Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF AUSTRIA	Assigned Ratings/Outlook: **AA+ /stable**	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	29-07-2016 24-03-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

Contents

Rating Action

Neuss, 24 March 2023

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA+" for the Republic of Austria. Creditreform Rating has also affirmed Austria's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA+". The outlook remains stable.

Key Rating Drivers

1. Austria's real GDP growth should ease significantly, following strong economic recovery in 2021 and 2022; high core inflation, rising financing costs, and economic uncertainty will presumably constrain domestic demand, with the economic fallout of the Russian invasion mitigated by public support, while tourism revenues will aid export growth; we expect only modest growth for the current year, before real GDP should pick up in line with moderating inflation rates

2. Resilient medium-term growth, mirroring measures to reduce dependency on Russian energy and building on key strengths such as a high per capita income, a robust labor market, and a high degree of diversification and competitiveness; reforms and investment to further facilitate the twin transition should aid underlying growth, compensating for demographic headwinds and shortages in skilled labor

3. Very high institutional quality, further buttressed by the sovereign's EMU and EU membership; while political volatility has receded notably, implementation of reforms fostering the green transformation, eliminating the bracket creep, and reducing the labor tax wedge as well as swift contingency planning regarding energy security, reflect high government effectiveness; high-level corruption cases have translated into a deterioration in the World Bank metric on perceived corruption

4. Public finances should continue to improve this year and next, driven by declining pandemic-related aid and gradually receding energy support measures; we expect strong nominal growth and moderate headline deficits to lead to a further declining public debt ratio over the medium term, although likely remaining above its pre-pandemic levels; while we expect interest outlays to edge up over the medium term, debt affordability will remain high, reflecting a very favorable debt profile and low effective interest rates as a result of the authorities' sound debt management; risks surrounding Austria's residential property market have receded somewhat as of late, whilst fiscal risks related to contingent liabilities and demographics remain in place

5. External risks remain limited, although the current account surplus has narrowed significantly in the wake of the pandemic; while this year's current account will likely post an only modest surplus, the positive and rising net international investment position indicates sufficient external buffers

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Boasting a wealthy economy with one of the highest per capita income levels in the EU, Austria's economy is characterized by a high degree of diversification and competitiveness. Overall healthy labor market conditions, a moderate level of private indebtedness, and significant innovative capacities complete the strong macroeconomic profile. Risks related to energy security with regard to the Russian war against Ukraine and the tense geopolitical situation still remain, but have receded significantly since our last review, also thanks to swift and determined policy action. Structural bottlenecks to Austria's growth potential are increasingly addressed, with the abolition of the bracket creep, which will prospectively lower the tax wedge, serving as a prominent example. While the Recovery and Resilience Plan (RRP) has initiated important reform processes, it will strengthen investment activity over the medium term. Reforms and investment should foster potential growth noticeably, notwithstanding a likely drag presented by decreasing labor input stemming from skills shortages and demographic developments.

Despite headwinds from the Russian invasion of Ukraine, Austria's economy enjoyed persistently robust real GDP growth in 2022, with total output growing by 5.0% (2021: 4.6%). Last year's economic expansion came on the back of vivid household spending, which increased by 4.1% in 2022, and contributed 2.2 p.p., benefiting from the withdrawal of pandemic-related restrictions and pent-up demand. Moreover, real GDP growth was buttressed by net external trade (3.2 p.p.) as dynamic export growth, leaping by 11.1% and supported by the strong recovery of tourism, considerably exceeded import growth (5.7%). Contrarily, investment activity contracted by 0.9%, with industrial production and construction suffering from economic uncertainty and markedly rising energy and commodity prices.

Last year's robust annual growth rate masks a mixed quarterly profile, as economic activity decelerated considerably in the second half of the year. Following robust growth in Q1 and Q2, coming in at 0.8% and 2.1% q-o-q respectively, the quarterly growth rate plummeted to 0.1% in the third quarter, before real GDP stagnated in Q4-22 (0.0%). From Q2-22, private consumption declined, with the implementation of energy relief measures geared towards cushioning the negative effects of high consumer price inflation likely preventing a worse outcome.

Austria continues to be one of the most prosperous economies in Europe, further added to by last year's comparatively strong economic growth, which outpaced the respective euro area (EA) and EU averages (both 3.5% in 2022). Drawing on IMF estimates, Austria posted an estimated per capita GDP (PPP terms, current prices) of USD 66,680 in 2022 (USD 59,759 in 2021), equating to roughly 124% of the weighted EU average. Whilst Austria displays higher wealth levels than

---

[1] This rating update takes into account information available until 17 March 2023.

the other sovereigns in our AA-rated universe, e.g. Finland, France, and the UK, it also exceeds Germany's estimated GDP per capita (2022: USD 63,835).

Going forward, we expect resilient economic expansion, but repercussions from the energy crisis are set to weigh heavily on Austrian growth performance. While the HICP annual rate of change appears to have plateaued at the turn of the year, it remained at a high level at 11.0% in Feb-23, following a peak at 11.6% recorded last October. In tandem with support measures to soften the blow from soaring energy prices for consumers and businesses, efforts to reduce energy consumption as well as finding some alternative energy suppliers have contributed to stabilizing energy costs, while energy markets seem to have normalized as of late.

That said, core inflation (excl. energy, food, alcohol, tobacco) continued to rise briskly until recently, standing at 7.8% in Jan-23, as compared to 2.8% in Jan-22. Increasingly dynamic wage developments should keep core inflation elevated throughout 2023. Overall, high inflation should dampen household spending, weighing on real disposable income, before the latter should pick up in 2024. Accordingly, consumer sentiment remains downbeat, moving at historically low levels, despite having been on the rise over recent months. Significant government support should continue to shield households from negative reverberations from the energy crisis to some extent, while we expect households to increasingly resort to savings.

Furthermore, consumption should be aided by resilient labor market conditions and wage growth. Fueled by wage agreements and labor shortages, nominal wages are projected to increase notably this year and next, posting somewhat above inflation and leading to gradually rising real wages going forward. Meanwhile, the abolition of the bracket creep via the indexation of personal income tax brackets effectively increases taxpayer's real income. The adjustment comprises a compensation of two thirds of the bracket creep, with the remaining third envisaged to be used for targeted income tax relief (see below).

Labor conditions continue to be favorable. Austria's monthly unemployment rate stood at 5.1% in Jan-23, well below the average of the euro area as a whole (6.6%) and somewhat above the previous year's figure (Jan-22: 4.7%). Employment has grown strongly since the pandemic-induced decline, remaining resilient in the second half of last year (Q3-22: 1.4% y-o-y, Q4-22: 1.3%). Labor participation bounced back from the decline triggered by the corona crisis, at 77.8% Q3-22 exceeding its pre-pandemic level (Q4-19: 77.3%) and standing significantly above the euro area average (74.5%).

While well-performing indicators in the categories 'equal opportunities' and 'social protection and inclusion' of the EU Social Scoreboard add to the overall favorable impression of Austria's labor market conditions, we would continue to flag persisting challenges related to labor market mismatches. These appear to have become more pronounced recently, as signaled by misaligned unemployment and job vacancy data. In fact, Austria exhibits one of the highest job vacancy rates among EU member states, posting at 4.9% in Q3-22 (Eurostat data, industry, construction, services, sa).

The drag exerted by high energy and commodity prices will presumably subside only gradually and continue to weigh on fixed Investments, which we expect to expand only modestly this year, picking up from 2024. Moreover, increasing financing costs, as well as shortages in labor supply, are also likely to hamper investment activity. Survey data on industry new order books up to Q1-23 do not bode well for industrial production, whilst the backlog of orders shrank in the second half of last year. Capacity utilization in the industry sector continues to stand above its long-term average (87.1% in Jan-23 vs. 85.3%), but was down from 88.2% in the year before.

Ongoing pervasive economic uncertainty should also continue to mute investment activity in the near terms, as suggested by weak confidence in the industry and construction sectors. As regards construction investment, the residential property cycle should have passed its peak (see below), suggesting that housing investment will not act as a supporting factor in the near term, compounded by the higher interest rate environment.

Although the widespread decline in real disposable income of households from origin countries should soften foreign demand for tourist services this year, we believe that tourism will be a supportive pillar to the Austrian economy, although 2024 should see more lively growth in this area. Whilst tourism arrivals in 2022 accounted for 86.1% of the pre-pandemic levels in 2019, they increased further by 53.6% y-o-y in Jan-23, with the number of overnight stays rising by 46.9%.

Service exports should thus prove to be an important offsetting factor to goods exports, which are likely to suffer from weakening external demand, as key trading partners in the euro area also face weaker growth prospects and headwinds from inflation. Uncertainty over energy market developments and the effects emanating from tightening financing conditions, as well as rising material costs and still poor export expectations in the industry sector, weigh on export prospects. Tangible improvements in the export industry, in our view, will materialize with the anticipated recovery of the global economy in 2024 and the European market in particular. As import growth should be curtailed by lackluster domestic demand, we still expect a moderate positive contribution from net external trade this year, which should become larger in 2024.

On the whole, we expect Austria's real GDP to expand by 0.7% in 2023 and 1.5% in 2024, acknowledging high uncertainty surrounding these projections, in particular in light of risks related to energy security and possibly stronger and more persistent price pressures. Against the backdrop of strong energy dependency on Russia, the government agreed on the buildup of a strategic gas reserve in May-22, comprising the equivalent of two winter months that could be accessed in the event of emergency. Moreover, substantial efforts have been made to reduce the share of energy imported from Russia. The share of gas imported from Russia was halved to below 40% as of Feb-23, with a considerable share obtained from other sources (OeBFA intelligence).

Thanks to savings in natural gas consumption (-19.9% in H2 2022 vs. 2017-21 avg.) and the mild winter season, gas storage levels remain relatively high, posting at 66.6% as of 08-Mar-23 (EU: 57.4%), well above the last year's level at that time (AGSI+ data). Additionally, Austria displays a balanced energy mix, with renewables and biofuels making up for one of the highest shares in gross available energy among euro area members (Eurostat, see also below). Considering these achievements, risks related to a scenario requiring the rationing of gas are in our view limited at present. However, we note that Austria remains vulnerable to sudden disruptions in Russian energy supply, posing a downside risk to our anticipated path of economic activity.

Medium-term growth prospects are set to improve due to the implementation of reforms related to the Recovery and Resilience Plan (RRP). A majority of the resources needed for reform and investment projects (EUR 3.46bn) will be provided in grants under the Recovery and Resilience Facility (RRF). In our view, authorities are making headway in reform implementation. On 22-Dec-22, Austria submitted the first payment request to the tune of EUR 700mn, which was greenlighted by the European Commission (EC). The disbursement of RRF funds was contingent on the achievement of 44 milestones in a variety of areas (see below).

Furthermore, we assess as positive that structural challenges, such as Austria's high tax wedge, are addressed via structural reforms, which should prove conducive to growth prospects over the medium term. To put things into perspective, Austria displayed the third-largest tax wedge among the 38 OECD countries in 2021, after having increased by 0.3 p.p. to 47.8%.

Against the backdrop of Austria's overall favorable international competitiveness, we also deem medium-term growth perspectives as favorable, with Austria ranked 20th out of 63 economies considered in the 2022 edition of the IMD global competitiveness ranking. We also have to highlight Austria's efforts regarding innovation and digitization. According to the European Innovation Scoreboard 2022, Austria remains a strong innovator and displays above average performance in its peer group. By the same token, Austria is ranked at 17 out of 132 economies worldwide in the UN's Global Innovation Index 2022, with human capital and research (rank 11) as well as infrastructure (rank 9) seen as key strengths. As concerns the EC's Digital Economy and Society Index, Austria reached the 10th position among the 27 member states in 2022. What is more, Austria was the country with the third-highest R&D expenditure among the EU-27 member states in 2021, posting at 3.19% of GDP (Eurostat, EU: 2.26%).

Turning to cost competitiveness of Austria's highly productive economy, we note that nominal labor productivity per hour worked exceeded the EU total by 16.1% in 2021, thus posting above its pre-pandemic reading. Real unit labor costs developed positively over the past year as well as over the medium term (2017-22), comparing favorably against main trading partners such as Germany and Italy. While the global export market share of goods and services decreased slightly to 0.97% in 2021, we expect it to have edged up again, mirroring the robust development of exports in 2022 (see above).

Austria continues to display rather moderate levels of private indebtedness, with both, non-financial corporation and household debt ratios having come down since our last review. NFC debt (liabilities: loans and debt securities) decreased to 77.8% of GDP in Q3-22 (Q3-21: 80.7%), approaching pre-pandemic readings and representing an average level among the euro area economies. Austria's household debt-declined to 84.2% of disposable income in Q3-22, from 86.4% in Q3-21, also almost reaching its pre-pandemic level.

Institutional Structure

The Republic of Austria's credit ratings continue to reflect the very high quality of the sovereign's institutional framework, being ultimately underscored by the World Bank's Worldwide Governance Indicators (WGIs), although we note a deterioration related to the perception of corruption. Institutional conditions remain buttressed by the ECB's highly credible and accountable monetary policy, with movements in wages, inflation and interest rates having been broadly synchronized with those in the euro area overall in the longer term. Also, we believe that the sovereign benefits greatly from membership in the euro area and the European Union, and we view policy-making as responsive and forward-looking. While the government promotes its agenda to facilitate the green transformation and has progressed in terms of fiscal reforms, some key reform initiatives related to the judicial system and the combat of corruption remain pending.

A phase of political volatility, including three chancellors in quick succession, appears to have largely abated since our last review, with the re-election of President Van der Bellen at the turn of the year being a case in point. The President won well over 50% in the Presidential election last October, thus achieving the required absolute majority, eliminating the need for a runoff election.

That being said, alleged high-level corruption cases elaborated in our past reviews, have translated into a deterioration in the World Bank's metric on perceived corruption. While the national anti-corruption body WKStA ('Wirtschafts- und Korruptionsstaatsanwaltschaft') proceeds with its investigations into alleged cases of high-level corruption, the sovereign slipped in its relative ranking regarding the WGI control of corruption which measures the perceived degree to which public power is exercised for private gain. In the latest vintage, which refers to the base year 2021, Austria was thus ranked 29th out of 209 economies, down from rank 20 a year before and corresponding to its lowest relative ranking since the inception of the WGIs. To be sure, the sovereign still outperforms the euro area average (median rank 45) by a considerable margin.

At the same time, Austria displays a broadly stable and persistently favorable performance concerning the remaining World Bank WGIs most relevant to our assessment of the institutional quality. Thus, Austria's rank 12 out of 209 economies on the WGI government effectiveness continues to indicate a very high quality in policy formulation and implementation, well above the euro area average (rank 38), as well as the median among our 'AA'-rated sovereigns (rank 29). When it comes to the WGI voice and accountability, which measures freedom of expression and association as well as free media, the sovereign stands at relative rank 12 (EA: rank 29), down from rank 10 in the previous year. Furthermore, the sovereign retained its excellent rank 7 related to the WGI rule of law (EA: rank 34), i.e. the perceived quality of courts, contract enforcement, and property rights.

Efforts to advance legislation geared towards preventing corruption is progressing, although the pace of implementation appears to have slowed down during the pandemic. In this vein, the recent GRECO evaluation report (Mar-23) related to the fifth evaluation round finds that key reforms such as the criminal legislation reform, the lobbying act, and the transparency act await further development. GRECO also concludes that there appears to be a lack of systematic analysis of major corruption risk factors pertaining top executive functions, whereas the EC sees limited efforts to effectively address risks of conflict of interest for members of parliament, as per Rule of Law report (Jul-22).

While we gather that the civil society initiative for a Rule of Law and Anti-Corruption Referendum is pending in parliament, and work on the reform of the prosecution service with an independent Prosecutor General is ongoing, a new whistleblower protection law and accompanying amendments to the law were passed by the National Council this February, implementing a corresponding EU directive. Moreover, headway seems to have been made regarding the Freedom of Information Law ('Informationsfreiheitsgesetz'), with a revised draft law envisaged for mid-2023.

Underscoring the government's effective and forward-looking policy-making in our view, the government implemented important structural fiscal policy measures (see also below), which are geared towards lowering the tax wedge and enhancing cost competitiveness. This includes the indexation of PIT brackets (i.e. abolishing the 'tax bracket creep'), indexation of social contributions, valorization of child care contributions, as well as by a reduction of firms' labor contribution (FLAF, family compensation).

Significant progress was also achieved with a view to the milestones and targets related to the national RRP. Overall, 44 milestones and targets were positively assessed by the EC in December 2022, paying testament to the public administration's capacities in implementing large-scale investment projects, in this case associated with, e.g., the exchange of oil and gas heating systems, the provision of digital devices to the school system, or the construction of new railways.

As part of the initiatives, authorities have continued to forge ahead in terms of facilitating the transition towards a greener economy, underscoring their ambition to remain a European leader in this regard. In fact, Austria is placed at rank 3 as regards the EC Eco-Innovation Scoreboard. Key national initiatives implemented in the recent past include the national Energy and Climate Plan (2019), the Strategy for Research, Technology, and Innovation (2020). More recently, the government has enacted important RRP-related reforms, e.g. the Renewable Expansion Law, the adoption of regulatory criteria and funding guidelines for transforming the Austrian industrial sector towards climate neutrality, and the reform regarding the so-called climate ticket as part of the 2030 Mobility Mater Plan (2021).

While awaiting more timely cross-country data, Austria managed to lower its greenhouse gas (GHG) emissions in the first year of the Covid-19 pandemic, which fell from 9.3 tons of CO2-equivalent per capita to 8.4 tons p.c. in 2019-20. Still, this compares as somewhat elevated to the EU average (7.5 tons p.c.) and makes the achievement of the national climate target of reaching neutrality by 2040 appear challenging. At the same time, Austria remains among the EU member states with the highest overall share of energy from renewable sources, at 36.4% in 2021, virtually unchanged from a year before and well above the EU average (21.8%). In addition, Austria ranks 1st in terms of its share of energy from renewable sources in gross electricity consumption (2021: 76.2%).

Fiscal Sustainability

Although we believe that fiscal sustainability remains the sovereign's main credit weakness, fiscal risks will remain manageable and fiscal metrics will improve over the medium term, largely driven by waning pandemic-related measures and strong nominal growth, as inflationary pressures should subside only gradually going forward. Significant discretionary measures geared towards energy security and cushioning the adverse effects of strong growth in energy prices will have deficit-increasing effects on the revenue and spending side, while structural fiscal measures should hinder the deficit from falling further over the medium term. Despite unusually high uncertainty, we expect the public debt ratio to decline, but remain above pre-pandemic levels in our base scenario. Despite prospectively rising debt servicing costs, affordability should remain strong and fiscal risks should be limited due to the sovereign's favorable debt profile with long maturities and low effective interest rates over the medium term. This includes risks pertaining to still pronounced public guarantees and demographics.

While the adverse repercussions from the pandemic are still being felt, the Russian invasion of Ukraine and the concomitant substantial inflationary pressures, essentially pertaining to energy prices, but also involving broadening price pressures related to services and consumer goods, necessitated several rounds of fiscal measures which obstruct the fiscal consolidation path we would have otherwise expected.

The government adopted three sizable energy relief packages as well as structural measures to cushion the adverse effects from rapidly rising prices for households and businesses and to ensure energy security. The packages, enacted in June (package I) and October (II and III), amount to a total volume (2022-25) of approx. EUR 33.1bn or 7.4% of 2022 GDP (Ministry of Finance, BMF).

Overall, the headline deficit should have fallen to 3.1% of GDP in 2022 as compared to 5.9% of GDP a year before. The positive outturn was essentially driven by robust revenue growth, buttressed by brisk household spending and resilient labor market performance, but also by the inflation backdrop that lifted the tax base. At the same time, deficit-increasing temporary energy measures acted as a drag on the revenue side, totaling roughly 0.3% of GDP (based on BMF data).

On the other hand, measures to limit the economic and social fallout from the pandemic diminished markedly, decreasing from 4.6% of GDP in 2021 to 1.5% of GDP last year (Draft Budgetary Plan 2023, DBP23). As regards the spending side, this decline more than compensated for the implementation of temporary energy support measures with a budgetary impact of approx. EUR 5.7bn or 1.3% of GDP. In light of the geopolitical situation and its implications for Austria's energy security, the government furthermore decided to procure a strategic gas reserve, for which it shelled out a total of EUR 3.8bn (~0.8% of GDP).

Looking forward, near-term budgetary performance will ultimately be shaped by the further development of the geopolitical environment and inflation, implying that our fiscal forecasts remain subject to an unusually high degree of uncertainty. At the current juncture, we pencil in a decline in the sovereign's headline balance, to 2.6% of GDP in 2023, and further to 1.8% of GDP in 2024. Pandemic support measures will edge down further (0.4% of our estimated 2023 GDP, BMF intelligence), while solid wage and employment growth, inflation, and broadly stable household spending, which benefits from public support, will foster revenue growth.

By contrast, discretionary and structural measures to limit the adverse inflationary impact on the private sector, strengthen energy security and ensure national security, as well as to promote the economy's green transformation, will weigh on Austria's fiscal performance in 2023. Last year's temporary relief measures will be continued and supplemented by new initiatives such as lump-sum payments for low-income earners ('Teuerungsabsetzbetrag') and families ('Familienbonus Plus', 'Kindermehrbetrag'). On the whole, these measures should have a deficit-increasing effect of around 0.5% of our forecasted 2023 GDP. On the expenditure side, temporary aid measures targeted towards aiding households and businesses are forecast to total EUR 3.9bn (BMF, 0.8% of GDP), including in particular subsidies to households' energy bill ('Stromkostenbremse', EUR 2.7bn), whilst high inflation rates will likely translate into significant increases in the wage bill and pensions in the public sector.

Structural fiscal measures will add to this, e.g. the indexation of PIT brackets (0.3% of GDP) and social contributions (0.1% of GDP), and the reduction of corporate labor costs (FLAF, 0.1% of GDP). What is more, the government is to increase military expenses and climate change-related funding by 0.2% of GDP respectively.

We expect that the narrowing deficit coupled with brisk nominal growth will translate into falling general government debt as set against GDP. After having presumably dropped from 82.3% of GDP in 2021 to 77.7% of GDP last year, we project the sovereign's public debt ratio to fall further to 75.5% and 73.6% of GDP in 2023 and 2024, respectively.

While we assume public debt will remain sustainable, debt affordability should remain high, although interest expenditure will gradually rise over the coming years. The Austrian 10-year government bond yield has already picked up sharply since our last review, standing at 3.36%

(03-Mar-23, weekly quote), well above the level seen a year before (04-Mar-22: 0.35%). At the same time, the Bund spread has remained broadly stable and low (03-Mar-23: 65bp), moving in a narrow band over the last twelve months and being comparable to that of rating peers such as Finland and France.

In the face of broadening price increases, the ECB has stayed the course on its more aggressive tightening, without much forward guidance, as decisions remain highly data-dependent. From their current level (3.5% for main refinancing operations), we expect the ECB to raise its key policy rates by an additional 50bp by the end of this year. However, uncertainty around these expectations has arguably become more pronounced in view of the most recent market tensions. For the time being, the ECB's Governing Council intends to continue reinvesting the principal payments from maturing securities purchased under the PEPP until at least the end of 2024, whereas the APP portfolio will be wound down gradually from March 2023 onwards, with an initial monthly portfolio reduction of EUR 15bn until June 2023.

Judging by latest government finance statistics, Austrian interest expenditure fell to a new low, as the moving four-quarter average up to Q3-22 dwindled to 1.9% of total revenue (Q3-21: 2.3%). OeBFA gauges that interest outlays should have posted at around 0.7% of GDP in 2022, also marking a new multi-year low. The Austrian Treasury forecasts interest payments at 1.0% in the current year; debt servicing costs will remain historically low.

Furthermore, fiscal risks remain mitigated by the sovereign's favorable debt profile, mirroring prudent debt management. The maturity profile continues to be well-laddered, with a long average weighted maturity of 10.9 years at the end of 2022, up from 10.6 years a year before (OeBFA data). Austria features no foreign currency risks and a share of debt securities with a short-term original maturity of 17.6% as of Jan-23 (Jan-22: 15.6%, ECB data), well below the Treasury's 20% target. According to IMF data on the debt investor base, 40% of Austria's government debt was held by the foreign official sector and central banks as of Q2-22.

As regards fiscal risks, we continue to follow closely the elevated, though declining level of public guarantees. Based on BMF data (DBP23), public guarantees decreased from 18.9% of GDP to 16.5% of GDP in 2021-22, and are forecast to fall to 15.9% of GDP in the current year. While guarantees to the provision of export finance, which tend to be less default-prone, account for more than half (Q2-22: 55%) of total public guarantees, the capital subscription to the ESM is not included in public guarantee statistics, amounting to a further EUR 19.5bn or 4.4% of GDP (authorized capital as of Jan-23).

The Austrian banking sector remains in good shape and has hitherto successfully weathered both the negative impact of the pandemic and the geopolitical developments concerning Russia relatively well. As illustrated by EBA data, capital buffers seem comfortable, with the CET1 ratio ticking up from 14.3% in Q3-21 to 14.5% in last year's third quarter, by and large on par with the EU average (15.0%). Nor does the NPL ratio give reason for concern, having declined further from 1.9% to 1.7% in the year to Q3-22, slightly below the EU average of 1.8%.

We flag two main risks pertaining to Austrian banks which may entail adverse repercussions in terms of contingent liabilities. First and foremost, risks related to housing prices and solid mortgage lending persist, in particular against the backdrop of slowing economic activity and rising interest rates. That said, we note that authorities are already addressing these issues (see below).

While Eurostat data points to unabated growth in residential property prices up to the third quarter of 2022 (Q3-22: 22.3% y-o-y), latest available OeNB data indicates a sharp slowdown in the second half of 2022. Austria's residential property price index appears to be past its peak, with yearly growth posting at 10.8% and 5.2% in Q3 and Q4 respectively. On a quarterly basis, Q4-22 marked the first decline (-1.9%) since Q3-19.

That being said, house prices remain high from a longer-term perspective, surpassing the level of Q1-2000 by approx. 167% in Q4-22, and the OeNB's fundamentals indicator posted at 34.2%, suggesting an overvaluation in Austria overall. Household incomes have not kept pace, and the price-to income ratio stood 58% above its long-term average since 2000 in Q3-22 (OECD data).

Meanwhile, lending growth seems to have tailed off as of late, as the outstanding volume of mortgages grew by 3.6% y-o-y in Jan-23, down from 6.8% in Jan-22 and well below the monthly average observed in 2022 (6.5%). Still, households' debt servicing costs will increase significantly, as Austria's share of variable rate loans for house purchase in total household lending is relatively high. After dwindling from roughly 80% at the end of 2012 to below 40% in 2022 (ECB data), the share shot up to around 66% in Jan-23, as compared to approx. 25% in the euro area overall.

Moreover, we note that further banking stability risks could emanate from Austrian bank exposure towards Russia and CESEE economies. BIS data shows that Austria's exposure still has to be deemed significant, as Austrian bank claims on Russia totaled roughly USD 20.9bn, almost 25% of the overall amount of BIS reporting banks and corresponding to about 4.5% of GDP (in USD terms). The CESEE economies represent a key foreign market for Austrian banks, as approx. half of total foreign claims were related to the nine CESEE economies (OeNB survey).

To be sure, the most recent OeNB stress test suggests that the banking sector is able to withstand the simulated macro shocks, also including energy supply shocks. In addition, authorities are addressing the abovementioned risks. The FMA issued a Regulation for limiting of systemic risk in debt-based financing of residential real estate at credit institutions in June 2022, e.g. introducing new upper limits for LTV and DSTI ratios as well as loan maturities. The Austrian Financial Stability Board (FMSG) recommended maintaining the CCyB rate at 0% in light of a negative credit-to-GDP gap.

We have to reiterate that Austria faces considerable fiscal sustainability risks in the medium to long term, essentially reflecting high and rising age-related costs in light of demographic developments. According to the Aging Report 2021 (AR21), Austria's age-related outlays will increase by 3.1 p.p. GDP between 2019 and 2035. By contrast, the BMF, in its updated long-term budget forecast assumes that aging-costs, i.e. expenditure on pensions, health and long-term care, and education, will rise by 3.4 p.p. over that period, and by 5.5 p.p. in 2019-60 as compared to 3.9 p.p. in the AR21.

Foreign Exposure

We view external vulnerabilities as limited, given Austria's positive and rising net international investment position (NIIP) which points to building external buffers and advances in the sovereign's shock-absorbing capacities. Although Austria's tourism industry is making large strides in recovering from the pandemic, the current account surplus will likely narrow this year, but we expect it to recover gradually over the medium term.

Austria's current account balance concluded the year 2021 with a surplus of only 0.4% of GDP, representing the weakest result in more than 20 years (2011-20 average: 2.0% of GDP), mainly due to the weakening trade in goods (-0.1% of GDP, 2020: 0.9%) and services (0.6% of GDP, 2020: 2.1%) balances. The current account remained quite stable throughout 2022, as illustrated by the four-quarter rolling average, which posted at 0.7% of GDP in Q3-22.

While the services balance recovered to 1.4% of GDP, the goods deficit (-0.2% of GDP) and the primary income deficit (-0.1%of GDP) increasingly acted as a drag on Austria's current account balance. Services benefitted from the reinvigoration of tourism in winter, after the pandemic had caused significant revenue losses previously. In this context, foreign professionals who were working in domestic hotels contributed negatively to primary income.

Brisk growth in tourist arrivals suggests relatively strong performance during the current winter season to date, supporting our view that tourism should bolster the current account surplus this year, and we assume that tourism will remain a vital pillar for Austria's external performance over the medium term. That said, we believe that the adverse impact of the energy balance, though gradually subsiding, will still be felt in the current year and, together with still elevated import prices, will result in a narrowing current account surplus. At this stage, we expect the current account balance to become gradually more positive from next year, largely driven by normalization on the energy markets and recovering economic growth in Austria and in its main trading partners.

Persistent, though transitorily lower current account surpluses have resulted in continued increases in Austria's positive NIIP, which edged up from 11.5% of GDP in 2020 to 14.7% of GDP in 2021. Looking beyond 2021, the NIIP rose further to 20.2% of GDP as of Q3-22, thus mirroring Austria's net creditor position.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Austria's long-term credit ratings is stable, reflecting our expectation of resilient economic growth and a gradually declining public debt ratio over the medium term. While energy dependencies vis-à-vis Russia remain comparatively high, we believe that the immanent risks are balanced by the sovereign's robust institutional framework and sufficient fiscal and external buffers.

We could raise the sovereign's outlook or rating if the drag of the Russian war in Ukraine and adverse repercussions from high inflation turn out significantly lower than we expect at the current juncture, which could lift medium-term growth in real GDP from current subdued levels. Furthermore, faster-than-expected fiscal consolidation, leading to a significantly lower public debt ratio than in our base case scenario, could also put upward pressure on the outlook or the rating.

A negative rating action could be prompted by more severe consequences from the Russian invasion in Ukraine and/or further escalating geopolitical developments. Such a scenario could feature a more pronounced economic fallout, weighing on medium-term growth, and debt-to-GDP could rise against the weaker macro backdrop partly due to further energy relief measures. Crystalizing contingent liability risks could also result in a downgrade or revision of the outlook.

Analysts

Primary Analyst
Fabienne Riefer
Sovereign Credit Analyst
f.riefer@creditreform-rating.de
+49 2131 109 1462

Chairperson
Dr Benjamin Mohr
Head of Sovereign Ratings
b.mohr@creditreform-rating.de
+49 2131 109 5172

Ratings*

Long-term sovereign rating	AA+ /stable
Foreign currency senior unsecured long-term debt	AA+ /stable
Local currency senior unsecured long-term debt	AA+ /stable

*) Unsolicited

ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down [key principles of the impact of ESG factors on credit ratings.]

ESG Factor Box

Environmental Quality	Ecological Risks	Ressource Management	Education	Health	**Demographics**
Labor	Equality	Technology & Infrastructure	Saftey & Security	**Judicial system**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liberties/ Political Participation**	Market Access	**Business Environment**	Data Transparency

Environment	**Social**	**Governance**	**Highly significant**	**Significant**	**Less significant**	**Hardly significant**

The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the assessment of an economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, IMD Business School and the World Intellectual Property Organization (UN) add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Labor market metrics constitute crucial goalposts in Creditreform Rating's considerations on macroeconomic performance of the sovereign, and we regard the ESG factor 'Labor' as significant to the credit rating or adjustments thereof. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. We regard the ESG factor 'Demographics' as less significant.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	2.3	2.4	1.5	-6.5	4.6	5.0	0.7
GDP per capita (PPP, USD)	54,394	56,637	58,680	55,125	59,759	66,680	69,399
Credit to the private sector/GDP	87.1	87.3	88.7	95.7	95.7	91.8	n/a
Unemployment rate	5.9	5.2	4.8	6.0	6.2	4.8	n/a
Real unit labor costs (index 2015=100)	99.9	100.2	101.0	105.4	103.7	99.8	100.9
World Competitiveness Ranking (rank)	25	18	19	16	19	20	n/a
Life expectancy at birth (years)	81.7	81.8	82.0	81.3	81.3	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.8	1.9	1.9	1.8	1.8	n/a	n/a
WGI Control of Corruption (score)	1.5	1.6	1.6	1.5	1.3	n/a	n/a
WGI Voice and Accountability (score)	1.4	1.4	1.3	1.4	1.4	n/a	n/a
WGI Government Effectiveness (score)	1.5	1.5	1.5	1.6	1.6	n/a	n/a
HICP inflation rate, y-o-y change	2.2	2.1	1.5	1.4	2.8	8.6	6.3
GHG emissions (tons of CO2 equivalent p.c.)	9.6	9.2	9.3	8.4	n/a	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-0.8	0.2	0.6	-8.0	-5.9	-3.1	-2.6
General government gross debt/GDP	78.5	74.1	70.6	82.9	82.3	77.7	75.5
Interest/revenue	3.8	3.3	2.9	2.7	2.2	n/a	n/a
Debt/revenue	161.9	151.4	143.4	170.2	164.5	n/a	n/a
Total residual maturity of debt securities (years)	8.9	9.9	10.2	10.7	11.1	11.4	n/a
Foreign exposure							
Current account balance/GDP	1.4	0.9	2.4	3.0	0.4	n/a	n/a
International reserves/imports	0.1	0.1	0.1	0.2	0.2	n/a	n/a
NIIP/GDP	4.3	6.0	14.4	11.5	14.7	n/a	n/a
External debt/GDP	155.0	150.8	154.3	165.7	163.3	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, Statistik Austria, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	29.07.2016	AA+ /stable
Monitoring	30.06.2017	AA+ /stable
Monitoring	27.04.2018	AA+ /stable
Monitoring	26.04.2019	AA+ /positive
Monitoring	24.04.2020	AA+ /stable
Monitoring	16.04.2021	AA+ /stable
Monitoring	08.04.2022	AA+ /stable
Monitoring	24.03.2023	AA+ /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Austrian Treasury (OeBFA) participated in the credit rating process, as it provided additional information and commented on a draft version of the report prior to its publication. Thus, this report represents an updated version, which was augmented in response to OeBFA's factual comments during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, European Investment Bank, World Economic Forum, IMD Business School, European Center for Disease Prevention and Control (ECDC), Blavatnik School of Government, Österreichische Nationalbank, Statistik Austria, Fiskalrat, Österreichische Bundesfinanzierungsagentur (OeBFA), Republik Österreich – Bundesministerium für Finanzen, Finanzmarktstabilitätsgremium (FMSG).

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

Disclaimer

Any rating issued by Creditreform Rating AG is subject to the Creditreform Rating AG Code of Conduct which has been published on the web pages of Creditreform Rating AG. In this Code of Conduct, Creditreform Rating AG commits itself – systematically and with due diligence – to establish its independent and objective opinion as to the sustainability, risks and opportunities concerning the entity or the issue under review.

When assessing the creditworthiness of sovereign issuers, Creditreform Rating AG relies on publicly available data and information from international data sources, governments and national statistics. Creditreform Rating AG assumes no responsibility for the true and fair representation of the original information.

Future events are uncertain, and forecasts are necessarily based on assessments and assumptions. Hence, this rating is no statement of fact but an opinion. Neither should these ratings be construed as recommendations for investors, buyers or sellers. They should only be used by market participants (entrepreneurs, bankers, investors etc.) as one factor among others when arriving at investment decisions. Ratings are not meant to be used as substitutes for one's own research, inquiries and assessments. Thus, no express or implied warranty as to the accuracy, timeliness or completeness for any purpose of any such rating, opinion or information is given by Creditreform Rating AG in any form or manner whatsoever. Furthermore, Creditreform Rating AG cannot be held liable for the consequences of decisions made on the basis of any of their ratings.

Creditreform Rating AG

Creditreform Rating AG
Europadamm 2-6
D - 41460 Neuss

Phone +49 (0) 2131 / 109-626
Fax +49 (0) 2131 / 109-627
E-Mail info@creditreform-rating.de
Internet www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Michael Bruns
HRB 10522, Amtsgericht Neuss