Press Release

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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 declining trajectory of the public debt-to-GDP ratio — mainly as a result of a conservative fiscal policy, moderate nominal economic growth and further disposal of nationalised financial institutions' assets — more than offsets the remaining vulnerabilities stemming from the banking system and the relatively high stock of public debt. Austria's economic performance is expected to moderate in 2019, following an average 2.6% growth rate over the last two years. Nonetheless, growth is expected to remain above the euro area average and to contribute to the fall of the public debt-to-GDP ratio. The government projects a decline to around 64.0% in 2021 from 74.2% in 2018.

The ratings are underpinned by Austria's prosperous, diversified and stable economy, reflecting a gross domestic product (GDP) per capita that is nearly 28% higher than the Eurozone average, and the country's solid and credible institutions. In addition, Austria's ratings benefit from a prudent fiscal policy, favourable public debt profile and a moderate level of private sector debt.

RATING DRIVERS

Austria's ratings could come under downward pressure if the government departs significantly from the current fiscal consolidation 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

Prudent Fiscal Policies and an Improving Debt Profile Support Debt Affordability

The public debt as a share of GDP is on a visibly downward path. After peaking at 84.8% of GDP in 2015, it has started to decline and is now projected to fall to around 64.0% in 2021. The main underlining drivers remain - moderate nominal growth, prudent fiscal policy and the progressive disposal of some distressed financial institutions' assets and the liquidation of cash reserves.

Although total public sector contingent liabilities in the form of guarantees remain sizeable at around 17% of GDP those provided to the local state regarding the financial sector have declined significantly from 13.2% of GDP and now have stabilised at around 1.7% in 2018. This reduces risks arising from financial instability affecting the public debt-to GDP ratio.

In DBRS's view, adverse risks to the debt trajectory are 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 0.7% on average in the 2019-23 period, the public debt ratio will likely continue to decline in the forecast horizon. Similarly, a deterioration in the primary surplus shifting to a deficit of around 0.4% on average would lead to a fall in the public debt to around 68% of GDP at the end of 2023.

Austrian financing conditions are projected to remain favourable, and the still accommodative monetary policy will likely contribute to a continuation in the fall of the interest cost this year from 1.5% of GDP registered in 2018. Austria's 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 and mitigates the potential effect of abrupt interest rate increases.

Prudent fiscal policy and advantageous cyclical conditions have improved Austria's budgetary position over the last few years. The headline deficit has been on a declining trend since 2014, except for 2016 (1.6% of GDP) as a result of the 2015-16 tax reform. Last year it is estimated to have contracted to 0.2% of GDP from 0.8% in 2017 on the back of buoyant economic activity which contributed to higher tax revenues and decreasing interest costs. These have more than offset the abolishment of the public long-term care providers' recourse and the cut in the VAT rate on hotel overnight stays.

According to latest projections of the Austrian Institute of Economic Research (WIFO) included in the 2019 Draft budgetary Plan, the fiscal outlook will remain favourable despite lower economic growth and the budget balance could shift into surplus starting from this year. This despite the introduction of a non-refundable personal income tax credit called family bonus, estimated by the government impacting the budget by around EUR 700 million, and the slight reduction in the contribution to the accident insurance scheme to 1.2% from 1.3%. Moreover, the government has been making progress in reducing administrative costs through efficiency gains in public services and the reorganisation of the social insurance system. In DBRS's view, however, the improvement in fiscal position could be more moderate should economic growth loose further momentum, and the family bonus result into lower revenues than projected. Looking forward, additional measures are expected to be implemented as the government intends to reduce the tax burden to 40% of GDP from 42.4% in 2017 and to reform the tax system from 2020. The latter is expected to have an impact of around Eur 4.5 billion, but the budgetary implications in light of a more moderate economic performance are not clear in the coming years.

Austria's main fiscal vulnerabilities remain more in the medium- to long-term horizon due to rising cost of long-term and health care as well as pension spending. According to the European Commission 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 due to the 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. In this context, additional measures may be needed.

Economic Growth Strengthens While Banking Vulnerabilities Recede

After a robust economic performance Austria's GDP growth will be more moderate going forward. Following two years of strong growth at about 2.6% year-on year on average, the country's economic growth is expected to decelerate in 2019 with a real GDP likely to expand at around 1.6%, a level more in line with its potential but still above the euro area average. Private consumption and still resilient investment will likely continue to remain supportive, while the external environment will be less favourable. Strong wage growth, the family bonus and the declining unemployment are projected to be the key drivers for economic growth in 2019.

Beyond a further weakening of the Eurozone's growth momentum, in particular in Germany, external risks in the short-term including the indirect impact of the UK's disorderly departure from the EU and trade tensions, might cloud Austria's economic outlook. By contrast, in the medium-term economic prospects remain in part constrained by strict regulation in the private service sector and the high tax wedge.

Banking system vulnerabilities have receded over the last years, but to some extent still remain a point of attention. In Austria, the share of new variable rate loans at around 50% is still above the euro area average (slightly above 20%). This exposes households to some degree to an abrupt increase in interest rates. At the same time, the legacy exposure of foreign exchange loans in CESEE countries and in Austria have declined substantially, but still represent a risk, particularly to the former. In addition, three quarters of these foreign exchange loans in Austria are bullet and linked to repayment vehicles which continue to show an estimated shortfall of around 29%, equivalent to EUR 4.4 billion, according to the latest estimate from the Austrian National Bank (OeNB).

House prices have been increasing since 2000s and present a risk of correction. Low interest rates and sustained immigration have contributed to Vienna's residential property prices deviating by around 25% from their estimated fundamental values. Nation-wide house price inflation has started to accelerate again recently to around 8% year-on-year as of Q3 2018. Nevertheless, household resilience is supported by a moderate debt level overall, which has remained broadly stable as a share of the net disposable income at around 92% over the last five years. A relatively high net financial wealth estimated at about 123% of GDP as of Q1 2018 makes households resilient to absorb a shock arising from financial instability. Moreover, the Austrian authorities continue to monitor housing market development and have introduced new legal tools to contain risky borrowers and strengthened the public communication on lending standards over the last years. This, alongside less housing demand due to lower immigration inflows could lower the pressure on housing prices.

Improving credit quality and increasing capitalisation have been strengthening Austria's banking sector. As the economic growth continues to expand and banks make progress in restructuring themselves both in Austria and abroad, the non-performing loan ratio is trending downwards. According to the European Banking Authority (EBA) it is well below pre-crisis levels at about 3.2% as of Q2 2018, although it remains more elevated in CESEE countries at 3.9%. The latter, however, has declined significantly from the peak of 11.5% registered in 2015. At the same time, Austrian banks have improved their level of capitalisation with the common equity tier 1 ratio at 15.1% as of Q2 2018 compared with 11.5% in Q1 2015. This ranks slightly favourably compared with the EU average (14.9%) and, combined with the high level of coverage ratio at about 54% (versus the EU average of 45%), mitigates the risk arising from the still high exposure and concentration in CESEE countries and the housing market.

Ratings Benefit from a Sound External Sector and Predictable Policy Framework

Austria's track record of current account surpluses and a surplus in net international investment position (NIIP) underpin a sound external position. This mirrors the healthy tourism inflow and growing business services receipts, which compensate for the negative position in secondary income. Despite global headwinds related to trade tensions, the external outlook appears to be resilient. This is because of the supportive demand from CESEE countries and the expectation that a moderation of import growth may occur as domestic demand in Austria softens. The OeNB projects a continuation in the improving current account position with a surplus reaching 2.4% in 2019 following the average outturn recorded over the last five years of 2.1%. This should further support the NIIP which has already shifted to surplus in 2013 and now stands at 5.4% of GDP, improving the country's ability to absorb external shocks.

Consensus-oriented policy as well as democratic institutions make Austria's political system conducive to a stable and predictable policy framework. Following last the 2017 snap elections, the new ruling coalition comprising the Austrian People's Party (ÖVP) and the Freedom Party of Austria (FPÖ) remains committed to budgetary consolidation. Moreover, it is expected to pursue a pro-European agenda, despite the fact that lower immigration and stricter border controls represent the key themes of its foreign policy.

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 the economic outlook, public debt-to-GDP trajectory, contingent liabilities, household FX exposure, housing market pressures and mortgage lending, macroprudential policies.

KEY INDICATORS

Fiscal Balance (% GDP): -0.8 (2017); -0.2 (2018E); 0.0 (2019F)
Gross Debt (% GDP): 78.3 (2017); 74.2 (2018E); 71.0 (2019F)
Nominal GDP (EUR billions): 369.9 (2017); 386.2 (2018E); 401.1 (2019F)
GDP per Capita (EUR): 42,058 (2017); 43,449 (2018E); 44,732 (2019F)
Real GDP Growth (%): 2.6 (2017); 2.7 (2018E); 1.6 (2019F)
Consumer Price Inflation (%): 2.2 (2017); 2.1 (2018); 2.1 (2019F)
Domestic Credit (% GDP): 147.6 (2017); 146.6 (Sept-2018)
Current Account (% GDP): 2.0 (2017); 2.1 (2018E); 2.4 (2019F)
International Investment Position (% GDP): 3.7 (2017) 5.4 (Sept-2018)
Gross External Debt (% GDP): 154.3 (2017; 151.8 (Sept-2018)
Governance Indicator (percentile rank): 91.8 (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 (BMF/European Commission), Gross debt (WIFO/European Commission), Nominal GDP (WIFO/Statistics Austria), GDP per Capita (European Commission/WIFO/Statistics Austria), Real GDP Growth (European Commission Winter forecast 2019), Inflation (Eurostat/IMF), Domestic Credit (WIFO/Statistics Austria/OeNB), Current Account (OeNB), International Investment Position (WIFO/Statistics Austria/OeNB), Gross External Debt (WIFO/Statistics 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 Statistics Austria, OeNB, Austrian Ministry of Finance (BMF), European Commission, the 2018 Ageing report, European Banking Authority (EBA), OeBFA, WIFO, 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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Correction: On February 19, 2019, DBRS Ratings Limited corrected this press release originally issued on February 15, 2019 for the Republic of Austria. The correction better specifies that the household foreign exchange risk is greater in CESEE countries than in Austria and that the three quarters of loans to households in Austria that are bullet and linked to repayment vehicles relate to the total foreign exchange loans.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Austria, Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Feb 15, 2019
Austria, Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-1 (high)	Stb	Feb 15, 2019
Austria, Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	AAA	Stb	Feb 15, 2019
Austria, Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	AAA	Stb	Feb 15, 2019

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