FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Austria at 'AA+'; Outlook Stable

Fri 08 Apr, 2022 - 5:03 PM ET

Fitch Ratings - Frankfurt am Main - 08 Apr 2022: 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

Ratings Strengths and Weaknesses: Austria's 'AA+' 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 level of public debt relative to peers, although refinancing risks are mitigated by long maturities and low financing costs.

War in Ukraine Drives Weaker Growth: Fitch has lowered its growth forecast to 3.3% from 4.6% for 2022 due to the economic spillovers from Russia's invasion of Ukraine. Higher energy and food prices will have a dampening effect on domestic demand, while we expect exports to Russia, Ukraine and Belarus to almost completely stop (although the share of total goods exports to these three countries is small, at 1.6% in 2021). Potential negative impacts from supply chain disruptions and higher energy costs on the manufacturing sector will be partially offset by the continued recovery of private consumption following the pandemic, amid high household savings, and further recovery in international tourist arrivals (overnight stays of tourists remained 50% below their 2019 level in 2021). The household savings rate fell to 11.8% by end-2021, down from a peak of 14.8% but remains above pre-pandemic levels, providing a buffer against higher energy prices.

Energy Supply Disruptions are Downside Risk: Russia is an important supplier of natural gas for Austria, accounting for 80% of natural gas imports (and 18% of total energy consumption), and its gas would be difficult and potentially costly to substitute in the short term. The ECB has calculated that Austrian gross value added could decline by more than 1.2% if gas supply was cut by 10%, the second-largest decline among eurozone countries when accounting for the direct and indirect effects of gas rationing. Gas storage utilisation fell to a low level 12.4% of storage capacity at the end of March, indicating heightened vulnerability in case Russian gas deliveries came to a halt. The Austrian government aims to purchase an additional gas reserve of 12.6TWh by November 2022 to provide an additional safety buffer, which would double the current supply. Nonetheless, the uncertain outlook on energy supply presents a downside risk to both our macro and fiscal baseline.

Inflation Reaches New Highs: HICP inflation was already increasing prior to the invasion of Ukraine, reaching on average 2.8% in 2021 (compared with a five-year average of 1.6% during 2016-2020). Flash estimates indicate that inflation further accelerated to 6.7% in March, the highest reported value since 1981, primarily driven by higher energy prices. Producer prices were on a downward trend during 2020 amid the pandemic shock but price increases reached historical highs in late 2021 (December: 16.7% yoy), which will feed into higher consumer price inflation with a lag this year. We forecast that annual inflation will average 6.1% this year before falling back to 3.3% in 2023 as inflationary pressures unwind.

Fiscal Deficit Reduction: Preliminary results published by Statistics Austria indicate a general government deficit of 5.9% of GDP for 2021, close to our October forecast of 6.0%. Fitch expects a reduction of the deficit to 2.9% of GDP this year, reflecting an improved revenue base and the continued phasing-out of Covid-19 support measures (of around 4.3% of GDP). These will more than offset new support measures for households and businesses to mitigate the impact from higher inflation, including one-off payments to households and a reduction of the electricity and gas tax, as well as higher spending for Ukrainian refugees. The purchase of the strategic gas reserve will cost EUR1.6 billion this year (0.4% of GDP). Moreover, the Austrian government plans to gradually increase its low defence spending quota from 0.6% to 1.0% of GDP over the next years.

A key downside risk to our projections is a worsening of the energy crisis, which could lead to additional fiscal support. Longer-term spending pressures from an ageing demographic are already evident and will further intensify as they have largely remained unaddressed. The European Commission estimates that ageing-related expenditures will further increase to 30.3% of GDP by 2050 from 26.7% in 2019, compared with an average increase to 26.5% from 24.0% for the EU27.

High, But Declining Public Debt: General government debt was 82.8% of GDP at end-2021, in line with our October forecast. The debt reduction was primarily driven by strong nominal GDP growth (6.3%) and sizeable stock-flow adjustments (-1.2% of GDP) relating to the collection of tax deferrals, a reduction in deposits and the continued divestment of assets from Austria's bad banks. We forecast that public debt will fall to 78.5% of GDP by end-2023, still significantly above the pre-pandemic level of 70.6% and forecast 'AA' median of 50.2%. Austria's debt/GDP ratio will continue to decline beyond the SRM forecast horizon, supported by moderate fiscal deficits and low debt service costs. Interest payments as a share of government revenue will fall to 1.6% in 2023, below the 'AA' projected median of 1.9%. The debt structure is favourable. At 11.2 years, the average maturity of general government market debt is the longest in the EU.

Banking Sector Exposure to Russia: The Austrian banking sector's exposure towards Russia and Ukraine is overall moderate but still ranks as one of the highest among EU countries. The European Banking Authority calculates that exposures to these two countries stood at 2.8% of total exposures as of December 2021, primarily reflecting the exposure of Raiffeisen Bank International. Austrian banks have strong capital and liquidity buffers and should be able to absorb losses associated with their Russian or Ukrainian subsidiaries (common equity Tier 1 ratios reached 16.6% at end-2021). However, second-round effects from a slowdown in economic growth and deterioration of asset quality in the broader Eastern Europe region represents a downside risk, given the sizeable exposure to this region in terms of assets and profits.

Fitch's Macro-Prudential Risk Indicator (MPI) for Austria stands at '2', indicating a moderate vulnerability from rising real credit growth and asset price growth. New macroprudential measures will become legally binding in 2H22 in response to accelerating house prices, while risks are mitigated by low private sector indebtedness.

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 90.6, 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:

- Macro: A large adverse macroeconomic shock, for example due to energy rationing or other spillovers from the war in Ukraine, particularly if it were to have negative effects on public finances and/or the banking sector.

- Public Finances: Persistent increase in general government debt, for example, due to a prolonged period of fiscal deterioration in response to the energy crisis, weaker medium-term growth prospects, or crystallisation of contingent liabilities.

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

- Public Finances: General government debt/GDP continuing on a firm 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 reflecting macroeconomic performance, policies and prospects. The positive notch adjustment offsets the deterioration in the SRM output driven by volatility from the pandemic shock, including on GDP growth. The deterioration of the GDP growth and volatility variables reflects a very substantial and unprecedented exogenous shock that has hit the vast majority of sovereigns, and Fitch believes that Austria has the capacity to absorb it without lasting effects on its long-term macroeconomic stability.

- Public Finances: +1 notch to reflect our expectation that government debt/GDP ratio will decline beyond the SRM 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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure 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.

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.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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

FITCH RATINGS ANALYSTS

Hannah Dimpker
Associate Director
Primary Rating Analyst
+49 69 768076 263

hannah.dimpker@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Kit Yeung
Director
Secondary Rating Analyst
+49 69 768076 129
kit.yeung@fitchratings.com

Ed Parker
Managing Director
Committee Chairperson
+44 20 3530 1176
ed.parker@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Apr 2021) (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, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

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

Sovereign Rating Model, v3.12.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Austria	EU Issued, UK Endorsed

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Austria (Unsolicited)

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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 9.2 bln 4.85% bond/note 15-Mar-2026	AT0000A0DXC2	Long Term Rating	Unsolicited
Austria EUR 100 mln Variable bond/note 02-May-	XS0166935535	Long Term Rating	Unsolicited

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Sovereigns Europe Austria