FitchRatings

RATING ACTION COMMENTARY

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

Fri 07 Oct, 2022 - 5:01 PM ET

**Related Content:**
Austria - Rating Action Report

Fitch Ratings - Frankfurt am Main - 07 Oct 2022: 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 reflects the following key rating drivers and their relative weights:

**Medium**

**Energy Supply Risks:** Austria's macroeconomic outlook and public finances are exposed to downside risks to energy supply and prices, such as a more complete and prolonged cut-off of Russian gas supplies, given its high reliance on Russian gas, limited domestic alternatives and the sizeable gas needs of the manufacturing sector, despite mitigating factors that provide a cushion in the short term. Energy supply risks are pronounced in the context of a high level of public debt and limited headroom at the 'AA+' rating to absorb further shocks.

Reliance on Russian gas remains high by European comparison, even as imports from Russia have reportedly declined to below 50% from 80% before the war. Austria's largest utility supplier OMV AG (A-/Stable) has secured 4.1bcm in additional pipeline capacities (45% of annual consumption) for one year, unlocking existing capacities in Norway and Rotterdam and allowing for new LNG supplies from Italy.

Austria has sufficient natural gas supplies in storage to fill consumption needs this winter. At the beginning of October, Austria's gas storage facilities were 80% full, accounting for around 85% of annual gas consumption, well above the current EU average storage level of 26% of annual consumption. However, securing new supplies will be a challenge in 2023 once storage capacities are running low after the winter months. Austrian gas reserves would be depleted by end-2023 in a scenario where Russian gas is completely cut off and no alternative gas deliveries are received or domestic consumption is significantly lowered.

**Macro Outlook Weakens:** Fitch now projects that Austria's economy will contract by 0.2% in 2023, reflecting a significant downward revision from the agency's April forecast of 2.4%. We predict a recession in the manufacturing sector amid exceptionally high energy prices, faster monetary policy tightening and negative spillovers from Austria's key trading partners. At the same time, we now predict stronger growth this year at 4.5% (vs. 3.3% previously) as GDP growth was exceptionally strong in 1H22, supported by resilient industrial production and a rebound in the tourism sector, which recovered from a national lockdown in late-2021.

Our baseline forecast assumes that Russian gas flows will continue at currently reduced volumes. While Russian gas via Nord Stream 1 has been permanently cut, Austria has historically received most of its Russian gas supplies through the Transgas pipeline, passing Ukraine and Slovakia. However, Austria remains highly exposed to high and volatile wholesale prices for gas and electricity. Permanently higher energy prices pose a risk to potential growth in the medium to long term due to a loss of international price competitiveness.

**Slower Fiscal Consolidation:** Fitch forecasts wider fiscal deficits than previously expected, owing to the weaker economic outlook and new fiscal measures to deal with the repercussions from Russia's invasion of Ukraine. The Austrian government has so far announced three relief packages and is working on further measures that are to be included in the 2023 budget. These include an electricity price cap for households, longer-term tax measures and various direct one-off payments to households and companies. The announced relief measures total around 1.6% of GDP in 2022 and 1.7% in 2023. On top comes the cost of a strategic gas reserve, with a final cost of 0.9% of GDP in 2022. Given the severity of the energy crisis and our weak growth outlook, our fiscal forecast for 2023 cautiously includes another 0.5% of GDP in discretionary spending measures.

We forecast that the fiscal deficit will reach 3.2% in 2022 but widen to 3.4% of GDP in 2023, before improving again to 2.2% of GDP in 2024. Some relief measures will permanently impact the government's budget balance and reduce fiscal flexibility in the medium to long term. These include the indexation of personal income tax brackets to avoid the contractionary impact from high inflation. At the same time, a number of social benefits will be tied to inflation, making current expenditure more rigid. While we currently believe that the government can meet a balanced primary balance in 2026 as revenues rebound and discretionary spending is phased out, substantial budgetary risks remain regarding energy price developments and a deeper economic recession or lower potential growth, which could require larger fiscal support and reverse positive revenue developments.

**Less Certain Public Debt Trajectory:** Fitch projects that nominal GDP growth and small fiscal deficits will support a further reduction in general government debt to 76.1% of GDP by end-2024 (down from a peak of 82.9% in 2020). However, public debt will remain significantly above the pre-pandemic level of 70.6% of GDP and the forecast 'AA' median of 47% of GDP. In our baseline, we expect Austria's debt/GDP ratio to continue to decline before levelling off around 75% of GDP beyond 2026. While the downward trajectory is supported by small fiscal deficits and nominal GDP growth, there is significant uncertainty about the evolution of public finances.

**Debt Cost Rising from Low Levels:** As for other sovereigns, government bond yields have risen over recent months and will likely increase further due to monetary policy tightening in the eurozone. Fitch now expects that the ECB will hike rates to 2% by end-2022. The impact is mitigated by the very long average maturity of general government debt of 11.5 years, the longest in the EU with respect to market debt. We project interest payments/revenue to fall to 1.8% in 2022, below the forecast 'AA' median of 2.3% despite a higher debt burden, before starting to rise again to 2.7% in 2024.

**Inflationary Pressures Accelerate:** Flash estimates indicate that HICP inflation accelerated to 11% year-on-year in September. While energy remains the largest driver of higher consumer prices, inflation pressures have become increasingly broad-based, with sizeable contributions from the nonenergy, food and services components. We expect that inflation will average 8.3% this year (compared with 8.1% for the eurozone) before easing to 6.1% in 2023.

Austria 'AA+' rating also reflects the following key rating drivers:

**Credit Fundamentals:** The 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.

**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. It primarily reflects Raiffeisen Bank International's exposure. Any losses related to Russian subsidiaries would likely be manageable for the sector, given the banks' strong capital and liquidity buffers. However, we expect second-round effects from the war in Ukraine as well as recessionary developments in the broader Eastern European region to weigh on profitability of the sector, leading to higher loan impairment charges, which will be only partially offset from earnings tailwinds from rising interest rates.

**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 90.0, 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:** Failure to reduce general government debt/GDP over the medium term, 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:

- **Macro:** Easing of the downside risks from the energy crisis, particularly in terms of the potential impact on public finances.

- **Public Finances:** Increased confidence that public finances will be resilient to the energy crisis, for example as evidenced by a continued reduction in general government debt/GDP.

- **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 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 | ST F1+ Affirmed | F1+ |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 11 Jul 2022) (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, v3.13.1 (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 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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