on the economic outlook, the swift government support mitigates the risk of a long-lasting impact on growth. According to the latest Central Bank forecast (Oesterreichische Nationalbank, OeNB), Austria's gross domestic product (GDP) is expected to have decreased by 7.1% in 2020, before rebounding by 3.6% in 2021.

The ratings are underpinned by Austria's prosperous, diversified, and stable economy, reflecting a real GDP per capita that is about 27% higher than the European Union (EU) average, as well as the country's solid and credible institutions. Moreover, Austria's historical track record of conservative fiscal policy bodes well for a post-pandemic improvement in public finances in the medium term. This, along with moderate private sector debt levels, offsets some vulnerabilities stemming from the cost associated with an ageing population, a rising public debt and a likely deterioration in banking system credit quality going forward.

RATING DRIVERS

One or a combination of the following factors could lead to a downgrade: (1) Austria fails to achieve a gradual improvement in public finances over the medium term; or (2) there is a prolonged deterioration in macroeconomic prospects, placing the public debt ratio on an even more rapid upward trajectory.

RATING RATIONALE

Substantial Government Support Provides Relief but at the Cost of a Record Deficit

After two years of budgetary surpluses, the comprehensive fiscal support package implemented by the Austrian government to mitigate the negative effects of the coronavirus pandemic on its economy has caused a significant deterioration of its deficit. However, once the pandemic is under control and the recovery on a steady course, Austria's fiscal position is expected to continue to benefit from conservative government budgetary policy demonstrated by a good track record.

A series of measures including public sector guarantees, short-time work arrangements, fixed cost subsidies, tax deferrals, and debt moratoria are supporting households' income and liquidity in particular to small and medium-size enterprises. Including the reduction in the lowest income tax rate to 20% from 25%, retroactively effective since 1 January 2020, the whole support envelope is providing relief to the economy. This is resulting in a sharp deterioration in the fiscal accounts. Latest estimates from the government point to a deficit of 9.8% of GDP in 2020 but the outcome might be better than expected if tax revenues eventually turn out higher. The government plans to extend some temporary measures to sustain the economy this year, including the short-term labour scheme, the fixed cost subsidy and state guarantees. These measures along with the permanent personal income tax reduction could delay the improvement in fiscal accounts, albeit the economy is expected to recover. The government projects a decline in the budget deficit to 7.1% of GDP this year. In DBRS Morningstar's view, however, in light of new restrictions because of the rise in infections, the extent of the improvement in the fiscal trajectory remains subject to high uncertainty. Depending on the take-up rate of some government initiatives, along with the recovery and a rapid roll-out of the vaccines, the government could decide to extend the fiscal stabilization package further, delaying the reduction in the budget deficit. This makes Austria's fiscal outlook uncertain and negatively weighed on DBRS Morningstar's qualitative assessment of the "Fiscal Management and Policy" building block.

Austria's additional fiscal vulnerabilities relate more to the long-term because of the rising cost of pension-related and long-term care spending. In particular, according to the 2018 Ageing Report, Austria's pensions spending is among the highest in Europe, and it is expected to increase more than the EU average, reducing fiscal space in the future. Latest projections by the Austrian Institute of Economic Research (Österreichisches Institut für Wirtschaftsforschung, WIFO) prior to the outbreak, pointed to an increase of 1.6 percentage points in pension costs to 15.1% of GDP between 2020 and 2040. Similarly, long-term care could increase by 1.0 percentage point to 2.6% of GDP by 2040 from 1.6% in 2020.

The Unprecedented Shock Interrupts the Improvement in the Debt Trajectory but Debt Affordability Remains Strong

After years of a steady improvement in the debt trajectory, the unprecedented crisis related to the pandemic will result in a stark rise in the public debt ratio in 2020. The shock has interrupted the downward trend that had seen Austria reducing its public debt by around 14 percentage points in almost five years to 70.5% of GDP in 2019. This was achieved thanks to conservative fiscal policy, sound nominal growth accompanied by efforts to wind down nationalised banks. The government projects the sharp recession and large fiscal package to have brought the public debt-to-GDP ratio to 84.9% in 2020, before a further increase to 87.9% projected for this year. However, as the government starts to receive grants from the EU within the Recovery and Resilience facility (RRF), which is part of the Next Generation EU (NGEU) programme, stock flow adjustment will be affected positively and in turn so will the debt trajectory. In DBRS

Morningstar's view, provided that the pandemic shock on the economy remains temporary, once the recovery is firmly underway, the government's prudent fiscal strategy mitigates the risk of a more material deterioration in the debt trend.

Austria's liquidity position is very sound. Around 84% of total outstanding government bonds are now trading at negative yields and total interest payments on the federal debt are expected to continue to decline to 0.9% of GDP this year and a further reduction is likely going forward. Moreover, Austria's average debt maturity profile is sound at approximately ten years, one of the longest maturities in the EU. Moreover, its debt structure of about 90% of total outstanding bonds at fixed rates reduces rollover risk, and mitigates the potential effect of abrupt interest rate increases. All these factors contributed to DBRS Morningstar's positive qualitative assessment of the "Debt and Liquidity" building block.

The Prolonged Impact of the Pandemic Will Weigh on the Recovery but Long-Lasting Effects are Projected to be Limited

The government's rapid implementation of the support programme has cushioned the negative effects of the pandemic and of the related restrictive measures. Nevertheless, the prolonged impact of the COVID-19 outbreak is weighing on the recovery in the short-term. Depending on the containment of the pandemic domestically and abroad, and on the rapid rollout of the vaccines, economic activity is expected to accelerate from Q2/Q3 2021 and long-lasting effects are projected to be limited as a result of government support.

The sharp decline in economic activity registered in the first half of last year, with (seasonally adjusted) GDP contracting by 14.2% year-on-year (y/y), was followed by a partial rebound in the third quarter, leaving GDP 4.2% lower than the year before in Q3 2020. However, over recent months, the rise in infections has led to a reimposition of new confinement measures with a further hit to economic activity. Nonessential shops, restaurants, and bars are closed until the first week of February 2021 with the risk of a further extension, should infections rise again or should a more aggressive coronavirus variant spread in Austria. Latest estimates from OeNB, point to a GDP contraction of 7.1% in 2020, and the prolonged impact of the pandemic will likely be a drag on the performance at the beginning of 2021. DBRS Morningstar views an uneven recovery among sectors with the tourism sector, which accounts for around 15% of GDP, likely to remain affected by the physical distancing measures imposed both in Austria and abroad during the winter season. This will likely weigh on the GDP recovery, projected at 3.6% this year by the OeNB. In DBRS Morningstar's view, however, the country's fundamentals remain sound, the unemployment rate has increased modestly and the manufacturing sectors showed resilience. This mitigates against the risk of long-lasting effects.

Risks to the economic outlook in the short-term are tilted to the downside, largely related to the evolution of the pandemic in Austria and abroad as well as to the distribution of the vaccine. 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 that although declining still constrains potential GDP.

Trade and Tourism Key for Austria's External Accounts

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. However, the disruption in global value chains during the first lockdown in Europe has taken a toll on the export performance, in particular in the automotive sector. As the recovery globally gains momentum, Austria's export performance is expected to improve and also to benefit from Central, Eastern, and Southeastern European (CESEE) countries' demand likely boosted by a large amount of EU funds from the NGEU.

Moreover, the flow of tourism, particularly from Germany, which contributes largely to the surplus in services (2.5% of GDP in 2019), has been affected by the restrictive measures imposed. After recovering during the summer, it has now been further affected by the new restrictions implemented during the winter season. However, the recovery in export of goods and domestic tourism, along with the sharp fall in imports, have enabled the current account surplus to remain in a sound position. According to the EC, Austria's current account surplus should have declined to 2.1% of GDP in 2020 from 2.8% in 2019. As the health situation improves, albeit gradually, tourist flows are expected to return to normal, positively affecting Austria's external position. The country also benefits from a sound positive NIIP of 11.4% of GDP in Q3 2020, which has increased over the years thanks to a reduction in the negative net portfolio position and sound positive net direct investment flows.

High Capital Ratios Mitigate Risks for Banks Stemming From The Expected Deterioration in Loan Quality Because of Coronavirus

The banking sector is in a substantially stronger position compared with the one it had when entering the Global Financial Crisis (GFC) and it has improved its resilience. An elevated level of capitalisation, and high coverage ratios should enable the banking system to cope with the consequences of the pandemic. In addition, nonperforming loans (NPLs) are currently low thanks to a steady decline in the past. From 2012 to June 2020, NPL ratios declined to 1.5% from 4.7% and to 2.3% from 13.9% in Austria and CESEE countries, respectively. Moreover, indirectly, government support to the real economy is easing the impact of the coronavirus on the banking system. Nevertheless, past improvements in loan quality are expected to be interrupted and loans classified at stage two (IFRS9) are rising. Once the consequences of the crisis unfold and the government support measures are phased out, credit quality is expected to deteriorate but frontloaded provisions along with the high level of capitalisation mitigate the risk to financial stability. Still, major losses are expected to weigh on the banking system in the medium-term, according to the OeNB.

Liquidity shortages and working capital needs are benefiting from government measures including moratoria, and the State guarantees that have supported credit lending. Nevertheless, exposure to sectors most affected by the lockdown measures remains limited at around 6% of total loans, and although the overall debt of nonfinancial corporations is rising, higher deposits and low interest costs support debt affordability. A large share of loans at variable rates, elevated reliance on the CESEE market with regard to profits, and a high but declining forex mortgage loan portfolio remain vulnerabilities.

A risk of correction in the housing market after a prolonged increase in residential property prices is mitigated by the good financial position of households. Although the increase has not been credit-driven, years of low interest rates and steady levels of immigration have contributed to Austria's residential property prices being approximately 17% higher than their estimated fundamental values in July 2020, according to the OeNB. The effect of the pandemic seems to have provided an acceleration to housing prices. With more people working from home, demand increased and house price growth accelerated with a 9.7% year-on-year increase registered in Q3 2020 compared with 1.2% in Q4 2019. However, 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 approximately 142% of GDP as of Q3 2020 provides a buffer for households to absorb the economic shock.

Ratings Are Supported by Credible Institutions

The country benefits from its good track record of consensus-oriented policies, strong and credible institutions, and a prudent fiscal framework. 2019's national elections followed by months of negotiations 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 coalition, although supported by a slim majority, with the leadership of the prime minister Sebastian Kurz (ÖVP), has rapidly passed several measures to counteract the economic fallout of the pandemic and contain the spread of the virus.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework and its methodologies can be found at: https://www.dbrsmorningstar.com/research/357792.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments.

EURO AREA RISK CATEGORY: LOW

Notes:

For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: https://www.dbrsmorningstar.com/research/357883.

All figures are in euros (EUR) 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 https://www.dbrsmorningstar.com/research/364527/global-methodology-for-rating-sovereign-governments (27 July, 2020).

The sources of information used for this rating include Statistik Austria, OeNB (Financial Stability report November 2020), OeBFA (Investor Presentation January 2021), Austrian Ministry of Finance (BMF) (Austria Draft Budgetary Plan, October 2020), 2018 Ageing report, EC, EC (November forecast 2020, Commission opinion on the 2021 Draft Budgetary Plan of Austria November 2020, Staff working document - Analysis of the 2021 Draft Budgetary Plan of Austria November 2020, Country Report Austria 2020), ECB, WIFO, Eurostat, IMF, World Bank, UNDP, 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.

With Rated Entity or Related Third Party Participation: YES
With Access to Internal Documents: NO
With Access to Management: NO

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 12-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. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: https://www.fca.org.uk/firms/credit-rating-agencies.

The sensitivity analysis of the relevant key rating assumptions can be found at: https://www.dbrsmorningstar.com/research/372983.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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

Issuer	Debt Rated	Rating Action	Rating	Trend
Austria, Republic of	Long-Term Foreign Currency – Issuer Rating	Confirmed	AAA	Stable
Austria, Republic of	Long-Term Local Currency – Issuer Rating	Confirmed	AAA	Stable
Austria, Republic of	Short-Term Foreign Currency – Issuer Rating	Confirmed	R-1 (high)	Stable
Austria, Republic of	Short-Term Local Currency – Issuer Rating	Confirmed	R-1 (high)	Stable

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Austria

Scorecard Indicators

Fiscal Management and Policy	2015	2016	2017	2018	2019	2020	2021	2022	2023	Source	Current Scorecard Input	
Overall Fiscal Balance (% of GDP)	-1.0%	-1.6%	-0.7%	0.2%	0.7%	-9.9%	-3.9%	-2.3%	-1.8%	IMF WEO	13 year average	-2.3%
Government Effectiveness (Percentile Rank)	90.4	91.8	91.8	90.9	91.8	-	-	-	-	World Bank	5 year average	91.3
Debt and Liquidity	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
General Government Gross Debt (% of GDP)	84.4%	82.6%	78.4%	74.0%	70.3%	84.8%	84.3%	82.4%	81.1%	IMF WEO	5 year projection	77.0%
Interest Costs (% of GDP)	1.9%	1.7%	1.5%	1.2%	1.0%	1.0%	0.9%	0.8%	0.6%	IMF WEO	5 year average	1.0%
Economic Structure and Performance	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
GDP per Capita (USD thousands)	44.3	45.2	47.4	51.3	50.4	48.6	54.8	57.8	60.0	IMF WEO	10 year average	49.0
Output Volatility (%)	1.6%	1.6%	2.4%	2.5%	2.4%	2.4%	2.4%	-	-	IMF WEO	Latest	2.4%
Economic Size (USD billions)	382	395	418	456	446	433	490	519	542	IMF WEO	5 year average	430
Monetary Policy and Financial Stability	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Rate of Inflation (%, EOP)	1.0%	1.5%	2.3%	1.7%	1.8%	1.0%	1.9%	1.8%	2.0%	IMF WEO	13 year average	1.8%
Total Domestic Savings (% of GDP)	195%	198%	202%	197%	202%	217%	-	-	-	ECB/IMF	Latest[1]	217%
Change in Domestic Credit (% of GDP)	-0.3%	0.6%	-0.6%	-0.9%	-1.7%	9.7%	-	-	-	BIS/IMF	7 year average[1]	0.4%
Net Non-Performing Loans (% of Capital)	13.2%	11.2%	10.9%	8.0%	6.3%	4.2%	-	-	-	IMF IFS	Latest[1]	4.2%
Change in Property Price/GDP Index (%)	0.8%	3.4%	0.2%	2.6%	0.6%	12.8%	-	-	-	OeNB/IMF	7 year average[1]	3.0%
Balance of Payments	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Current Account Balance (% of GDP)	1.7%	2.7%	1.6%	2.3%	2.6%	2.4%	2.5%	2.3%	2.4%	IMF WEO	8 year average	2.4%
International Investment Position (% of GDP)	2.2%	4.1%	4.3%	5.3%	12.1%	12.4%	-	-	-	IMF	5 year average[1]	7.6%
Share of Global Foreign Exchange Turnover (Ratio)	201.1%	194.4%	200.2%	198.6%	206.3%	208.7%	-	-	-	BIS/IMF	Latest	208.7%
Exchange Rate Classification (see footnote)	5	5	5	5	5	5	-	-	-	IMF	Latest	5
Political Environment	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Voice and Accountability (Percentile Rank)	94.1	93.6	93.6	93.1	93.6	-	-	-	-	World Bank	5 year average	93.6
Rule of Law (Percentile Rank)	96.2	95.7	96.2	97.6	97.1	-	-	-	-	World Bank	5 year average	96.5

See DBRS Morningstar's Global Methodology for Rating Sovereign Governments for additional details on the methodology behind the scorecard indicators and associated scoring thresholds. Exchange Rate Classifications: Freely floating exchange rate = 1; Float = 2; Crawls, banded pegs, and other managed = 3; Stabilized = 4; Pegs, currency unions and dollarized arrangements = 5.

[1] Scores for 2020 have been computed using the most recent data when year-end data is not available.

Rating Committee Date: 26-Jan-2021

Austria

Building Block Assessments and Rating Committee Summary

26-Jan-2021

Building Blocks	Scorecard Result	Quantitative Assessment	Net Impact of Qualitative Factors	Building Block Assessment
Fiscal Management and Policy	17.14	Strong	- 1 Category	Strong/Good
Debt and Liquidity	12.26	Good/Moderate	+ 1 Category	Good
Economic Structure and Performance	14.49	Good	N/A	Good
Monetary Policy and Financial Stability	18.30	Strong	N/A	Strong
Balance of Payments	15.00	Strong/Good	N/A	Strong/Good
Political Environment	20.00	Very Strong	N/A	Very Strong
Overall Assessment	**Composite Scorecard Result**	**Scorecard Rating Range**	**Composite Building Block Assessment**	**Indicative Rating Range**
	81.0	AAA - AA	81.0	AAA - AA

Austria's Long-Term Foreign Currency - Issuer Rating AAA

Main topics discussed in the Rating Committee include: Austria's fiscal outlook, tourism flows, vulnerabilities in the banking system, political environment, Austria's external position, public debt affordability and economic recovery. For additional details on DBRS Morningstar analysis and opinions, please see the accompanying rating report.

DBRS Morningstar Scorecard: Scoring Ranges and Associated Assessment Categories

Lower Bound	0.00	1.00	3.00	5.00	7.00	9.00	11.00	13.00	15.00	17.00	19.00
Upper Bound	0.99	2.99	4.99	6.99	8.99	10.99	12.99	14.99	16.99	18.99	20.00
Assessment Category	Very Weak	Weak	Weak/ Poor	Poor	Poor/ Moderate	Moderate	Good/ Moderate	Good	Strong/ Good	Strong	Very Strong