FitchRatings

Fitch Affirms Austria at 'AA+'; Outlook Positive

Fitch Ratings-London-18 January 2019: Fitch Ratings has affirmed Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA+' with a Positive Outlook.

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

KEY RATING DRIVERS
Austria's 'AA+' IDRs reflect the following key rating drivers:

Austria has a rich, diversified, high value-added economy with strong political and social institutions. It benefits from low private-sector indebtedness and a high household savings rate. Fitch considers the government's debt structure as favourable, reflecting an average debt maturity of almost 10 years, low borrowing costs and strong financing flexibility. The Positive Outlook reflects favourable fiscal developments and our expectations of a firm downward trajectory for gross general government debt (GGGD)/GDP.

We expect economic growth will decelerate slightly to 2.0% in 2019, having peaked at 2.7% in 2018, driven by robust domestic demand and good performances of Austrian exports. Dynamic labour market, rising wages and fiscal stimulus will support consumption, while favourable growth in Austria main trading partners including CESEE countries and Germany will boost exports.

Rising labour supply, dynamic productivity gains and several quarters of robust private investment point towards high potential growth in Austria, relative to similarly rated peers, which we assess at 1.7%. The employment rate rose by 0.7pp yoy to 76.1% in 2Q18 and unemployment stood at 5.1% at end-October 2018. Capacity utilisation remains at an historical high, indicating potential upside risks to our decelerating investment growth forecast, although these are being offset by external risks including rising trade tensions, which could hinder export performances.

Fitch forecast general government fiscal deficit to narrow slightly to 0.2% of GDP in 2019, versus a current peer median fiscal surplus of 0.7%. Strong economic growth and employment will boost tax performances while unemployment benefits and interest payment will decrease. However, higher federal transfers will weigh on spending following the reform of long-term care for the elderly (Pflegeregress). We expect the fiscal output to be balanced in 2020 as income tax relief for family, and cuts in VAT and unemployment contribution are partly compensated by efficiency savings in the public administration.

The Draft Budgetary Plan 2019 remains in line with the March 2018 Stability Programme Update and provides for a range of structural reforms including social security reform, a restrictive expenditure path and a cut in personnel expenditure along with a medium-term target of decreasing the tax rate towards 40%. The government expects revenues to decrease by 1pp over 2018-2022 while expenditure is forecast to decrease by 1.8pp. However, our forecasts are slightly more conservative, as expenditure savings are not fully specified, and structural reforms are yet to be implemented.

GGGD is on a fast downward trend and we forecast it to decrease to 71.3% of GDP in 2019 compared with a current 'AA' median of 38.8%. GGGD will likely decline below 70% of GDP by 2021, supported by strong potential growth, prudent fiscal policy and low interest burden. Ongoing disposal of the assets of the state-owned bad banks, including HETA, KAF and immigon, will contribute up to 0.7% of GDP to the debt decline in 2019, according to the government's estimate. Contingent liabilities are decreasing and account for 15.8% of GDP in 2017, down from 16.8% in 2016.

Banking sector health has improved, helped by ongoing consolidation, leading to rising capitalisation. Credit growth is picking up and profit is rising supported by improved asset quality and lower provisioning. Nonetheless, the cost-to-income ratio remains high, and although exposure of Austrian subsidiaries to CESEE has declined and funding sources are more stable, the region remains crucial for Austrian banks' subsidiaries profitability. Geographic concentration is elevated, with Czech Republic, Slovakia, Russia, Romania, Croatia and Hungary accounting for 80% of the subsidiaries' loan exposures.

House prices keep growing at a fast pace with real estate prices up 8% y-o-y in 3Q18. The Central Bank estimates prices overvaluation in Vienna at 21.4% in 2Q18 and 11% in Austria as a whole. However, rising housing supply and decelerating demand with lower population growth and net immigration point toward a soft landing. A new macro-prudential toolkit has been available to the Financial Market Authority since June 2017 and the Financial Stability Market Board recently issued new lending standard guidance, which should also help contain rising price pressures.

Austria net external position has sustainably improved on the back of ongoing current account surpluses and large deleveraging of the banking sector. We forecast Austria's net external debt to decrease to 10.7% of GDP in 2019 (12.4% in 2018), compared with a net asset position of 21.2% for the current 'AA' median. We forecast the current account surplus will increase in 2019-2020 to an average 2.5% of GDP, in line with the current peer median of 2.4%, supported by booming tourism and dynamic exports, while imports growth decelerate due to the slowdown in investment.

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 our expectation that the downward path of Austria's GGGD will continue beyond the SRM forecast horizon.

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
Future developments that could individually or collectively, result in positive rating action include:
-A continued decline in the GGGD/GDP ratio.
-Sustained economic growth and greater confidence in medium-term growth prospects, particularly if supported by the effective implementation of structural reforms.

Future developments that could individually or collectively, result in a stabilisation of the Outlook include:
-Weaker nominal GDP growth or failure to place public debt on a downward trajectory over the medium term, for example because of significant slippage from fiscal consolidation targets.
-Crystallisation of contingent liabilities, for example from the banking sector, which worsens the government debt profile.

KEY ASSUMPTIONS
Our long-run debt sustainability calculations are based on assumptions of medium-term GDP growth of 1.7%, a GDP deflator converging towards 2% and an average primary fiscal surplus of 1% of GDP over the next 10 years. Under these assumptions, we forecast GGGD/GDP to decline to 54% by 2027.

The full list of rating actions is as follows:

Long-Term Foreign-Currency IDR affirmed at 'AA+'; Outlook Positive
Long-Term Local-Currency IDR affirmed at 'AA+'; Outlook Positive
Short-Term Foreign-Currency IDR affirmed at 'F1+'
Short-Term Local-Currency IDR affirmed at 'F1+'
Country Ceiling affirmed at 'AAA'
Issue ratings on long-term senior unsecured foreign-currency bonds affirmed at 'AA+'
Issue ratings on long-term senior unsecured local-currency bonds affirmed at 'AA+'
Issue ratings on short-term senior unsecured local-currency bonds affirmed at 'F1+'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Country Ceilings Criteria (pub. 19 Jul 2018)
(https://www.fitchratings.com/site/re/10037793)
Sovereign Rating Criteria (pub. 19 Jul 2018)
(https://www.fitchratings.com/site/re/10037181)

Additional Disclosures

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UNSOLICITED ISSUERS

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
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 4 bln 4.35% Gov Bonds 15 Mar 2019	AT0000A08968	Long Term Rating	Unsolicited
Austria EUR 3 bln 1.95% Gov Bonds 18 Jun 2019	AT0000A0VRF9	Long Term Rating	Unsolicited
Austria EUR 50 mln Variable Rate Notes 2 Dec 2019	XS0235645487	Long Term Rating	Unsolicited
Austria EUR 200 mln Variable Rate Notes 04 Mar 2020	XS0212688013	Long Term Rating	Unsolicited

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria EUR 70 mln Variable Rate Notes 22 Apr 2020	XS0216258763	Long Term Rating	Unsolicited
Austria EUR 50 mln Variable Rate Notes 27 Apr 2020	XS0217517829	Long Term Rating	Unsolicited
Austria EUR 100 mln Floating Rate Notes 29 Jun 2020	XS0221500571	Long Term Rating	Unsolicited
Austria EUR 3.9% Gov Bonds 15 Jul 2020	AT0000386115	Long Term Rating	Unsolicited
Austria EUR 3.5% Gov Bonds 15 Sep 2021	AT0000A001X2	Long Term Rating	Unsolicited
Austria JPY 2 bln Fixed/Floating Rate Notes 09 Nov 2021	XS0138067995	Long Term Rating	Unsolicited
Austria JPY 1 bln Fixed/Floating Rate Notes 19 Nov 2021	XS0138429229	Long Term Rating	Unsolicited
Austria EUR 5.46 bln 3.65% local currency gov bonds 20 Apr 2022	AT0000A0N9A0	Long Term Rating	Unsolicited
Austria JPY 2.1 bln 3% Currency Linked Notes 5 Aug 2022	XS0151767687	Long Term Rating	Unsolicited
Austria EUR 3 bln 3.4% Gov Bonds 22 Nov 2022	AT0000A0U3T4	Long Term Rating	Unsolicited
Austria EUR 100 mln Inflation-Linked Notes 02 May 2023	XS0166935535	Long Term Rating	Unsolicited
Austria EUR 3 bln 1.75% Gov Bonds 20 Oct 2023	AT0000A105W3	Long Term Rating	Unsolicited
Austria DEM 2 bln 6.5% Notes 10 Jan 2024	DE0004123500	Long Term Rating	Unsolicited

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria NLG 1 bln 6.25% Notes 28 Feb 2024	NL0000133924	Long Term Rating	Unsolicited
Austria CAD 250 mln 5% Notes 20 Dec 2024	US052591AT11	Long Term Rating	Unsolicited
Austria EUR 3.09 bln 4.85% Gov Bonds 15 Mar 2026	AT0000A0DXC2	Long Term Rating	Unsolicited
Austria EUR 6.25% Gov Bonds 15 Jul 2027	AT0000383864	Long Term Rating	Unsolicited
Austria EUR 109 mln 3.56% Gov Bonds 19 Oct 2029	XS0749005186	Long Term Rating	Unsolicited
Austria EUR 21 mln 2.452% Gov Bonds 19 Oct 2029	XS0749005343	Long Term Rating	Unsolicited
Austria GBP 200 mln Step-Up Notes 19 Oct 2029	XS0102835237	Long Term Rating	Unsolicited
Austria JPY 3 bln Fixed/Floating Rate Notes 26 Nov 2031	XS0138663173	Long Term Rating	Unsolicited
Austria JPY 1 bln 5% Currency Linked Notes 24 Sep 2032	XS0154915820	Long Term Rating	Unsolicited
Austria SKK 500 mln 5.125% Notes 2 Jan 2034	XS0182592062	Long Term Rating	Unsolicited
Austria EUR 1.5 bln 2.4% Gov Bonds 23 May 2034	AT0000A10683	Long Term Rating	Unsolicited
Austria CAD 300 mln 5.375% Notes 1 Dec 2034	US052591AS38	Long Term Rating	Unsolicited
Austria EUR 4.15% Gov Bonds 15 Mar 2037	AT0000A04967	Long Term Rating	Unsolicited
Austria EUR 2 bln 3.15% Gov Bonds 20 Jun 2044	AT0000A0VRQ6	Long Term Rating	Unsolicited

Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Austria EUR 2 bln 3.8% Gov Bonds 26 Jan 2062	AT0000A0U299	Long Term Rating	Unsolicited
Austria ECP D	-	Short Term Rating	Unsolicited
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