FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Austria at 'AA+'; Outlook Stable

Fri 07 May, 2021 - 17:02 ET

Fitch Ratings - Frankfurt am Main - 07 May 2021: Fitch Ratings has affirmed Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA+' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Austria's 'AA+' rating is supported by a rich, diversified, open and high-value-added economy with strong political and social institutions. It benefits from low private sector indebtedness and sound external finances. These strengths are balanced by Austria's high and rising level of public debt relative to peers and an ageing population, which is set to put pressure on already high pension spending.

The Stable Outlook reflects our expectation that following last year's sharp rise, general government debt will resume its downward trajectory. However, the fiscal adjustment will be gradual and debt will peak only in 2022. The government's debt structure is favourable, with an average debt maturity of around 11 years, low and declining borrowing costs and strong financing flexibility underpinned by the ECB's ultra-loose monetary policy.

The Austrian economy contracted by 6.6% in 2020, on par with the average decline in growth observed across the eurozone. Following another spike in Covid-19 cases, the government introduced new lockdown measures at the beginning of November, leading to a contraction of 2.7% in 4Q20 (seasonally adjusted). The government started to partially ease containment measures again at the beginning of February with a focus on geographically-concentrated lockdown measures combined with an extensive testing strategy to allow for the conditional reopening of schools, office spaces and non-essential shops.

Despite these efforts and a strong rebound in construction and manufacturing activity, a first flash estimate for 1Q21 shows that economic output was almost unchanged compared with the previous quarter.

Austria's economic recovery in 2021 will be weaker compared with the eurozone (2.5% vs. 4.7% according to Fitch's latest forecast) due to a weak performance of the tourism sector, which will weigh on private consumption and service exports. While last year's winter season was only moderately affected by the pandemic and tourism strongly rebounded during the summer months, this year's skiing season has been almost completely lost, with tourist arrivals in 1Q21 95% below pre-pandemic levels. We anticipate that international travel restrictions and strict quarantine measures imposed by neighbouring governments will continue to limit the inflow of tourists over the coming months.

We forecast Austria's economy to grow by 4.3% in 2022 but economic output will reach its pre-pandemic level only by 1Q23. The impact from the EU's Recovery Fund will be limited given the small size of the allocated funds relative to the size of the Austrian economy (EUR3.5 billion until 2026 or 0.9% of projected 2021 GDP). The Austrian government has submitted projects to the European Commission for a total volume of EUR 4.5 billion or 1.1% of projected 2021 GDP, of which two-thirds will be allocated towards new projects while the rest will go towards previously budgeted projects. However, Austria could indirectly benefit from economic gains achieved among European trading partners who are net recipients, and from enhanced economic, financial and political resilience of the eurozone. We believe that the Austrian economy can return to pre-pandemic growth in the long term and estimate that potential growth is unchanged at 1.5%.

Following two years of fiscal surpluses in 2018-19, the government provided sizeable fiscal support to ease the impact of the Covid-19 crisis on the Austrian economy. Direct and temporary support measures to the economy amounted to around EUR21 billion (5.5% of GDP) in 2020. In addition, built-in automatic stabilisers and the reduction of the first income tax bracket to 20% from 25% helped cushion the impact from the pandemic and support household incomes, in particular for low-income earners. Overall, the general government balance deteriorated substantially from a surplus of 0.6% of GDP in 2019 to a deficit of 8.9% of GDP in 2020, well above the peak deficit during the global financial crisis (-5.3% of GDP) and above the current 'AA' median of 6.5% of GDP for 2020.

The government has announced additional fiscal support in response to the relatively weak growth outlook for this year. We now project that the government's fiscal deficit will remain wide at 8.2% of GDP in 2021, factoring in the announced extension of the short-term work scheme for the first half of the year and additional direct support for companies and families during 2021. While these measures are temporary, the government has announced others that aim primarily to encourage corporate investments and that will affect the government's fiscal balance over the next several years.

The longer-term measures include sizeable subsidies for (green) investments and additional tax incentives that will have a combined deficit-increasing effect of about 1.6% of GDP annually until 2024. We forecast a fiscal deficit of 5.3% of GDP in 2022 and believe that the government will be able to achieve its target of a 3% deficit by 2023, complying again with EU fiscal rules.

Our deficit and growth projections imply an increase in the general gross government debt to 87.7% of GDP this year from 83.9% of GDP in 2020, exceeding the current 'AA' median at 46.1% by a wide margin. Our debt forecast includes the materialisation of contingent liabilities from the government's Covid-19-related state guarantee programme of around 0.4% of GDP per year, partially offset by proceeds from the continued resolution of Austria's bad banks.

Despite the projected increase in public debt levels, Austria's favourable debt structure remains a credit strength. We expect that interest payments as a share of government revenue will fall to 1.9% in 2022, below the 'AA' projected median (2.4%). This reflects benign financing conditions underpinned by the ECB's monetary easing measures, and a long average maturity of debt (10.7 years, among the longest among EU27 countries), which provides some buffer in the event of interest rate rises.

The Austrian banking sector has weathered the pandemic well so far. Capital and liquidity buffers remained strong throughout 2020, helped by regulatory relief and state aid measures introduced at the start of the crisis. Austrian banks reported an aggregate common equity Tier 1 ratio of 16.8% by year-end, 90bp above the 2019 level, and comfortably exceeding the regulatory requirements. Asset quality remained remarkably strong and non-performing loan (NPL) ratios further declined to close to 1.6% in 2020, down from 3.5% at the end of 2014 due to pandemic-related support measures, including automatic stabilisers, guarantees and forbearance measures.

We expect corporate default rates to rise as the suspension of the obligation to file for insolvency due to over-indebtedness is lifted. However, we expect the increase in NPLs to be contained and believe that the Austrian banking system is sufficiently well-capitalised to deal with higher loan losses.

ESG

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, as is the case for all sovereigns. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Austria has a WBGI ranking at the 91 percentile, reflecting strong institutional capacity and effective rule of law.

Austria has an ESG Relevance Score of '5' for Political Stability and Rights as World Bank Governance Indicators 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.

Austria has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators 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.

Austria has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver.

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.

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 SENSITIVITIES

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO NEGATIVE RATING ACTION/DOWNGRADE:

Public Finances: Persistent increase in general government debt, for example due to a more prolonged period of fiscal loosening in response to sustained disruptions from the coronavirus pandemic, weaker medium-term growth prospects, or crystallisation of contingent liabilities.

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 and long term toward pre-pandemic levels faster than projected, for example due to a stronger economic recovery and/or fiscal consolidation post-coronavirus.

- Macro: Increased confidence that Austria can return to sustained economic growth in the medium term, particularly if supported by the effective implementation of structural reforms.

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

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.

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:

- +1 notch: 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 and volatility variables 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.

- +1 notch: Public Finances: to reflect to reflect Austria's favourable debt structure, including one of the longest weighted average maturity of market debt in the EU27, and a forecasted decline in the already-low debt service burden

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.

KEY ASSUMPTIONS

The global economy performs broadly in line with Fitch's latest Global Economic Outlook published on 17 March 2021, which projects eurozone growth at 4.7% in 2021 and 4.5% in 2022.

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.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Austria	LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

ENTITY/DEBT	RATING			PRIOR
•	ST IDR	F1+	Affirmed	F1+
•	LC LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
•	LC ST IDR	F1+	Affirmed	F1+
•	Country Ceili...	AAA	Affirmed	AAA

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Apr 2021) (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, v1.7.1 (1)

Debt Dynamics Model, v1.2.1 (1)

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

Sovereign Rating Model, v3.12.2 (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	No
With Access to Management	Yes

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UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS
Austria EUR 6.25% Gov Bonds 15 Jul 2027	AT0000383864	Long Term Rating	Unsolicited
Austria EUR 1.02 bln 6.5% bond/note 10-Jan-2024	DE0004123500	Long Term Rating	Unsolicited
Austria EUR 109 mln 3.56% Gov Bonds 19 Oct 2029	XS0749005186	Long Term Rating	Unsolicited
Austria	-	Local Currency Long Term Issuer Default Rating	Unsolicited
Austria JPY 1 bln	XS0138429229	Long Term Rating	Unsolicited

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Sovereigns Europe Austria

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