FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Austria's Outlook to Negative; Affirms at 'AA+'

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Related Content:
Austria - Rating Action Report

Fitch Ratings - Frankfurt am Main - 10 Jan 2025: Fitch Ratings has revised the Outlook on Austria's Long-Term Foreign-Currency Issuer Default Rating (IDR) to Negative from Stable and affirmed the IDR at 'AA+'.

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

KEY RATING DRIVERS

The revision of the Outlook on Austria's IDRs reflects the following key rating drivers and their relative weights:

High

Fiscal and Macro Challenges: Austria's fiscal and macroeconomic outlook has deteriorated since our last review, while political uncertainties following the 2024 parliamentary elections further complicate fiscal and economic policy-making. In our view, it is now less likely that the authorities will manage to bring government debt/GDP back on a firm downward trend over the medium term and closer to pre-pandemic levels. In the absence of additional fiscal tightening, budget deficits will remain above 2.5% of GDP over the medium term, driving government debt close to 85% of GDP by 2028.

Higher 2024 Budget Deficit: The general government fiscal balance for 2024 is now estimated by Fitch at 3.7% of GDP, significantly overshooting its July forecast and the government's April deficit target of 2.9%. The worse deficit is driven by the lagged inflation-indexation of public expenditure (especially pensions and public sector wages) and the downward revision of growth. Absent fiscal consolidation, we project that the deficit will further deteriorate to 4.0% of GDP this year, incorporating another round of strong pension and public sector wage growth and additional spending measures that have already been agreed, including for the green transition.

Persistently Higher Budget Deficits: Revenues and expenditure measures enacted since 2020 have reduced Austria's fiscal room relative to pre-pandemic years. The measures include the eco-social tax reform, the new Intergovernmental Fiscal Relation Act and the abolition of bracket creep. None of these measures has been offset by deficit-improving measures. As a result, we now expect that deficits will remain at 3.6% of GDP in 2026 before falling to 3.1% in 2027, exceeding the 'AA' medians of 1.8% and 1.5%, respectively. However, we could adjust our forecast if a new government implements fiscal consolidation measures to support medium-term fiscal consolidation.

EDP Looming: Austria has until mid-January to present credible fiscal consolidation measures to the European Commission to bring the 2025 deficit below 3% and avoid the opening of an Excessive Deficit Procedure (EDP). Based on the European Commission's November calculations, this would require the frontloading of sizeable fiscal savings of EUR6.3 billion (1.3% of GDP). In our view, it is unlikely a new government will adopt the required fiscal consolidation measures to avoid an EDP, given the already weak macroeconomic outlook.

Reversed Government Debt Trajectory: Under our new baseline projections, general government debt is no longer expected to fall to 75.9% of GDP by end-2026, as forecast in July 2024. Instead we expect that debt will rise to 83.3% by end-2026, driving debt to levels well above the 'AA' forecast median of 50.7% and 12.3pp above pre-pandemic levels. This is driven by a combination of weaker nominal GDP growth and higher primary deficits.

Our forecast also takes into account a rise in interest payments/revenue, which will gradually rise to 3.1% by 2026, but will stay well below the 'AA' median of 3.9%. The increase is softened by lower spreads to German bunds and the long average maturity of general government debt.

Medium

Weaker GDP Growth Prospects: Fitch estimates Austria's economy contracted by 0.9% in 2024, with all GDP components declining except public consumption. Export-oriented firms are struggling amid high energy costs and wage growth, partially absorbing these increased expenses, as evidenced by shrinking profit margins. The outlook for Austria's economy remains subdued, with a forecast of weak real GDP growth of 0.8% for 2025, amid persistently weak short-term indicators and only weak growth in neighbouring

Germany. A more substantial recovery is only expected in 2026, with real GDP growth projected to accelerate to 1.2% as part of a cyclical upswing.

Failed Coalition Talks: Protracted government formation and political fragmentation hinder the implementation of substantial budget reductions and impede efforts to stimulate the faltering economy. Karl Nehammer has announced his resignation as Chancellor and leader of the conservative People's Party (ÖVP) after failing to form a centrist coalition with the Social Democrats and the liberal Neos party. The right-wing FPÖ (Freedom Party), which secured an historic first place in September's parliamentary elections and has gained additional support since then according to polls, has now been tasked with forming a government coalition, potentially relying on the ÖVP as a junior partner.

Austria's 'AA+' IDRs also reflect the following key rating drivers:

Credit Fundamentals: Austria's 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 the median ratios of both 'AA' and 'AAA' category peers, although refinancing risks are mitigated by long maturities and low financing costs.

End of Gazprom contract: Austria's largest public utility company, OMV AG (A-/Stable), terminated its long-term gas supply contract with Gazprom in December last year. This previously covered around two-thirds of Austria's annual consumption. The supply halt was due to a dispute over missed gas deliveries to OMV's customers in Germany. Additionally, a gas transit agreement through Ukraine expired at end-2024, which had previously ensured the delivery of Russian gas to Austria.

Despite the supply stop from Russia and Austria's historically high dependence on Russian gas, major gas supply or price shocks are unlikely. The country has taken steps to diversify its gas resources over the medium and long term and its large gas storage facilities are adequately filled.

Erosion of International Competitiveness: Unit labour costs in Austria surged by approximately 10% during 1Q-3Q24, double the pace observed in the broader eurozone. However, recent collective wage agreements, weak employment growth and a slight increase in unemployment suggest a moderation in wage growth for 2025. Higher wages and elevated energy prices have put pressure on Austria's international cost competitiveness. However, Austria is running a current account surplus, its 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.

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. These 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 87.6, 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

- Public Finances: Failure to agree on a credible fiscal consolidation plan that is consistent with bringing general government debt/GDP on a clear downward path over the medium term.

- Macro: A persistent weak growth outlook, for example, due to weaker potential growth and/or an erosion of external competitiveness.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- **Public Finances:** Implementation of a credible fiscal consolidation plan that is consistent with bringing general government debt/GDP on a clear downward path over the medium term.

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 grow 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 the potential that government debt/GDP will decline beyond the forecast horizon, based on the record of debt reduction prior to the pandemic and the potential for fiscal consolidation by an incoming government. In addition, it reflects Austria long average maturity of government debt. The Negative Outlook indicates that this notch could be removed due to the deteriorating fiscal outlook and reduced potential for fiscal consolidation efforts.

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 a 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 Negative	Affirmed	AA+ Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA+ Rating Outlook Negative	Affirmed	AA+ Rating Outlook Stable
	LC ST IDR	F1+	Affirmed	F1+
	Country Ceiling	AAA	Affirmed	AAA

senior unsecured	LT	AA+	Affirmed	AA+
Senior Unsecured-Local currency	LT	AA+	Affirmed	AA+
senior unsecured	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceiling Criteria (pub. 24 Jul 2023)

Sovereign Rating Criteria (pub. 24 Oct 2024) (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, v2.0.2 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.14.2 (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 15.17 bln 4.15% bond/note 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 EUR 1.5 bln	AT0000A10683	Long Term Rating	Unsolicited

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