FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Austria's Outlook to Stable; Affirms IDR at 'AA+'

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Related Content:
Austria - Rating Action Report

Fitch Ratings - Frankfurt am Main - 25 Aug 2023: Fitch Ratings has revised the Outlook on Austria's Long-Term Foreign-Currency (LTFC) Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR at 'AA+'.

A full list of rating actions is detailed below.

KEY RATING DRIVERS

The revision of the Outlook reflects the following key rating drivers and their relative weights:

Medium

Diminishing Energy Supply Risks: Austria remains one of a few EU countries that is still receiving material shares of Russian pipeline gas, which averaged close to 60% of monthly imports in 1H23. A cut-off from Russian gas supplies could materialise if the transit contract between Ukraine and Gazprom is not renewed beyond 2024.

A complete and permanent stop of Russian gas flows should, however, now be manageable given Austria's access to newly secured non-Russian gas supplies. Austria's gas storage facilities are currently 92% full and include a government-controlled strategic gas reserve. Austria is also very well-integrated into EU gas pipeline networks and EU gas supply pressures have eased significantly since last year due to ample LNG supplies and very high gas storage levels, which would make it much easier for Austria to purchase gas on spot markets in case Russian gas is cut off.

Efforts to Diversify Gas Sources: Austria's largest public utility company OMV (A-/ Stable) has taken important steps to diversify its gas resources over the medium-and-long term. OMV has booked additional pipeline capacities until 2026 and again until 2028 for 45% and 22% of annual consumption, respectively. In July, OMV announced the discovery of a domestic gas reserve, which could increase low annual domestic production by 50% as of 2024. It has also signed a 10-year LNG contract with BP (A/Positive), securing 16.5% of annual consumption from 2026 onwards. In the long term, large-scale investments in Romania could yield additional gas supplies.

Contractual Risks Contained: Uncertainty remains due to a long-term take-or-pay contract between OMV and Gazprom that runs until 2040. Compared with our last review, we view it as less likely that domestic or international political pressures could lead to a premature end of the contract at a potentially substantial fiscal cost that would erode public debt sustainability. There is a lack of transparency on the details of the contract with Gazprom but arbitration proceedings would likely take years to get resolved and could be absorbed, in our view.

Austria's 'AA+' rating also reflects the following key rating drivers:

Credit Fundamentals: 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 public debt relative to peers', although refinancing risks are mitigated by long maturities and low financing costs.

Fiscal Deficit Shrinks: Fitch forecasts that fiscal deficits will narrow to 3.0% of GDP in 2023 and to 1.5% in 2024 from 3.2% in 2022, but remain above the 'AA' medians of 2.1% and 0.8%, respectively. We expect temporary energy and inflation relief measures to cost 2.5% of GDP in 2023, higher than 1.8% in 2022, but this will fall to 1.0% in 2024 and to 0.1% in 2025. At the same time, the impact from the indexation of personal income tax brackets as well as the government's 'eco-social tax reform' have started to permanently lower government revenues. Next year's parliamentary elections are a source of uncertainty around the future fiscal policy direction.

Government Debt Reduction: Fitch estimates that general government debt will decline to 76.6% of GDP at end-2023 and to 73.4% in 2025 from 78.4% at end-2022. Sizeable stock-flow adjustments of almost 1% of GDP per year over the next two years mean that debt will fall more gradually than implied by the headline deficit. Stock-flow adjustments primarily reflect below par bond issuance due to the impact of rising interest rates on bond market valuations. Austria's debt/GDP will continue to decline to 70.9% of GDP by end-2027, near the pre-pandemic level of 70.6%, driven by nominal GDP growth and small primary surpluses.

Gradual Increase in Interest Expenses: We project that interest payments will gradually increase to 2.9% of revenues by 2024, converging towards the forecast 'AA' median of 3.0%. The impact from higher ECB policy rates is mitigated by a very long average maturity of general government debt.

Economic Weakness in 2023: Following a strong post-pandemic recovery, economic growth has weakened markedly since 2H22. We now predict that economic growth will stagnate in 2023, versus our previous forecast of 0.4%. Real GDP dropped 0.4% qoq in 2Q23 and short-term indicators point towards a further decline of growth in 3Q23.The manufacturing sector has been a key weakness, suffering from still high energy prices and a lack of demand. At the same time, the tourism sector continues to do very well, with overnight stays on average reaching 95% of their 2019 record levels in 1H23.

We now believe that the current economic weakness will take longer to be resolved and have revised down our forecast for 2024 to 1.2% from 1.5%. Growth will pick up again to 1.6% in 2025. We expect that this year's small negative output gap will be closed by 2026 and real GDP growth should approach potential growth of around 1.3% in the medium term.

Heightened Inflation: Inflation has been higher and more persistent versus other euro zone economies. The Austrian government focused on compensatory measures and did not directly interfere in the energy price mechanism which fuelled prices in other sectors. Both HICP and core inflation exceeded the eurozone averages in July at 7.0% and 7.7%, respectively. We expect wage growth to be strong this year as wage indexation in Austria is quasi-automatic given that average inflation over the past 12 months is used as a basis for collective wage agreements. Risks from a wage-price spiral are mitigated by a cooling labour market as economic activity slows.

Resilient Banking Sector: The Austrian banking sector is resilient, with a consolidated sector common equity Tier 1 ratio of 16.3% at end-2022 and a non-performing loans ratio of 1.7% at end-1Q23. In 2023, continued geopolitical uncertainty and high inflation are likely to slow loan demand and result in higher borrower default rates, but higher interest rates will partly support banks' performance. Risks from a decline in house prices are mitigated by very low household indebtedness while mortgage debt is primarily held by households with above-average incomes. Fitch's macro prudential indicator for Austria stands at '2', indicating a moderate vulnerability from rising real credit growth and asset price growth.

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 Sovereign Rating Model (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 insufficient progress on fiscal consolidation, weaker medium-term growth prospects, or the crystallisation of sizeable contingent liabilities.

- **Macro:** A large adverse macroeconomic shock, for example, due to adverse energy supply or price developments or other spillovers from the war in Ukraine, particularly if leads 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: 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 LTFC IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM score to arrive at the LTFC 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 and subsequent inflation shock. 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 Finances:** +1 notch to reflect our expectation that government debt/GDP will decline beyond the 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 LTFC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the LTFC IDR, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for the Austria is 'AAA', one notch above the LTFC IDR and at the top of the rating scale. We view the risk of exchange and capital controls as de minimal. Fitch's Country Ceiling Model produced a starting point uplift of 3 notches above the IDR and Fitch's rating committee did not apply a qualitative adjustment to the modelled result.

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 \ track 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). Fitch's ESG Relevance scores are not inputs in the rating process; they are an observation of the materiality and relevance of ESG factors in the rating decision. 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 Stable	Affirmed	AA+ Rating Outlook Negative
	ST IDR	F1+	Affirmed	F1+

	LC LT IDR AA+ Rating Outlook Stable 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

Sovereign Rating Criteria (pub. 06 Apr 2023) (including rating assumption sensitivity)

Country Ceiling Criteria (pub. 24 Jul 2023)

APPLICABLE MODELS

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

Country Ceiling Model, v2.0.0 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.14.0 (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%	XS0182592062	Long Term Rating	Unsolicited

UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS
bond/note 02-Jan-2034			
Austria EUR 4.15% Gov Bonds 15 Mar 2037	AT0000A04967	Long Term Rating	Unsolicited
Austria EUR 8.51 bln 3.15% bond/note 20-Jun-	AT0000A0VRQ6	Long Term Rating	Unsolicited

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