FitchRatings

RATING ACTION COMMENTARY

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

Fri 15 May, 2020 - 16:01 ET

Link to Fitch Ratings' Report(s):
Austria - Rating Action Report

Fitch Ratings - Frankfurt am Main - 15 May 2020: Fitch Ratings has revised the Outlook on Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) to Stable from Positive and affirmed the IDR at 'AA+'.

KEY RATING DRIVERS

The revision of the Outlook on Austria's IDRs reflects the following key rating drivers and their relative weights:

High

The Outlook revision reflects the significant impact of the global coronavirus pandemic on Austria's economy and public finances. Fitch forecasts real GDP to contract by 8.3% in 2020, reflecting the health crisis shock to the global economy and tourism, and the government's containment measures, as both firms' and households' spending is put on hold. Growth in public consumption will provide some limited cushion, on the back of increased spending in the healthcare sector.

There are material downside risks to our forecasts, which assume that restrictions continue being lifted at a relatively fast pace and that the coronavirus pandemic will be contained in 2H20, leading to an economic recovery in 2021 (4.1%). Economic outturns could be significantly weaker for 2020 and 2021 in the event of a second wave of infections and a resumption of lockdown measures, or if Austria's trading partners fail to recover.

The impact of the shock on the domestic economy will be partially softened by proposed government relief measures to combat the disease and support the economy. The authorities announced they would be implementing a package amounting to EUR38 billion (9.5% of 2019 GDP), with the composition and volume of each instrument being adjusted according to future needs. Fitch estimates that EUR9 billion (2.3% of GDP) will be used for wage subsidies, adding to EUR6.5 billion (1.6% of GDP) in emergency aid

to SMEs, self-employed workers and the healthcare sector. Tax deferrals will lead to an overall revenue tax loss of EUR8.5 billion (2.1% of GDP) in 2020, but we expect EUR6 billion (1.5% of GDP) to be recouped in 2021.

Fitch believes Austria has fiscal room to absorb this shock, owing to its record of fiscal prudence, but there are downside risks to our estimates. We estimate the general government balance to deteriorate to a deficit of 9.6% of GDP in 2020, from a better-than-expected surplus of 0.7% in 2019, based on the operation of automatic stabilisers and the direct budget impact of close to EUR20 billion (5% of GDP) from the government measures. Lower spending and a rebound in economic activity would shrink the deficit to 3.7% of GDP in 2021.

We forecast general government debt to increase to 86.4% of GDP in 2020, from an estimated 70.4% in 2019. Fitch projects public debt to resume its downward trend in 2021, lowering to 85.6%. However, under our long-term projections, which include a 1.5% medium-term potential growth and a return to primary surpluses from 2024 onwards, government debt only reaches 2019 level by 2027, indicating a potential risk to structurally higher debt levels in the medium and long term.

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

The large size of guarantees in the government's balance sheet (16.3% of GDP at end-2018) is a potential risk. Fitch assumes only a small portion of those guarantees will be called in 2020 and 2021 (0.8% of GDP in each year), but the extent to which state guarantees will be used is uncertain at this stage. Furthermore, we do not include public support to the banking sector or Austrian Airlines, which represent additional risks to debt sustainability if they were to materialise.

Despite the projected increase in public debt levels, Austria's debt structure remains quite favourable, with the weighted average maturity of the portfolio at 9.9 years (end-2019), the longest in the EU27, and the weighted average effective interest rate at 2%. While the winding down of the state owned bad banks' assets continued at a strong pace in 2019 (EUR2.4 billion), we forecast this momentum to slow down (EUR0.6 billion), resulting in a total EUR8.7billion (2.2% of GDP) left to dispose by end-2020. This provides some upside risks to our debt forecasts, as faster disposal of the assets would allow for accelerated debt reduction.

The unemployment rate has surged due to the effects of the coronavirus pandemic, with the national definition reaching 12.8% by end-April, a stark rise from the 8.1% registered at end-February. We estimate the rise in the Eurostat definition to have been slightly lower, given the different methodology and data collection (not including workers currently receiving training for example), but we still expect the April number to have risen above 9.0% from 4.5% in March. An additional 1.2 million people, or about one quarter of Austria's workforce, were registered for the short-time work scheme (kurzarbeit) as off 30 April, under which employers can keep employees on their books in a part-time scheme and only pay for hours actually worked.

We expect the labour market will deteriorate markedly in 2Q20, improving slightly in 2H20, with the unemployment rate (Eurostat definition) set to increase to 6.7% in 2020 from 4.5% in 2019, before edging down to 5.6% in 2021. This would be highest unemployment rate since at least 1990. We see downside risks to these projections, given the fast pace of the rise of unemployment rate in April and the large share of companies requesting wage subsidies and registering their workers under the kurzarbeit scheme.

Despite the external shock, Fitch projects Austria will maintain a current account surplus in the medium term, with a small deficit in 2020 (-0.2% of GDP) being rapidly offset in 2021 (0.7%), as the

tourism sector starts recovering and exports of services rise to previous levels. Net external debt is forecast to rise in 2020 (23.4% of GDP) owing to increased financing from the government side. Likewise, we expect Austria's net international investment position to deteriorate to 8.6% of GDP in 2020 from 9.6% in 2019.

Financial soundness indicators are strong and provide buffers to the financial system in the event of a sharper contraction than forecast with high common equity Tier 1 ratio (15.9% at end-2019), return on equity (9.2%) and return on assets (0.7%). While asset quality is likely to deteriorate, the share of non-performing loans was very low at end-2019, having declined to 1.6% from 1.9% (end-2018). Exposure to central and eastern European markets, the share of outstanding foreign-currency loans (11.3%) and loans to non-residents (24.4%) remain high and a risk factor, but they continue on a decreasing trend. We expect credit to the private sector to contract 3.1% in 2020, given the effects of the pandemic on the economy. Austria's banking system scores 'bbb' on Fitch's Banking System Indicator (BSI) and '1' on Fitch's Macro-Prudential Risk Monitor (MPI).

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 (SRM). Austria has a very high WBGI ranking at the 90.9 percentile, above the 'AA' median (84.6).

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

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 rated peers, as follows:

- Public Finances: +1 notch, to reflect Austria's favourable debt structure, including longest weighted average maturity, low debt service burden, and strong track record of fiscal consolidation.

The committee decided to remove the -1 notch on the structural features, which had reflected the ongoing political volatility and uncertainty since the May corruption-related scandal, which had led to early elections in September. Fitch believes the uncertainty around the outlook for fiscal and economic policy was greatly reduced, owing to the formation of a stable government, putting structural features on a positive trend.

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.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- General government debt/GDP returning to pre-pandemic levels faster than projected and continuing on a firm downward path over the medium and long term, for example due to a post-coronavirus-shock fiscal consolidation.

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

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Severe and prolonged economic weakness due to the pandemic, including from repeated waves of infections.

- 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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance 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

We assume that the global economy develops in line with our Global Economic Outlook published on 22 April, with the global economy to go through a deep but short-lived recession in 2020 due to the pandemic. In particular, eurozone GDP is forecast to decline 7.0% in 2020, before recovering 4.3% in 2021. Fitch notes that there is an unusually high level of uncertainty around these forecasts and that risks are firmly to the downside.

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 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 the recent coalition formation has eased the risks from political uncertainty; this is highly relevant

to the rating and a key rating driver with a high weight.

- Austria has an ESG Relevance Score of 4 for Human Rights and Political Freedoms as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore relevant to the rating and a rating driver.

- Austria has an ESG Relevance Score of 4 for Creditors Rights as willingness to service and repay debt is relevant to the rating and a rating driver, as for all sovereigns.

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+
•	Country Ceiling	AAA	Affirmed	AAA
• senior unsecured	LT	AA+	Affirmed	AA+
• senior	ST	F1+	Affirmed	F1+

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 05 Jul 2019)

Sovereign Rating Criteria (pub. 27 Apr 2020) (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, v1.2.0 (1)

Macro-Prudential Indicator Model, v1.4.0 (1)

Sovereign Rating Model, v3.12.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Austria	EU Issued

ADDITIONAL DISCLOSURES FOR UNSOLICITED CREDIT RATINGS

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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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
Austria EUR 100 mln Floating Rate Notes 29 Jun 2020	XS0221500571	Long Term Rating	Unsolicited

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