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Research Update:

Austria Affirmed At 'AA+/A-1+'; Outlook Stable

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Overview

- We believe that Austria's prosperous economy is well positioned to weather upcoming challenges stemming from softer external demand.
- Although its GDP growth is set to moderate, debt to GDP should continue to reduce, supported by balanced general government accounts and the wind-down of failed banks.
- We are therefore affirming our 'AA+/A-1+' ratings on Austria.
- The outlook is stable.

Rating Action

On March 15, 2019, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Austria. The outlook is stable.

At the same time, we affirmed our 'AA+' long-term and 'A-1+' short-term issue ratings on Austria's senior unsecured debt. We also affirmed our 'AA+' long-term local currency issue rating on the sovereign-guaranteed bond (XS0863484035) of subordinated debt issued by Heta Asset Resolution AG.

Outlook

The stable outlook reflects our expectation that Austria will maintain sound public finances, despite lower economic growth. We believe that proposed fiscal measures like the upcoming tax reform will not hinder the steady decline in public-sector debt.

We could raise the ratings if ongoing reforms result from more consensus-based policymaking, which we would see as confirmation of a stable and efficient institutional framework. A track record of more sustainable decision-making would give uplift to the ratings.

We could take a negative rating action if we observed a substantial deterioration in Austria's economic development prospects, which could arise from a significant external shock to Austria's open economy. We could also take a negative rating action if we observed a substantial deterioration in Austria's fiscal performance, particularly if we also concluded that an erosion of Austria's institutional strength and predictability of policymaking was the cause.

Rationale

The ratings on Austria are supported by its strong political system, with established checks and balances. Although some government officials have recently made unorthodox policy proposals that question the rule of law, we still view Austria's policymaking as a credit strength. The ratings also reflect our view of its prosperous, competitive, and export-oriented economy, the country's strong external position with sustained current account surpluses, and contained fiscal deficits. As a eurozone member, Austria benefits from the European Central Bank's (ECB's) monetary policy credibility and access to deep capital markets.

The ratings are constrained by Austria's relatively high public debt. The government has proposed a tax reform, with steps to be implemented over the next few years. That said, some details of the reform's financial impact are still unclear, reducing the predictability of Austria's fiscal path.

Institutional and Economic Profile: Consensus-based decision-making may become more challenging if economic growth abates

- Recent unorthodox policy proposals might make consensus-based decision-making more difficult.
- The Austrian government has confirmed its pro-EU stance, despite the generally critical sentiment of one coalition partner.
- Austria's economic growth may have peaked in 2018.

Austria has a strong legal system, with unbiased enforcement of contracts and independent courts. Although some government officials have recently made unorthodox policy proposals that question the rule of law and the European Convention on Human Rights, we still view policymaking in Austria as a credit strength. The government presented an ambitious reform program to be implemented over the next few years, and has already amended laws governing daily working hours and made changes to social security provision by merging public health care providers, among other reforms. As some of the laws require a constitutional majority in parliament, consensus is needed to facilitate major structural reforms.

We believe that Austria's recent heterodox approach to policymaking indicates that it may be departing from making decisions based on consensual agreements between all stakeholders, including social partners and states. This could destabilize the country's policy–setting process, weakening our currently strong institutional assessment. In addition, upcoming elections for the European parliament and in some Austrian states might put pressure on the generally pro-EU government and increase the likelihood of potentially costly populist measures. As was the case in previous electoral cycles, some fiscal relaxation is occurring in the last parliamentary session before elections.

The government's current financial plan does not incorporate a number of major reform initiatives that could have substantial fiscal impact. These include the proposed tax reform, an increase in the compensatory allowance for low-income pensioners, and the abolition of bracket creep (the process by which inflation pushes wages and salaries into higher tax brackets) in 2022. Given that the financing of these measures is rather vague, we see uncertainty around their financial impact.

Nevertheless, Austria's economy continues to prosper. Its GDP per capita is one of the highest in the EU, and GDP growth reached 2.7% in 2018, supported in particular by exports. That said, we believe GDP growth has peaked and will slow to about 1.6% over the next few years, with strong domestic demand mitigating dampening exports from a weaker external environment, possibly amplified by global trade tensions.

We expect real consumption growth will stabilize at 1.6% from 2019, slightly higher than in 2018, since annual tax cuts of €1.5 billion starting in 2019 will boost disposable income. At the same time, we expect that investment growth will turn from replacement to expansion, supported by the pick-up in domestic credit. We assess Austria's potential GDP growth rate at 1.0%-1.5%, and believe it should be able to meet this level in the next few years. Generally, Austria's economy is largely synchronized with that of the monetary union, and most trade is with eurozone member states.

Austria's economic growth per capita is somewhat subdued, because the population is also increasing from net immigration inflows (workers and refugees). After peaking at 6% in 2016, unemployment has been declining thanks to improved economic conditions. The unemployment rate reduced to 4.9% in 2018, and we forecast it will hover around this level through 2022. We estimate that employment will continue to increase by 1.0% on average, slightly lower than in our previous forecast. The lion's share of the jobs created have been filled with commuters.

Flexibility and Performance Profile: Strong external performance outweighs high public-sector debt

- Austria's external profile is a rating strength.
- Net government debt is high, but declining.
- Austria's plan to run a fiscal surplus in 2019 might prove challenging to execute.

Austria's external indicators are highly favorable. The current account has been in surplus since 2002, supported by a sound surplus in the services balance and roughly balanced trade balance. We forecast that current account surpluses will hover around 2% of GDP in 2018-2021. Export demand, including services and tourism, peaked in 2018, and we expect exports will continue to contribute to economic growth, although at considerably lower levels over our forecast horizon though 2021. Austria has found niche markets in the goods and services sector, and has identified differentiated offerings that are attracting new tourist groups, both for winter sports and city travel. The current account has been primarily hampered by net transfer payments, implying that the country as a whole pays higher transfers than it receives.

Continuous current account surpluses helped Austria become a net external creditor in 2013, as measured by its international investment position. External assets exceed liabilities by about 10% of current account receipts (equivalent to about 4%-5% of GDP in 2018), and are set to increase, further improving Austria's net external asset position.

We expect that narrow net external debt will stabilize at levels above 100% of current account receipts, since we do not expect external deleveraging will continue at the pace observed in recent years. Austria is in a net asset position, with funds invested abroad exceeding its external liabilities. Domestic credit--both of the corporate and household sector--is increasing at rates exceeding the eurozone average, indicating some potential for asset bubbles. The share of credit at variable rates to households declined to 50% of all credit granted in 2018. Foreign exchange-related risks are negligible, with foreign currency-denominated loans making up about 10% for nonfinancial corporations and less than 2% for private households.

The federal government plans to achieve the first fiscal surplus in years in 2019, but we consider this may be challenging to execute given possible spending pressure from reform proposals and less favorable economic tailwinds. While some expenditure items were incorporated in the budget in detail, several cost-saving measures could be smaller than budgeted, given the usual discrepancy between planned and actual savings. As such, we expect slightly weaker fiscal performance than the federal government targets, and project balanced accounts on average over the next four years.

Sizable and fiscally substantial reform projects--for instance, an increase in compensatory allowance for low-income pensioners and the abolition of bracket creep in 2022--are not included in the current financial plan. We therefore consider that there is still uncertainty with regard to Austria's future budgetary performance. Nevertheless, we understand that the government is committed to ongoing fiscal consolidation. In longer term, public finances could be pressured by age-related expenditure, which will gradually increase to 5.1% of GDP in 2021 from 4.9% in 2018. In our view, heightened fiscal pressures on age-related expenditure, currently not reflected in the financial plan, could emerge, with long-lasting structural repercussions.

We expect a reduction in Austria's general public debt, backed by the reduction in the balance sheet size of bailed-out banks and roughly balanced general government accounts through 2022. We expect public debt will decline, backed by a nominal GDP increase, while new borrowing will be contained. In addition, the remaining wind-down of previously bailed-out banks should help reduce net general government debt to GDP to 58.0% by 2022 from 67.6% in 2018. Austria has been taking advantage of loose monetary conditions to improve its debt profile, reduce its interest bill, and extend its debt maturities. According to our estimates, the share of interest expenditures to general government revenue will remain well below 5%.

Fiscal contingent liabilities are low, because most government-related entities are already included in general government debt. Therefore, we assess the contingent liabilities from remaining government companies at less than 5% of GDP. We do not take into account export and export-financing guarantees of €26 billion and €24 billion, respectively, since we have deemed these guarantees as bearing low risk with very limited claims since 1950.

Austria's eurozone membership is a credit strength, in our view, since it provides unfettered access to deep and liquid capital markets with minimal exchange rate risk. In addition, the euro is a reserve currency. The ECB maintains what we consider to be a highly credible and effective monetary policy, thanks to its operational independence, significant monetary flexibility, and overall longer-term track record on inflation compared with other monetary authorities.

In our view, the Austrian banking system has improved on the back of several material developments in recent years, including the derisking in Central, Eastern, and southeastern Europe (CESEE). The composition of risks has particularly shifted toward countries with lower risks in CESEE. Another prominent improvement relates to better capitalization at Austrian banks. Together with strong provisioning of about 60% of total loans on average, this provides a buffer for unexpected losses and increases the banking system's stability.

The Austrian banking industry benefits from a high share of core customer deposits, which limits dependence on external borrowing. We believe that most Austrian banks still have much work to do to improve profitability, since we continue to see moderate overcapacity in their domestic operations.

Key Statistics

Table 1

Austria Selected Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. €)	324	333	344	356	370	386	401	415	429	443
Nominal GDP (bil. $)	430	443	382	394	418	456	468	510	536	554
GDP per capita (000s $)	50.9	52.0	44.5	45.3	47.6	51.6	52.5	56.7	59.2	60.7
Real GDP growth	0.0	0.7	1.1	2.0	2.6	2.7	1.7	1.6	1.6	1.6
Real GDP per capita growth	(0.5)	(0.0)	0.2	0.7	1.7	1.9	0.9	0.8	0.8	0.8
Real investment growth	1.6	(0.4)	2.3	4.3	3.9	3.4	2.3	2.0	1.7	1.7
Investment/GDP	23.6	23.5	23.8	24.3	25.4	25.8	26.1	26.2	26.3	26.6
Savings/GDP	25.5	26.0	25.5	26.8	27.3	28.3	28.2	28.1	27.9	27.8
Exports/GDP	53.4	53.4	53.1	52.3	53.7	54.6	55.1	55.7	56.4	57.0
Real exports growth	0.6	2.9	3.5	2.7	4.7	4.4	2.5	2.5	2.5	2.5
Unemployment rate	5.4	5.6	5.7	6.0	5.5	4.9	4.9	4.9	4.9	4.9

Table 1

Austria Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
External indicators (%)										
Current account balance/GDP	1.9	2.5	1.7	2.5	2.0	2.4	2.2	1.9	1.5	1.2
Current account balance/CARs	3.2	4.0	2.9	4.0	3.1	4.0	3.5	3.0	2.4	1.9
CARs/GDP	60.5	61.2	59.0	61.5	62.7	61.7	62.2	62.4	63.0	63.6
Trade balance/GDP	(0.3)	0.3	0.7	0.5	0.2	0.1	(0.1)	(0.4)	(0.6)	(0.9)
Net FDI/GDP	(2.4)	0.6	(1.5)	(0.5)	(0.0)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
Net portfolio equity inflow/GDP	(0.6)	(0.9)	(1.1)	(2.0)	(1.4)	(1.2)	(1.2)	(1.2)	(1.2)	(1.2)
Gross external financing needs/CARs plus usable reserves	199.7	195.6	195.2	185.8	173.1	179.8	179.1	173.9	170.3	168.1
Narrow net external debt/CARs	116.1	108.6	119.3	110.6	120.0	117.4	117.5	110.8	107.5	107.6
Narrow net external debt/CAPs	120.0	113.2	122.9	115.2	123.8	122.2	121.7	114.2	110.2	109.7
Net external liabilities/CARs	(6.0)	(8.8)	(8.4)	(10.2)	(8.7)	(12.3)	(14.5)	(16.0)	(17.2)	(18.0)
Net external liabilities/CAPs	(6.2)	(9.2)	(8.7)	(10.6)	(9.0)	(12.8)	(15.0)	(16.5)	(17.6)	(18.4)
Short-term external debt by remaining maturity/CARs	123.8	116.5	119.7	106.9	91.6	97.5	96.9	88.8	83.6	80.2
Usable reserves/CAPs (months)	1.3	1.1	1.4	1.1	1.1	1.0	1.0	0.8	0.8	0.7
Usable reserves (mil. $)	23,290	24,941	22,250	23,270	21,622	23,198	21,575	21,575	21,575	21,575
Fiscal indicators (general government; %)										
Balance/GDP	(1.9)	(2.7)	(1.0)	(1.6)	(0.8)	(0.2)	0.0	(0.1)	0.0	0.1
Change in net debt/GDP	0.2	3.0	2.9	(0.5)	(0.9)	(1.2)	(0.6)	(0.2)	(0.1)	(0.2)
Primary balance/GDP	0.7	(0.3)	1.3	0.5	1.0	1.5	1.5	1.3	1.3	1.4
Revenue/GDP	49.7	49.7	50.1	48.7	48.4	48.3	48.3	48.3	48.3	48.3
Expenditures/GDP	51.6	52.4	51.1	50.3	49.2	48.5	48.3	48.4	48.3	48.2
Interest/revenues	5.2	4.9	4.7	4.3	3.8	3.4	3.0	2.8	2.7	2.7
Debt/GDP	79.6	82.3	83.2	81.5	76.7	72.2	69.0	66.5	64.3	62.1
Debt/revenues	160.2	165.6	166.1	167.4	158.6	149.5	142.9	137.7	133.1	128.5
Net debt/GDP	77.5	78.4	78.7	75.6	71.9	67.6	64.6	62.2	60.2	58.0
Liquid assets/GDP	2.1	3.9	4.5	5.9	4.8	4.6	4.4	4.3	4.1	4.0
Monetary indicators (%)										
CPI growth	2.1	1.5	0.8	1.0	2.2	2.1	2.1	2.1	2.0	2.0
GDP deflator growth	1.6	2.2	2.2	1.4	1.3	1.7	2.0	1.9	1.7	1.7
Exchange rate, year-end (€/$)	0.7	0.8	0.9	0.9	0.8	0.9	0.8	0.8	0.8	0.8
Banks' claims on resident non-gov't sector growth	(2.6)	(1.7)	0.3	5.9	(2.9)	3.0	2.5	2.0	2.0	2.0
Banks' claims on resident non-gov't sector/GDP	121.8	116.5	113.0	115.7	108.2	106.7	105.4	103.9	102.5	101.2
Foreign currency share of claims by banks on residents	8.6	7.9	7.4	6.1	4.8	4.0	3.8	3.5	3.5	3.0

Table 1

Austria Selected Indicators (cont.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	0.7	2.4	(4.0)	3.9	0.0	0.9	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments.The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. N/A--Not available.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot	
Key rating factors	
Institutional assessment	2
Economic assessment	1
External assessment	1
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	3
Monetary assessment	2

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, March 5, 2019
- Sovereign Ratings List, March 5, 2019
- Banking Industry Country Risk Assessment Update: February 2019, Feb. 22, 2019
- Guidance | Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Jan. 22, 2019
- Eurozone Sovereign Rating Trends 2019, Jan. 14, 2019
- Sovereign Debt 2019: Eurozone Commercial Borrowing To Increase 1.6% In 2019, Feb. 22, 2019
- Sovereign Ratings Score Snapshot, March 6, 2019
- Global Sovereign Rating Trends 2019, Jan. 14, 2019
- Central And Eastern Europe And CIS Sovereign Rating Trends 2019, Jan. 14, 2019
- Sovereign Risk Indicators, Dec. 13, 2018. An interactive version is also available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2017 Annual Sovereign Default Study And Rating Transitions, May 8, 2018
- Banking Industry Country Risk Assessment: Austria, May 30, 2018
- Why Politics Matters To Sovereign Ratings, Nov. 6, 2015
- How Standard & Poor's Assesses The ECB's Monetary Flexibility When Rating Eurozone Sovereigns, Feb. 11, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision. After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion.

The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Austria	
Sovereign Credit Rating	AA+/Stable/A-1+
Transfer & Convertibility Assessment	AAA
Senior Unsecured	AA+
Short-Term Debt	A-1+
Commercial Paper	A-1+
Heta Asset Resolution AG	
Subordinated	AA+

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.