FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Austria at 'AA+'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 23 Feb 2024: 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

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 government debt relative to peers, although refinancing risks are mitigated by long maturities and low financing costs.

Moderate Budget Deficits: We forecast the general government budget deficit to narrow slightly to 2.3% in 2024 and 2025, from 2.5% in 2023. This represents an upward revision from our forecasts of 1.5% and 1.3%, respectively, at our previous review in August 2023, reflecting weaker growth and higher expenditure. This includes new measures of up to EUR3.4 billion (0.7% of GDP) per year for 2024-2028 in intergovernmental transfers for health care and a newly-created investment fund.

Austria had a mixed compliance record under the old EU fiscal rules, which are being reactivated this year, with a good performance on the deficit rule but frequently not meeting the debt, structural balance and expenditure rules. We expect that Austria will be able to keep fiscal deficits below 3% over the medium term, but the European Commission still needs to outline an expenditure path that supports a reduction of government debt below the 60% threshold.

Government Debt Reduction Slows: We project that general government debt will fall to below 76% of GDP by end-2025, down from 83% in 2020 but still well above 'AA' median of 48.4%. This is a more gradual pace of decline than in our previous rating review. Sizeable stock-flow adjustments mean that debt will fall more gradually than implied by the headline deficit. Stock-flow adjustments will add another 1.2% to the debt ratio this year and 0.6% next year, primarily reflecting below-par bond issuances due to the impact from rising interest rates on bond market valuations and to a lesser extent, accrual-adjustments for pandemic and energy-related measures.

2024 Elections: National elections in the autumn increase political uncertainties. Polls currently suggest weakening support for the current ÖVP-Green coalition while the right-wing FPÖ would receive most votes. Austria's institutional strength, measured by the World Bank's World Governance Indicators (WGIs), still ranks well above the 'AA' median, but the gap has narrowed over previous years.

Macro Outlook Remains Weak: Austria's economy contracted by 0.7% in 2023 and we forecast that it will recover only modestly by 0.7% in 2024. Real disposable incomes will start rising again in 2024 as indicated by falling inflation and high wage growth settlements. We expect investment to remain subdued, while the contribution from net exports will be negative as export growth remains sluggish amid a weak recovery in Germany, Austria's main trading partner.

We forecast GDP growth will rebound more forcefully to 1.5% in 2025, as investment and export activity recovers. At present there are limited signs of scarring in the economy, but persistent external weakness could have a more structural impact. Potential growth is estimated at 1.2%, weighed down by structural factors, including an ageing demographic.

Limited Energy Supply Risks: Austria remains one of a few EU countries that are still receiving material shares of Russian pipeline gas, but a potential permanent stop of Russian gas flows should be manageable, given Austria's access to recently secured non-Russian gas supplies. We currently view the risk as low that contingent liabilities around a long-term take-or-pay contract between Austria's largest public utility company and Gazprom will crystallise on the government's balance sheet.

Persistent Price and Wage Pressures: Inflationary pressures have been more persistent relative to other eurozone economies. HICP inflation in 2023 was more than 2pp higher than the eurozone average (7.7% vs 5.5%), reflecting higher relative wage growth and a higher weighting of high-inflation components in Austria's inflation basket. Unit labour costs have been increasing at a fast pace and a permanent rise in real wages and export prices could lead to an erosion of Austria's international price competitiveness.

Risks are somewhat mitigated by relatively higher productivity growth and a sharp rise in corporate profitability, which should help to absorb some of the price pressures. We expect headline inflation to average 3.7% this year, before falling to 3.0% in 2025 as service price inflation moderates.

Resilient Banking Sector: House prices have been declining since 3Q22, but remain above the pre-pandemic level. Risks to the financial system 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. Strong wage growth and prudent lending standards have helped to limit defaults on mortgages, even as almost 50% of all mortgages carry variable rates.

The banking sector's non-performing loans ratio had risen to 1.8% at end-3Q23, but remains below the pre-pandemic level of 2.2% at end-2019. Fitch's MPI for Austria is '2', indicating a moderate vulnerability from real credit growth and asset price developments.

Strong Private External Position: Austria's external private sector balance sheets are strong and in a net creditor position compared with the rest of the world, relative to a net debtor position for the public sector. We estimate that Austria's sovereign net foreign assets stood at -43% of GDP at end-2023 (significantly worse than the 33.1% estimated for the 'AA' median), but public external indebtedness is inflated by TARGET2 liabilities, which stood at 17.5% of GDP by end-2023.

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. Austria has a high WBGI ranking at 87.1, reflecting its long track 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 it leads to lower medium-term growth potential or has 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 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 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:

- **Macro:** +1 notch to offset 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 very substantial and unprecedented exogenous shocks that have hit the vast majority of sovereigns, and Fitch believes that Austria has the capacity to absorb them 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 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.

COUNTRY CEILING

The Country Ceiling for Austria is 'AAA', one notch above the LT FC IDR. This reflects very strong constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of +3 notches above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

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. As Austria has a percentile rank above 50 for the respective 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 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. 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 World Bank Governance Indicators is relevant to the rating and a rating driver. As Austria has a percentile rank above 50 for the respective 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 and captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Austria	LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
	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, v2.0.1 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.14.1 (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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UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP	RATING TYPE	SOLICITATION STATUS
Austria EUR 16.6 mln 5.125% bond/note 02-Jan-2034	XS0182592062	Long Term Rating	Unsolicited
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-2044	AT0000A0VRQ6	Long Term Rating	Unsolicited
Austria CAD 250 mln 5% Notes 20	US052591AT11	Long Term Rating	Unsolicited

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