Press Release

DBRS

Insight beyond the rating.

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DBRS Confirms Republic of Austria at AAA, Stable Trend

Industry: Public Finance--Sovereigns

DBRS Ratings Limited (DBRS) confirmed the Republic of Austria's Long-Term Foreign and Local Currency – Issuer Ratings at AAA. At the same time, DBRS confirmed the Republic of Austria's Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trend on all ratings remains Stable.

KEY RATING CONSIDERATIONS

The confirmation of the Stable trend reflects DBRS's view that the risks to the ratings are limited. Higher political uncertainty regarding the formation of the next government following the collapse of the ruling coalition in May 2019 might have an impact on progress regarding reform implementation but it is unlikely, along with more moderate GDP growth, to substantially undermine the downward trajectory of the country's public debt-to-GDP ratio. DBRS believes that a consensus-oriented and prudent fiscal policy, supportive of nominal economic growth and additional disposal of nationalised financial institutions' assets will further contribute to the fall of the public debt ratio to around 66.8% of GDP in 2020 from 73.8% last year. Following the average 2.7% real GDP growth rate registered over the last two years, Austria's economic activity has been moderating, mainly because of a weaker external environment. However, with forecast average growth of around 1.6% in 2019-20, growth is set to remain above the euro area average of 1.4%.

The ratings are underpinned by Austria's prosperous, diversified and stable economy, reflecting a real GDP per capita that is nearly 27% higher than the European Union (EU) average, and the country's solid and credible institutions. Moreover, Austria's conservative fiscal policy, favourable debt profile and moderate private debt contribute to offsetting some vulnerabilities stemming from the banking sector, the relatively, although decreasing high level of public debt, and ageing population costs.

RATING DRIVERS

Austria's ratings could come under downward pressure if fiscal policy departs significantly from its current trajectory, leading to materially higher-than-expected deficits and rapidly worsening debt metrics. In addition, downward pressure on Austria's ratings could emerge if macroeconomic prospects materially worsen and financial stability deteriorates, placing the public debt ratio on a rapid upward trajectory.

RATING RATIONALE

Political Uncertainty not Expected to Undermine Prudent Fiscal Policy

Austria benefits from strong institutions and the good track record of a consensus-oriented policy along with prudent fiscal frameworks that are not expected to be undermined by the recent increase in political uncertainty. A caretaker government is currently in place until elections are held in September 2019. This follows the collapse of the coalition government of the Austrian People's Party (ÖVP) and the Freedom Party of Austria (FPÖ) in May this year because of a political scandal involving the leader of the FPÖ, Heinz-Christian Strache. Recent opinion polls point to a significant ÖVP lead, with 36% of the expected share of the votes, but this remains far from an absolute majority. It is not clear cut whether the ÖVP will form a government in coalition with one of the other main parties, the FPÖ and Social Democratic Party (SPÖ), trailing in the polls at 20% and 22%, respectively. This adds uncertainty to the progress on the agenda implementation including fiscal measures announced in early 2019. However, despite this uncertainty, the continued political consensus on fiscal prudence is one of the country's key strengths and it is not expected to unravel in the foreseeable future.

Prudent fiscal policy and advantageous cyclical conditions have improved Austria's budgetary position over the last few years. Except for 2016 because of the impact of the 2015-16 tax reform, the budget balance has been improving over the past five years, and in 2018 shifted to a surplus of 0.1% of GDP for the first time since 1974. Although economic activity is moderating and despite the introduction in 2019 of a non-refundable personal income tax credit "family bonus" with a net impact of around EUR 700 million, the budget balance is set to improve to 0.3% of GDP in 2019. Going forward, because of the government collapse, it is not yet clear whether the announced tax reform aimed at decreasing the tax burden to 40% of GDP from around 42.2% registered in 2018, will be implemented in full. This, however, is expected to be implemented gradually so as not to undermine Austria's sound prudent fiscal position.

The country's main fiscal vulnerabilities remain more in the medium- to long-term horizon because of the rising cost of long-term health care as well as pension spending. According to the European Commission's (EC) 2018 ageing report, public spending on pensions, projected at about 13.9% of GDP in 2020, is among the highest in Europe and is expected to continue to rise going forward because of the country's ageing population. Similarly, long-term care could increase by 0.4 percentage points to 2.3% of GDP by 2030 from 1.9% in 2016.

Improving Debt Profile Supports Debt Affordability

The ratio of public debt to GDP is on a visibly downward path. Since the peak of 84.7% of GDP registered in 2015, sound nominal growth, prudent budget balance and the gradual wind-down of nationalised financial institutions have resulted in public debt-to-GDP gradually declining by around 11 percentage points. Going forward, these drivers are set to contribute further to a drop in the public debt ratio to around 60.0% in 2023.

Against this background, adverse risks to the debt trajectory appear limited. Even in a scenario of both a modest deterioration in economic performance and a moderate worsening in the primary surplus, the declining trend of the public debt ratio in coming years is unlikely to be substantially affected. Should economic growth slow to 0.6% on average in the 2020-24 period, the public debt-to GDP ratio would likely continue to decline. Similarly, a significant deterioration in the primary surplus shifting to a deficit of around 0.7% on average would lead to a gradual fall in the public debt to around 67.4% of GDP at the end of 2024.

The government's financing conditions are projected to remain favourable in the forecast horizon. The improvement in Austria's fiscal position along with the still accommodative monetary policy from the European Central Bank (ECB) are contributing to the reduction in the sovereign funding cost. Around 81% of the total outstanding government bonds are now trading in negative territory and, according to the Osterreichische Bundesfinanzierungsagentur (OeBFA), total interest cost is expected to drop to around 1.4% of GDP this year, around 0.6 percentage points below the one registered in 2016. Moreover, Austria's average debt maturity profile is sound at around ten years as well as its debt structure with about 95% of total outstanding bonds at fixed rates. This feature reduces rollover risk, mitigating the potential effect of abrupt interest rate increases.

Resilient Domestic Demand Set to Weather Headwinds Coming from the External Sector

After a robust economic performance, Austria's GDP growth is expected to be more moderate going forward. Following two years of strong growth of 2.7% year-on-year on average, the country's economic growth is expected to decelerate with a real GDP likely to expand by around 1.6% on average in the 2019-2020 period. This is a growth rate more in line with its potential but still above the euro area average projected by the EC at 1.4%. Domestic demand will likely be the main driver of growth while net exports are set to be less supportive given the weaker external environment. Private consumption and still resilient investment will benefit from the family bonus, sustained wage growth supported by healthy labour market conditions and the construction sector's good performance.

Risks to economic growth are tilted to the downside and are mainly external in nature. Beyond a further weakening of the Eurozone's growth momentum, in particular in Germany, in the short-term an intensification of inward trade measures and the impact of the UK's potentially disorderly departure from the EU might cloud Austria's economic outlook. By contrast, in the medium term, economic prospects remain in part constrained by restrictive regulation in the services markets, low labour participation of women and foreign nationals and the high tax wedge which constrain potential GDP.

Households' Moderate Debt Level Mitigates Risks Stemming from the Banking System

Banking system vulnerabilities have receded in recent years, but to some extent still remain a point of attention, in particular, those related to the housing market. Although the Austrian banks remain largely exposed to CESEE countries, the de-risking process has led to a significant decline in their exposure, especially in foreign currency. Despite some uncertainty remaining related to the outcome of some legislative measures on mortgage foreign currency conversion, especially in Poland, according to the Oesterreichische Nationalbank (OeNB), foreign currency loans do not represent a systemic risk. In Austria as well, the share of foreign currency loans to households has declined significantly to around 9% of total loans by Q1 2019. However, three quarters of these foreign exchange loans are bullet and linked to repayment vehicles which continue to show an estimated shortfall of around 30%, equivalent to EUR 4.2 billion, according to the latest estimate from the OeNB.

House prices have been increasing over the past decade and present a risk of correction. Low interest rates and sustained immigration have contributed to Vienna's residential property prices deviating by around 23% from their estimated fundamental values. Nationwide house price inflation remains sustained with residential property prices rising at around 7% year-on-year over the last 12 months. Although on a declining trend, in Austria, the share of new variable-rate loans, at around 45% as of June 2019, is substantially above the euro area average of 19% in the same period. To some degree, this exposes households to an abrupt increase in interest rates, in particular given that the mortgage loan growth rate remains elevated. Nevertheless, household resilience is supported by a moderate debt level overall, that has remained broadly stable as a share of net disposable income, at around 92% over the last five years. Moreover, a relatively high net financial wealth estimated at about 125% of GDP as of Q1 2019 makes households able to absorb a shock arising from financial instability. In this context, the Austrian authorities continue to monitor the development of the housing market and have introduced new legal tools to contain risky borrowers and have strengthened public communication on lending standards over recent years.

Improving credit quality and increasing capitalisation have been strengthening Austria's banking sector. Banks have made progress in restructuring themselves both in Austria and abroad, and the non-performing loan ratio is trending downwards. According to the OeNB, it is well below pre-crisis levels at about 2.6% as of end-2018, whereas it remains slightly more elevated in CESEE countries at 3.2%. The latter, however, has declined significantly since the 11.5% registered in 2015. At the same time, according to the ECB, Austrian banks have improved their level of capitalisation with the common equity tier 1 ratio at 15.4% as of end-2018 compared with 12.6% as of end-2015. This in combination with the level of coverage ratio of about 53% (versus the EU average of 45%), mitigates the risk arising from the housing market.

Ratings Benefit from a Sound External Sector

Austria's track record of current account surpluses along with a positive net international investment position (NIIP) support the country's ratings. The tourism inflow and healthy business services receipts that compensate for the negative position in net income, have resulted in a current account surplus of 2.2% of GDP on average over the last four years. At the same time, the reduction in the negative net portfolio investment position has contributed to the improvement in Austria's positive NIIP, which came in at 8% of GDP in March 2019. This underpins the ability of the country to absorb external shocks. Global headwinds related to trade tensions and the slowdown of Germany's economy, which is the largest export partner with around 30% of market share, is weighing on Austrian export performance. Nevertheless, supportive demand from CESEE countries, which continue to outperform euro area growth, lower import growth and the still healthy surplus from services are expected to sustain the current account surplus expected to average 2.2% of GDP in the 2019-20 period.

RATING COMMITTEE SUMMARY

The DBRS Sovereign Scorecard generates a result in the AAA – AA (high) range. The main points discussed during the Rating Committee include political outlook, public debt-to-GDP trajectory, household exposure to variable rate loans, and vulnerabilities in the banking sector.

KEY INDICATORS

Fiscal Balance (% of GDP): 0.1 (2018); 0.3 (2019F); 0.2 (2020F)
Gross Debt (% of GDP): 73.8 (2018); 69.7 (2019F); 66.8 (2020F)
Nominal GDP (EUR Billions): 386.1 (2018); 399.9 (2019F); 414 (2020F)

GDP per Capita (EUR): 43,652 (2018); 45,004 (2019F); 46,365 (2020F)
Real GDP Growth (%): 2.7 (2018); 1.5 (2019F); 1.6 (2020F)
Consumer Price Inflation (%): 2.1 (2018); 1.8 (2019F); 1.9 (2020F)
Domestic Credit (% GDP): 147.6 (2017); 144.4 (2018) 144.8 (Mar-2019)
Current Account (% GDP): 2.3 (2018); 2.2 (2019F); 2.3 (2020F)
International Investment Position (% GDP): 3.8 (2018); 8.0 (Mar-2019)
Gross External Debt (% GDP): 146.4 (2018); 151.6 (Mar-2019)
Governance Indicator (percentile rank): 93.9 (2017)
Human Development Index: 0.91 (2017)

EURO AREA RISK CATEGORY: LOW

Notes:
All figures are in euros (EUR) unless otherwise noted. Public finance statistics reported on a general government basis unless specified. Fiscal balance (OeNB/BMF), Gross debt (Statistik Austria, European Commission), Nominal GDP (Statistik Austria, European Commission), GDP per Capita (Statistik Austria, European Commission) Real GDP Growth (Statistik Austria, European Commission), Consumer Price Inflation (Eurostat/OeNB/European Commission), Domestic Credit (OeNB/haver/WIFO/Statistik Austria), Current Account (OeNB/Statistik Austria), International Investment Position (WIFO/Statistik Austria/OeNB), Gross External Debt (WIFO/Statistik Austria/OeNB). Governance indicator represents an average percentile rank (0-100) from Rule of Law, Voice and Accountability and Government Effectiveness indicators (all World Bank). Human Development Index (UNDP) ranges from 0-1, with 1 representing a very high level of human development.

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website www.dbrs.com at http://www.dbrs.com/about/methodologies. The principal applicable rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website at http://www.dbrs.com/ratingPolicies/list/name/rating+scales.

The sources of information used for this rating include Statistik Austria, OeNB, OeBFA, Austrian Ministry of Finance (BMF), EC, the 2018 Ageing report, European Banking Authority (EBA), ECB, WIFO, OECD, Eurostat, IMF, World Bank, UNDP, Haver Analytics. DBRS considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

This is an unsolicited rating. This credit rating was not initiated at the request of the issuer.

This rating included participation by the rated entity or any related third party. DBRS had no access to relevant internal documents for the rated entity or a related third party.

DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period. DBRS's outlooks and ratings are under regular surveillance.

For further information on DBRS historical default rates published by the European Securities and Markets Authority ("ESMA") in a central repository, see:
http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

Ratings assigned by DBRS Ratings Limited are subject to EU and US regulations only.

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For more information on this credit or on this industry, visit www.dbrs.com.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Austria, Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Aug 16, 2019
Austria, Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Aug 16, 2019
Austria, Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	AAA	Stb	Aug 16, 2019

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Austria, Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	AAA	Stb	Aug 16, 2019

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