FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Austria at 'AA+'; Outlook Stable

Fri 13 Nov, 2020 - 16:02 ET

Fitch Ratings - Frankfurt am Main - 13 Nov 2020: Fitch Ratings has affirmed Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AA+' with a Stable Outlook

KEY RATING DRIVERS

Austria's 'AA+' rating is supported by a rich, diversified, open, high-value-added economy with strong political and social institutions. It benefits from low private sector indebtedness and a historically high household savings rate. These strengths are balanced by Austria's high level of gross general government debt (GGGD/GDP) compared with peers and an ageing population, which is set to put pressure on already high pension spending.

The Stable Outlook reflects Austria's track record of fiscal prudence and our confidence that following this year's sharp rise, general government debt will resume its downward trajectory over time. However, the fiscal adjustment will be gradual and debt will peak only in 2023. The government's debt structure is extremely favourable, with an average debt maturity of over 11 years, low and declining borrowing costs and strong financing flexibility underpinned by the ECB's ultra-loose monetary policy.

The two waves of the COVID-19 pandemic are having a substantial impact on the Austrian economy and the sovereign's fiscal position. GDP contracted by 12.1% qoq in 2Q20, followed by 11.1% growth in 3Q20 according to preliminary data. Despite the swift rebound in 3Q, the pandemic is set to cause a very deep recession this year. Fitch expects GDP will fall by 7.8% in 2020, followed by a recovery of 2.8% in 2021 and 2.6% in 2022.

The Austrian government announced new lock-down measures effective 3 November, including the closure of restaurants, bars and cultural institutions for an initial four-week-period. The partial lock-down is expected to be less economically disruptive than during the first wave of the pandemic, as, for example, schools, shops and some services (e.g. hairdressers) remain open.

In our projections, we assume the new restrictions will be phased out gradually over the winter months. This assumption has a significant bearing on Austria, where the first quarter of the year is traditionally the busiest period for the tourism sector. Following a contraction in real GDP in 4Q20, we expect a weak recovery in 1Q21, followed by steadier growth only from 2Q21. On this basis, we see Austrian real GDP growing by 2.8% in 2021, a weaker recovery relative to the eurozone (4.5% according to Fitch's latest forecast). Our forecasts imply that the level of GDP will still be 2pp lower at the end of 2022 than before the COVID-19 shock.

The Austrian private sector has some buffers to withstand the economic deterioration. Household debt is extremely low (52.8% of GDP in 2Q20) and net financial wealth (financial assets minus financial liabilities) remains high at 143% of GDP. The household savings ratio rose to 15.9% in 2Q20 from 13.7% at end-2019. High households' saving rate and the strong household net financial position could lead to stronger private consumption once the pandemic is controlled and restrictions are eased.

The unemployment rate rose sharply to 5.9% in June (4.4% in January) before declining to 5.5% in September. The Kurzarbeit labour market support scheme, under which employers can keep workers on their books in a part-time scheme and only pay for hours actually worked, has mitigated the effect of the economic downturn on the labour market. The labour market recovery will slow down as the new lockdown measures are introduced but we expect the Kurzarbeit to prevent a further sharp rise in the number of unemployed this year. However, we expect labour market conditions to deteriorate in 2021 as fiscal support measures are gradually reduced. We expect the unemployment rate to rise to 5.5% in 2020 and 6% in 2021 from 4.5% at end-2019.

Austria has some fiscal room to absorb the pandemic shock, owing to its recent record of fiscal prudence. The general government has recorded budget surpluses in 2018 and 2019 and the stock of debt has declined sharply to 70.5% of GDP in 2019 from a peak of 85% in 2015. While the policy response has softened the economic impact of the pandemic, it has also interrupted the steady improvement in the public finances. Austria's fiscal response consisted of two main packages (on 15 March and on 16 June) with a budget envelope of EUR50 billion (13% of GDP). Following the announcement of the second lockdown, some measures (e.g. the Kurzarbeit scheme) have been extended to March 2021 and their terms adjusted.

We expect a sharp deterioration in the general government balance from a surplus of 0.7% of GDP in 2019 to a deficit of 10.1% of GDP in 2020, well above the peak deficit seen during the global financial crisis (-5.3% of GDP) and above the projected current 'AA' category median of 8.1% of GDP. The deficit increase is the result of the sharp decline in economic activity and operation of automatic stabilisers, as well as the government's measures to address the health emergency and support the economy. We estimate the direct fiscal cost of fiscal policy measures in 2020 at EUR23 billion (6.2% of GDP).

We expect the deficit to fall to around 7.2% of GDP in 2021 and 5.7% of GDP in 2022. Our forecasts factor in some additional discretionary fiscal stimulus next year (2.3% of GDP). Political pressure to maintain support to the economy (in particular for the sectors most badly affected by the pandemic) implies that expenditure will decline only very gradually relative to GDP. Our projections do not include measures funded by the Next Generation EU Recovery and Resilience Facility.

Our deficit projections imply an increase in the general gross government debt (GGGD) to 85.3% of GDP this year (AA median forecast 43.9%) and to 88% in 2021. Over the medium term, we expect debt to reach a peak of 90.3% of GDP in 2023 and decline thereafter. In our longer-term projections, we assume real GDP growth will trend down to 1.5% by 2024 and that deficit reduction will be gradual with the general government primary deficit improving to 2.0% of GDP in 2024 from 8.7% in 2020.

In addition to the direct stimulus, the fiscal package also includes EUR9 billion (2.3% of 2019 GDP) in guarantees to companies. As a result, the total stock of public guarantees rose to EUR73 billion (18.4% of GDP) in 2020. As of 15 October, the take-up of government guarantees was EUR6.7 billion (1.7% of GDP). The extent to which state guarantees will be called upon remains very uncertain but represents an additional risk to debt sustainability.

Despite the projected increase in public debt levels, Austria's debt structure is very favourable. We expect interest payments as a share of government revenues will fall to 2% in 2022, below the 'AA' projected median (2.2%). The average nominal effective interest rate is set to drop to marginally above 1% by 2022 from 2% in 2019. At 12.1 years the average maturity of government market debt is the longest in the EU27. The average yield at issuance for five-year and 10-year Republic of Austria government bonds (RAGBs) was -0.355% and -0.175% in 2020. The ECB's monetary easing measures will continue to underpin sovereign financing flexibility. Holdings of RAGBs by the Eurosystem stood at EUR79.7 billion (20 % of 2019 GDP) at end-September 2020.

The Next Generation EU Fund of EUR750 billion (5% of EU GDP) will likely involve an increase in net fiscal liabilities for the EU, which will fall more heavily on the balance sheets of wealthy member states, such as Austria. In Fitch's view, this increase in future net fiscal liabilities could be partially offset by potential positive developments from economic gains in Austria's European trading partners who are net recipients, and from enhanced economic, financial and political resilience of the eurozone.

The Austrian banking sector entered the pandemic crisis with solid financial profiles: 15.9% common equity Tier-1 ratio, 9.2% return on equity and 0.7% return on assets, all of which were significantly above the EU average. Operating profitability was affected in 1H20 by strong increases in provisioning for expected credit losses driven by the pandemic crisis but remained positive. Similar to other EU banking sectors, lending growth came to a halt at the start of the crisis but recovered strongly following the introduction of extensive state support measures, including loan moratoria and state guarantees.

The impact of the crisis on asset quality has been muted so far: while IFRS 9 Stage 2 loans roughly doubled at large Austrian banks in 1H20, driven by revised economic assumptions and management overlays, non-performing (Stage 3) loans further declined to a low 2%. In 2021, the expiration of state support measures could trigger an increase in insolvencies and thus in non-performing (Stage 3) loans. The high levels of loan loss provisions at some of the largest banks offers ample capacity to absorb significant increases in credit losses next year.

Exposure to Central, Eastern and Southeastern European (CESEE), the share of outstanding foreign-currency loans (11.3%) and loans to non-residents (24.4%) remain high and risk factors, but they continue to decrease. The profitability of CESEE subsidiaries declined sharply in 1H20 due to a sharp rise in loan loss provisions related to the pandemic. The deterioration of the pandemic situation in some CESEE countries and the subsequent economic impact pose a risk to CESEE subsidiaries, but we view this risk as manageable for large Austrian banks with sizeable CESEE operations. In addition, in the medium term the CESEE region will be the largest recipient of the 'Next Generation EU' funds, which is expected to boost growth in the region.

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, as is the case for all sovereigns. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model. Austria has a WBGI ranking at the 91 percentile, reflecting strong institutional capacity and effective rule of law.

RATING SENSITIVITIES

The Outlook is Stable. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a high likelihood of leading to a rating change. However, factors that could, individually or collectively, lead to positive rating action/upgrade: -Public Finances: General government debt/GDP returning to pre-pandemic levels faster than projected and continuing on a firm downward path over the medium and long term, for example due to a stronger economic recovery and/or fiscal consolidation post-coronavirus. -Macro: Increased confidence that Austria can return to sustained economic growth in the medium term, particularly if supported by the effective implementation of structural reforms. Factors that could, individually or collectively, lead to negative rating action/downgrade: --Public Finances: Persistent increase in general government debt, for example due to a more prolonged period of fiscal loosening in response to sustained disruptions from the coronavirus pandemic, weaker medium-term growth prospects, or crystallisation of contingent liabilities.

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 IDR scale, a one notch downward revision compared to the score at the previous rating review.

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:

- +1 notch: Public Finances: to reflect Austria's favourable debt structure, including longest weighted average maturity of market debt in the EU27, low debt service burden, and strong track record of fiscal consolidation.

- +1 notch: Macroeconomic performance, policies and prospects: we have introduced a new positive notch adjustment to offset 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.

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 Long-Term Foreign-Currency 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].

KEY ASSUMPTIONS

Fitch expects the global economy to experience a deep recession in 2020 due to the COVID-19 pandemic based on the Macro Dashboard report published on 5 November. In particular, eurozone GDP is expected to fall by 7.6% in 2020, followed by a recovery of 4.5% growth in 2021 and 3.2% in 2022. Fitch notes that there is an unusually high level of uncertainty around these forecasts and risks are firmly to the downside, not least due to the recent surge of the second wave of the pandemic in many eurozone countries and the corresponding new lock-down measures.

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 Sovereign Rating Model and are highly relevant to the rating and a key rating driver with a high weight.

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 Sovereign Rating Model and are therefore highly relevant to the rating and are a key rating driver with a high weight.

Austria has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as strong social stability and voice and accountability are reflected in the World Bank Governance Indicators that have the highest weight in the Sovereign Rating Model. They are relevant to the rating and a rating driver.

Austria has an ESG Relevance Score of '4' for Creditor Rights as willingness to service and repay debt is relevant to the rating and a rating driver for Austria, as for all sovereigns.

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

ENTITY/DEBT	RATING			PRIOR
•	LC ST IDR	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Greg Kiss
Director
Primary Rating Analyst
+49 69 768076 198
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Michele Napolitano
Senior Director
Secondary Rating Analyst
+44 20 3530 1882

James McCormack
Managing Director - Head of Sovereigns
Committee Chairperson
+852 2263 9625

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Oct 2020) (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, v1.7.1 (1)

Debt Dynamics Model, v1.2.0 (1)

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

Sovereign Rating Model, v3.12.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Austria	EU Issued

ADDITIONAL DISCLOSURES FOR UNSOLICITED CREDIT RATINGS

Austria (Unsolicited)

With Rated Entity or Related Third Party Participation	Yes
With Access to Internal Documents	No
With Access to Management	Yes

DISCLAIMER

OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

 In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP/COUPON RATE	RATING TYPE	SOLICITATION STATUS
Austria EUR 6.25% Gov Bonds 15 Jul 2027	AT0000383864	Long Term Rating	Unsolicited
Austria SKK 500 mln 5.125% Notes 2 Jan 2034	XS0182592062	Long Term Rating	Unsolicited
Austria	-	Local Currency Long Term Issuer Default Rating	Unsolicited
Austria EUR 109 mln 3.56% Gov Bonds 19 Oct 2029	XS0749005186	Long Term Rating	Unsolicited

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Sovereigns Europe Austria