Press Release

Date of Release: March 23, 2018

DBRS Confirms Austria at AAA, Stable Trend

Industry: Public Finance--Sovereigns

DBRS Ratings Limited (DBRS) has confirmed the Republic of Austria's Long-Term Foreign and Local Currency – Issuer Ratings at AAA and its Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trend on all ratings remains Stable.

The confirmation of the Stable trend reflects DBRS's view that the declining trajectory of the public debt-to-GDP ratio — mainly as a result of low deficits, higher economic growth and the disposal of nationalised financial institutions' assets — offsets the remaining vulnerabilities stemming from the banking system and the relatively high stock of public debt. Real GDP growth at 2.9% almost doubled last year compared with the 1.5% outcome recorded in 2016 and it is set to remain solid this year, rising by 3.2%. Moreover, job creation is anticipated to be robust and expand more than the labour force. This will translate into a further drop in the unemployment rate to 5.1% in 2018 from 5.5% in 2017. The new government's commitment to policy continuity and budgetary consolidation is evident by the further decline in the headline deficit to 0.4% of GDP this year, compared to 0.7% estimated for 2017.

The ratings are underpinned by Austria's prosperous, diversified and stable economy, reflecting a GDP per capita that is 28% higher than the Eurozone average, and an industrial sector that benefits from a high level of competitiveness. In addition, Austria's ratings reflect the country's prudent fiscal policy, a favourable debt profile and a moderate level of private sector debt.

These credit strengths offset the challenges associated with a relatively high public debt-to-GDP ratio and some remaining vulnerabilities in the banking system. While the former is mainly the legacy of the public interventions in the financial sector, the latter reflects the still high exposure of Austrian banks to Central, Eastern and Southeastern Europe (CESEE) countries, as well as the high share of loans at variable rates. This, in combination with elevated exposure in foreign currency, poses some risks to Austrian households. Finally, in the medium-term, the ageing population is expected to put pressure on Austrian public finances.

PRUDENT FISCAL POLICIES AND DEBT PROFILE BODE WELL FOR DEBT AFFORDABILITY

The public debt as a share of GDP is on a clear downward path. After peaking in 2015 at 84.3% of GDP, it has started to decline and is now projected to fall below 70% in 2020, led by stronger nominal growth, low deficits, as well as the progressive disposal of some distressed financial institutions' assets. The latter had already a significant impact on the debt last year with the sale of impaired assets of KA Finanz and Immigon accompanied by the disposal of earnings from HETA, contributing to a one-off drop of around 2.4% of GDP. Contingent liabilities remain a vulnerability despite the decline occurred over the last few years. While central government guarantees provided mostly to exports amount to around 11% of GDP, guarantees from local entities, largely linked to the financial sector, are estimated to have fallen to 2.4% of GDP in 2017 from 13.2% in 2013. This reduces the amount of potential government support to the banking sector, in line with the strengthening of Austrian banks. Moreover, despite slightly higher yields over the last few months, interest costs remain favourable at around 1.8% of GDP in 2017 and are expected to remain modest going forward. This largely reflects an average maturity profile for Austrian debt of around ten years as well as its debt structure, with about 95% of total outstanding bonds at fixed rates. This feature reduces rollover risk and mitigates the potential effect of abrupt interest rate increases.

Prudent fiscal policy and advantageous cyclical conditions have improved Austria's budgetary position over the last few years. The headline deficit, except for 2016 (1.6% of GDP) as a result of the effect of the 2015-16 tax reform, has been on a declining trend since 2014 and last year contracted markedly to 0.7% of GDP on the back of buoyant economic activity. According to the Austrian government, the fiscal outlook will remain favourable with the budget deficit falling to 0.4% of GDP in 2018 before achieving a balanced budget in 2019. Consolidation measures amounting to EUR 2.5 billion include the phasing out of both labour market subsidies and the job scheme for long-term unemployed elderly workers, as well as lower administrative costs.

Pressure on public finances from Austria's ageing population remains a challenge in the medium-term. According to the European Commission, public spending on pensions, at about 13.8% of GDP, is among the highest in Europe and is expected to continue to rise going forward. Despite the implementation of several measures to slow the growth of health-care spending and raise the effective retirement age, including stricter eligibility criteria for early pensions, additional measures may be needed.

GROWTH STRENGTHENS WHEREAS BANKING VULNERABILITIES RECEDE

Austria's economic performance is robust, with real GDP growth almost doubling last year to around 2.9%. This mainly reflects stronger private consumption, which benefited from the effect of the 2015-2016 tax reform. Investment further contributed to the very solid GDP outturn, also triggered by

higher exports as the recovery in external demand among neighbouring countries was robust. Economic growth is set to remain very strong, expanding by 3.2% this year before moderating to around 2.2% in 2019. This is because the effects of the tax reform will gradually dissipate and investment is forecast to moderate. In DBRS's view, this robust performance is partly cyclical, as potential growth remains constrained by strict regulation in the service sector and the high tax wedge.

Despite substantial deleveraging over the last few years, vulnerabilities remain in the banking system. This mainly reflects the still high share of variable loans in Austria which makes highly indebted households and corporations vulnerable to an abrupt interest rate increase. In addition to this, the proportion of foreign currency loans to total loans for households, although declining, is still high at around 13.6% as of January 2018. This means that households continue to carry considerable exchange rate risk, with 97% of the foreign currency loans denominated in Swiss francs. However, household resilience is supported by a moderate debt, which has remained broadly stable as a share of the net disposable income at around 91% over the last five years, as well as a relatively high net financial wealth estimated at about 125% of GDP as of Q3 2017.

Improving credit quality and rising capitalisation have been strengthening Austria's banking sector. As the economy recovers and banks make progress in restructuring both in Austria and abroad, the non-performing loan ratio continues to trend downwards. At about 4.3% as of Q3 2017, it has returned to the pre-crisis level, although it remains elevated due to exposures in CESEE countries, especially in Ukraine and in Russia. At the same time, Austrian banks have improved their level of capitalisation with the common equity tier 1 ratio at 15.1% as of Q2 2017 compared with 11.7% in Q4 2014. This ranks favourably compared with the EU average (14.5%) and, combined with the high level of coverage ratio at about 55% (versus the EU average of 45%), mitigates the risk arising from the still high exposure to CESEE and the housing markets. Nevertheless, total assets of Austrian bank subsidiaries in CESEE, following UniCredit Bank Austria AG's restructuring, have declined significantly by about 40%. By contrast, house prices have been increasing since 2000, especially in Vienna where residential property prices are more than 20% higher than measurements of their fundamental values.

SOUND EXTERNAL SECTOR AND PREDICTABLE POLICY FRAMEWORK

Austria's track record of current account surplus and an improving net international investment position (NIIP) underpin a sound external position. This mirrors the healthy tourism inflow and growing business services receipts, which compensate for the negative position in secondary income. It is worth noting that overall export growth last year, supported by stronger demand from neighbouring countries, appears to have arrested the persistent decline in Austria's export market

share since 2007. The external sector outlook is set to remain positive. The OeNB projects a current account surplus of 2.1% of GDP this year, which is slightly higher than the average outturn recorded over the last five years of 1.9%. This should further strengthen the NIIP which has already shifted to surplus in 2013 and now stands at around 5.4% of GDP, therefore improving the country's ability to absorb external shocks.

Consensus-oriented policy as well as democratic institutions make Austria's political system conducive to a stable and predictable policy framework. Following last year's snap elections, the new ruling coalition between the Austrian People's Party (ÖVP) and Freedom Party of Austria (FPÖ) is expected to remain committed to budgetary consolidation. Moreover, it is anticipated to pursue a pro-European agenda, albeit less immigration and stricter border controls are expected be the key themes of its foreign policy. Internal frictions between the two coalition parties may emerge should progress in these areas not be achieved.

RATING DRIVERS

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

RATING COMMITTEE SUMMARY

The DBRS Sovereign Scorecard generates a result in the AAA – AA (high) range. The main points discussed during the Rating Committee include financial stability, fiscal measures, public debt, and economic growth.

KEY INDICATORS

Fiscal Balance (% GDP): -1.6 (2016); -0.7 (2017E); -0.4 (2018F)
Gross Debt (% GDP): 83.6 (2016); 78.1 (2017E); 74.5 (2018F)
Nominal GDP (EUR billions): 353.3 (2016); 369.2 (2017); 387.3 (2018F)
GDP per Capita (EUR): 40,424 (2016); 41,904 (2017); 43,657 (2018F)
Real GDP growth (%): 1.5 (2016); 2.9 (2017); 3.2 (2018F)
Consumer Price Inflation (%): 1.0 (2016); 2.2 (2017); 2.1 (2018F)
Domestic Credit (% GDP): 147.8 (2016); 146.3 (Sept-2017)
Current Account (% GDP): 2.1 (2016); 1.9 (2017E); 2.1 (2018F)

International Investment Position (% GDP): 5.7 (2016); 5.4 (Sept-2017)
Gross External Debt (% GDP): 165.1 (2016); 156.0 (Sept-2017)
Governance Indicator (percentile rank): 91.8 (2016)
Human Development Index: 0.89 (2015)

Notes:

All figures are in euros unless otherwise noted. Public finance statistics reported on a general government basis unless specified. General Government Gross Debt is calculated on a Maastricht basis. Governance indicator represents an average percentile rank (0-100) from Rule of Law, Voice and Accountability and Government Effectiveness indicators (all World Bank). Human Development Index (UNDP) ranges from 0-1, with 1 representing a very high level of human development.

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website www.dbrs.com at http://www.dbrs.com/about/methodologies. The principal applicable 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 Statistics Austria, OeNB, Austrian Ministry of Finance, European Commission, AMECO, IMF, OeBFA, WIFO, Fiskalrat, Eurostat, IMF, World Bank, UNDP, Haver Analytics. DBRS 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 had no access to relevant internal documents for the rated entity or a related third party.

DBRS 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's outlooks and ratings are under regular surveillance.

For further information on DBRS 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.

Ratings assigned by DBRS Ratings Limited are subject to EU and US regulations only.

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Initial Rating Date: 21 June 2011
Last Rating Date: 6 October 2017

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Information regarding DBRS ratings, including definitions, policies and methodologies, is available on www.dbrs.com.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Austria, Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	AAA	Stb	Mar 23, 2018
Austria, Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	AAA	Stb	Mar 23, 2018
Austria, Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Mar 23, 2018
Austria, Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Mar 23, 2018

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