3 February 2023

Sovereign and Public Sector

Republic of Austria
Rating Report

SCOPE AAA STABLE OUTLOOK

Credit strengths

- Wealthy, resilient, diversified economy
- Strong external position with low private sector indebtedness
- Sound banking sector
- Favourable public debt profile and market access

Credit challenges

- High public debt stock relative to peers
- Adverse demographic trends weighing on growth prospects and public finances

Rating rationale:

Wealthy, resilient, diversified economy: Austria's rating benefits from high wealth levels and a competitive, highly diversified economy. After achieving a robust post-pandemic recovery, the Austrian economy is expected to slow-down materially over 2023, in the context of weakening real incomes and subdued external demand from euro area trading partners.

Strong external position: Austria has a solid track record of current account surpluses. It also has a robust net international investment position with low private sector debt and a favourable external liability structure, providing the country with a resilient external position.

Sound banking sector: The resilience of Austria's banking sector has increased in recent years, enabling it to weather the Covid-19 crisis well. Capital and liquidity buffers are robust, asset quality continues its upward trend, and profitability recovered well from the Covid-19 shock. These strengths have enabled the sector to absorb the shock from the war in Ukraine thus far, although a large presence in CESEE countries constitutes a risk exposure.

Debt profile and market access: Austria benefits from very strong market access and a favourable debt profile, with an exceptionally long average maturity and low interest rates.

Rating challenges include: i) a high public debt stock relative to other highly rated peers; and ii) long-term spending pressures arising from high pension and healthcare costs and an ageing society. The latter also weighs on growth prospects in the absence of structural reforms.

Austria's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic economic risk		35%	aa+	EUR [+1]	+1/3	AAA
Public finance risk		20%	a+		+1/3	
External economic risk		10%	bb		+2/3	
Financial stability risk		10%	aaa		+1/3	
ESG Risk	Environmental factors	5%	a+		0	
	Social factors	7.5%	bb		0	
	Governance factors	12.5%	aaa		0	
Indicative outcome			**aa**		**+2**	
Additional considerations					**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's Sovereign Rating Methodology. Source: Scope Ratings

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Growth outlook deteriorating substantially
- Fiscal outlook worsening materially
- Risks re-emerging in the banking sector

This is a republished version (6 February 2023) of the rating report originally published on 3 February 2023.
It reflects minor corrections of historical data, as well as minor clarifications in the growth outlook, market access, current account, private debt, financial imbalances and environment sections.

Ratings and Outlook

Foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

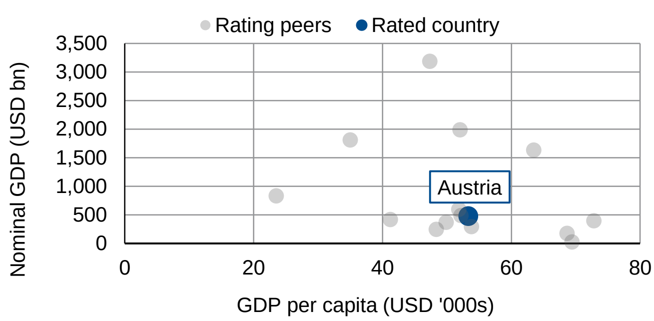
Domestic economic risk

- **Growth outlook:** The Austrian economy grew by 4.6% in 2021, despite negative real GDP growth in the last quarter of the year (down 1.4% QoQ) caused by a new round of Covid-19 restrictions. The recovery picked up in the first half of 2022, bringing quarterly GDP 3.3% above its end-2019 level by Q2 2022. The main growth drivers in H1 2022 were a strong rebound in private consumption and net exports. Growth decelerated sharply in H2 2022, experiencing a 0.7% QoQ contraction in the fourth quarter following a dip in household consumption and weak performances in the services and construction industries. We expect the economic momentum to remain subdued over the medium term, as elevated inflation, high uncertainty and tightening funding conditions are hampering private demand growth, while subdued external demand and inflated energy and food imports are weighing on net exports. After an estimated real GDP growth rate of 4.7% in 2022, we anticipate the rate will slow to 0.6% in 2023 (revision of negative 0.9pp relative to our August 2022 projections), before picking up to 1.5% in 2024.
- **Inflation and monetary policy:** Inflation accelerated markedly in 2022 and stabilised near historical highs at 10.5% (HICP, YoY) in December 2022, after having slightly moderated from a peak of 11.6% in October. This was initially driven primarily by energy and food prices, but core inflation has picked up in recent months, rising to 8.6% in December (3.4pp above the euro-area average). Headline inflation is expected to slow down significantly over the medium term, in line with falling global fuel prices and the activation of the government's electricity price brake. However, core inflation is expected to only decline gradually, due to a continued increase in services inflation resulting from accelerated wage dynamics. The ECB increased its deposit facility rate to 2.0% in December 2022, the highest level since 2008, although the 50bps hike marked a slowdown from the two previous increases.
- **Labour market:** The unemployment rate is low, at 5.5% (seasonally adjusted) as of November 2022, despite having increased slightly from previous months. At the same time, employment and job vacancy rates have continued to increase, both standing at historically elevated levels (74.7% and 5.0% respectively as of Q3 2022), pointing to the resilience of employment dynamics and labour market tightness. These have fuelled robust nominal wage growth, although that was largely outpaced by consumer price growth, resulting in an estimated 3.7% decline in gross real wages over the year. Acute recruitment difficulties and skills shortages represent a significant impediment to long-term growth.

Overview of Scope's qualitative assessments for Austria's *domestic economic risk*

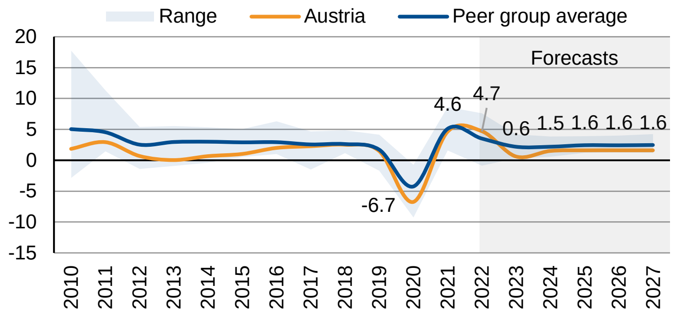
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Growth potential of the economy	Strong	+1/3	Relatively high growth potential compared to peers
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macro-economic stability and sustainability	Neutral	0	Competitive and well-diversified economy; limited structural labour market rigidities

Nominal GDP and GDP per capita, USD '000s



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

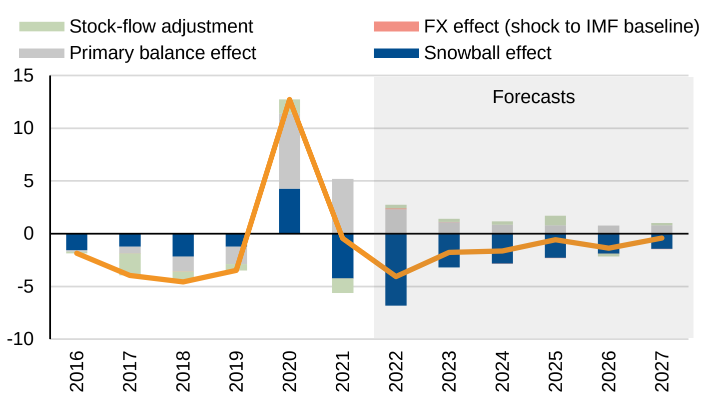
Public finances risk

- **Fiscal outlook:** The Austrian government's fiscal track record is robust, having achieved average primary surpluses of close to 1% over 2015-19. After dipping to 8.0% of GDP in 2020, the general government budget deficit improved to 5.9% of GDP in 2021, thanks to a rebound in economic activity. The government's fiscal position is estimated to have improved further to a 3.2% of GDP deficit in 2022, thanks to strong nominal growth and the phase-out of most pandemic-era measures, and despite the roll-out of support measures aimed at alleviating the impact of inflation on the private sector (estimated at 5.7% of GDP over 2022-23). A number of these measures, including the indexation of income tax brackets and social benefits payments to inflation, will have a lasting impact on the government revenue base and slow the fiscal consolidation process. We expect the general government deficit to decrease to 2.2% of GDP in 2023, before stabilising at around 2% of GDP over 2024-27.
- **Debt trajectory:** After a period of steady decline, the general government debt-to-GDP ratio increased by about 12pps to 82.3% between 2019-21. We estimate that the debt ratio decreased to around 79% at YE 2022 on the back of high nominal growth. We expect it to decrease further over subsequent years, to about 73% by 2027. It will thus remain above its pre-pandemic level and the Maastricht criterion. Adverse demographic trends represent a long-term challenge for debt sustainability and the country's long-term growth outlook. Austria's pension expenditure is among the highest in the euro area, representing 15.3% of GDP in 2020 according to Eurostat. Under a 'no policy change' scenario, the European Commission expects the total cost of ageing to rise from a high 26.7% of GDP in 2019 to 29.1% in 2030.
- **Market access:** Austria benefits from a very favourable debt structure, with a high average maturity (10.9 years), no foreign currency exposure and low interest payments (0.72% of GDP in 2022). Like peers, however, Austria's funding costs have increased in recent months, with the yield on its ten year bonds at 2.8% on average in January 2023, up from 0.2% a year earlier. Federal gross financing needs are expected at around EUR 45bn via RAGBs in 2023, stable from the previous year.

Overview of Scope's qualitative assessments for Austria's *public finances risk*

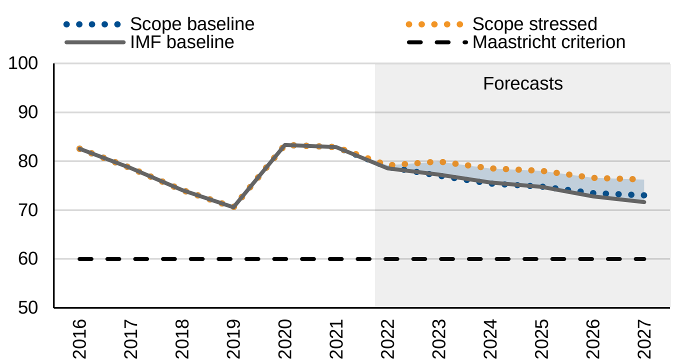
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Fiscal policy framework	Neutral	0	Appropriate budgetary response to Covid-19 crisis; pre-crisis budget surpluses; elevated need for medium-term fiscal consolidation
	Debt sustainability	Neutral	0	Elevated public debt level relative to highly-rated peers, debt trajectory projected to decline, though only gradually
	Debt profile and market access	Strong	+1/3	Excellent government market access, low government financing costs, long public debt maturity

Contributions to changes in debt levels, pp of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

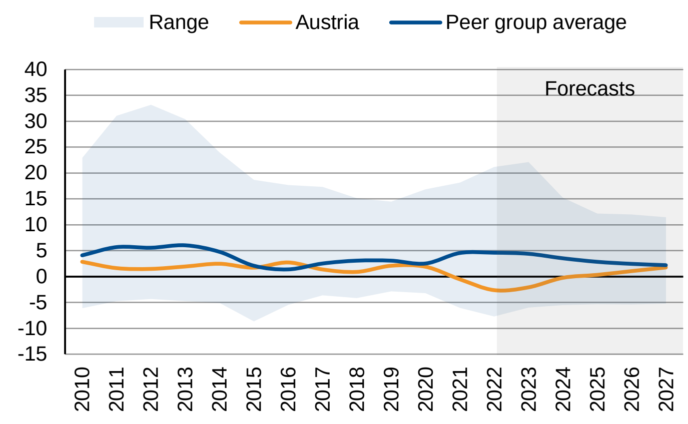
External economic risk

- **Current account:** Following a period of comfortable, steady current account surpluses averaging 2.0% of GDP over 2011-20, the current account balance weakened to 0.4% of GDP in 2021. This was due to lower tourism receipts and a small deficit in the goods trade balance in the context of strong domestic demand, soaring nominal energy imports and global supply chain disruptions. Despite a recovery in international tourism, the current account balance only recovered partially in recent months, recording a 0.7% surplus in the year to Q3 2022. Going forward, we anticipate current account surpluses to gradually edge back towards pre-pandemic averages, thanks to the continued rebound in tourism exports and a moderation in global energy prices. However, a weaker growth outlook among Austria's key European trading partners is likely to weigh on export growth over the medium term.
- **External position:** Austria benefits from a comfortable positive net international investment position of 20.2% of GDP in the four quarters to Q3 2022. The level of external debt is moderate and stable from to its pre-pandemic levels, at 151% of GDP. Its composition is favourable, being primarily comprised of public sector liabilities (42.3% of total). The share of banking sector external debt has declined steadily over recent years, from 42% to 30% of the total between 2012-22. The maturity structure is favourable, with less than a third of liabilities due within one year.
- **Resilience to shocks:** Like all euro area members, Austria benefits from the euro's status as a global reserve currency, which significantly mitigates the risk of external shocks.

Overview of Scope's qualitative assessments for Austria's *external economic risk*

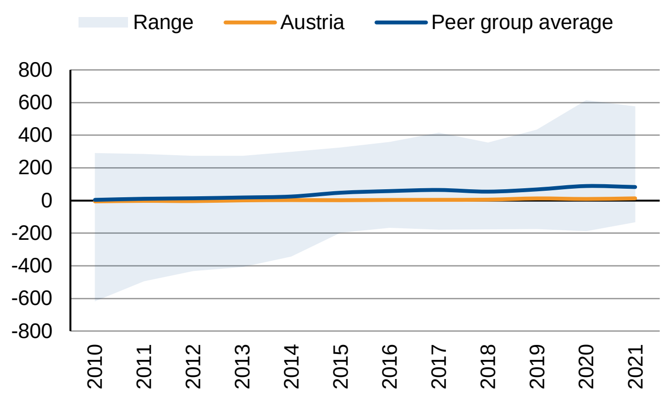
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Current account resilience	Strong	+1/3	Diversified, competitive export sector; recurrent current account surpluses
	External debt structure	Strong	+1/3	Low gross and short-term external debt
	Resilience to short-term external shocks	Neutral	0	Highly open economy; benefits from euro area membership

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

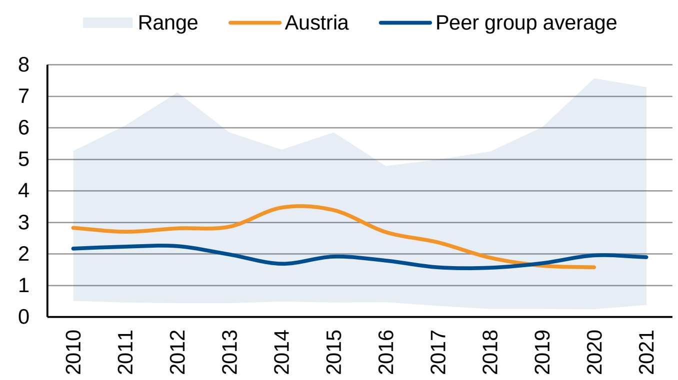
Financial stability risk

- **Banking sector:** The resilience of the Austrian banking sector is underpinned by sound capitalisation and profitability metrics, as reflected in aggregate CET-1 and return on equity ratios of 16.0% and 11.6% respectively as of Q3 2022. The NPL ratio stood at 1.8% as of H1 2022, down from 2.2% at end-2019. Going forward, rising interest rates should support net interest income in view of the large stock of variable rate loans, although it is also likely to weigh on lending growth. The negative impact of high inflation and slowing economic activity on household and corporate real income could also weigh on asset quality, although this should be partially offset by government support measures. The significant exposure of Austrian banks to CESEE countries adds a degree of uncertainty to the outlook, although the comfortable capitalisation, liquidity and funding levels of subsidiaries in the region constitute buffers against a potential increase in credit risk.
- **Private debt:** Private sector debt is moderate at 147% of GDP as of Q3 2022, well below the euro area aggregate level and below most highly rated peers. Lending to non-financial corporates has decelerated somewhat in recent months, while remaining elevated relative to historical averages. Household credit growth has moderated as well, primarily driven by weaker mortgage lending growth, in the context of rising interest rates and tightening lending standards. A relatively high share of variable rate loans for house purchase of around 40% on average of new euro-denominated loans over the past five years represents a significant risk exposure in a rising interest rate environment.
- **Financial imbalances:** Residential real estate price growth has decelerated in recent months, to 5.3% YoY in Q4 2022, down from 10.8% in the previous quarter, albeit remaining above pre-pandemic averages. After a period of strong growth, residential construction activity is expected to slow down over the medium-term, in view of high building costs, while rising interest rates will weigh on demand. In February 2022, the European Systemic Risk Board issued specific recommendations to Austria related to signs of overheating in the property market. To address related risks, the Financial Market Authority introduced legally binding standards, including maximum loan durations and minimum down payments.

Overview of Scope's qualitative assessments for Austria's *financial stability risks*

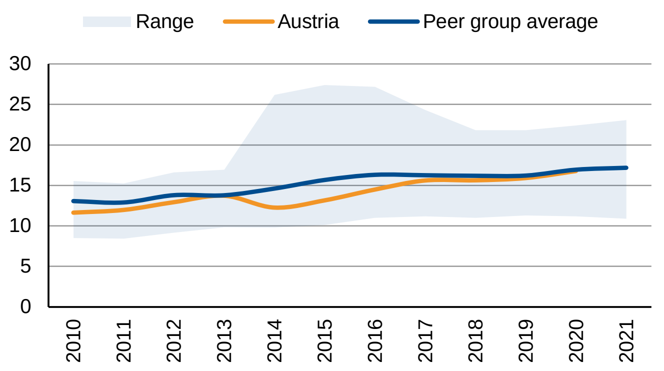
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Adequate banking-system capitalisation, comfortable liquidity, low NPLs, significantly lowered exposure to foreign currency-denominated loans in CESEE countries
	Banking sector oversight	Neutral	0	Effective oversight under the national competent authority and the ECB as part of the banking union
	Financial imbalances	Strong	+1/3	Relatively low household and non-financial corporate sector indebtedness; decelerating residential real estate dynamics

Non-performing loans (NPLs), % of total loans



Source: World Bank, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

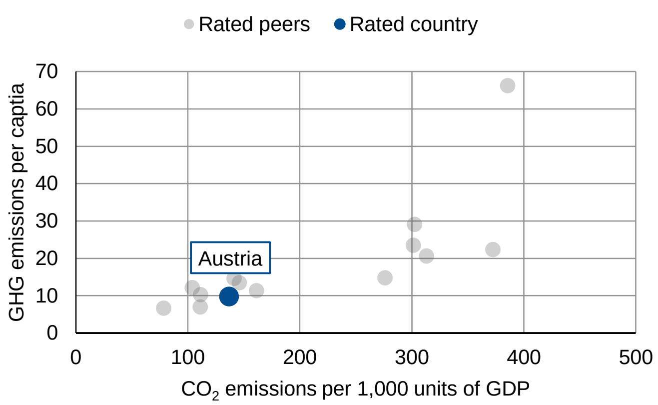
ESG risk

- **Environment:** Despite a high share of renewables in its total energy mix (36% as of 2021), Austria remains reliant on fossil fuels, particularly imported oil (35%) and natural gas (24%). Supply risks related to the country's high dependence on Russian energy imports, which covered 79% of its natural gas consumption before the outbreak of the war in Ukraine, have been significantly curtailed, through swift diversification in supply sources and the constitution of large natural gas inventories. The Austrian government has taken a number of measures towards achieving its goal of climate neutrality by 2040, including the implementation of a carbon tax in October 2022, increased subsidies and relaxed regulatory requirements for new renewable energy projects. Additionally, Austria is exposed to physical risks, primarily related to the negative impact of global warming on its winter tourism industry. Overall tourism, including the summer season, contributes about 7%-8% to annual GDP.
- **Social:** Austria scores highly on the European Union's social scoreboard indicators, with relatively low-income inequality and a low share of people at risk of poverty or social exclusion (17.3% versus the eurozone average of 21.9%). Despite strong performance overall, the Austrian labour market is characterised by significant employment gaps for certain groups. For instance, it compares poorly to other highly rated peers with regard to participation rates for women and elderly workers. Increased capacity in the realm of childcare infrastructure and lifelong learning is needed to bridge these gaps.
- **Governance:** Austria has a robust track record of a stable political environment despite a recent increase in political turnover. Karl Nehammer became Austria's fifth chancellor in four years in December 2021 following the resignation of Sebastian Kurz amid a corruption probe. The ruling coalition currently comprises chancellor Nehammer's conservative Austrian People's Party (ÖVP) and The Greens as a junior partner. The next election is scheduled for 2024.

Overview of Scope's qualitative assessments for Austria's *ESG risk*

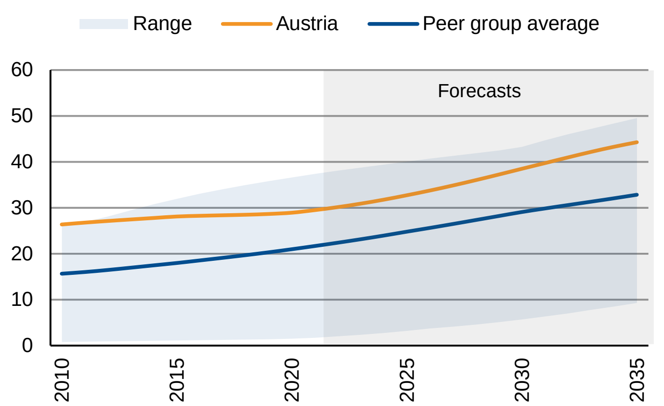
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Environmental factors	Neutral	0	A high share of renewables now and ambitious decarbonisation targets by 2030; however, a significant gap remains in a 'no policy change' scenario
	Social factors	Neutral	0	Strong social safety net and positive social outcomes, in line with peers
	Governance factors	Neutral	0	High-quality institutions and stable political environment, in line with peers

CO_2 emissions per GDP, $mtCO_2e$



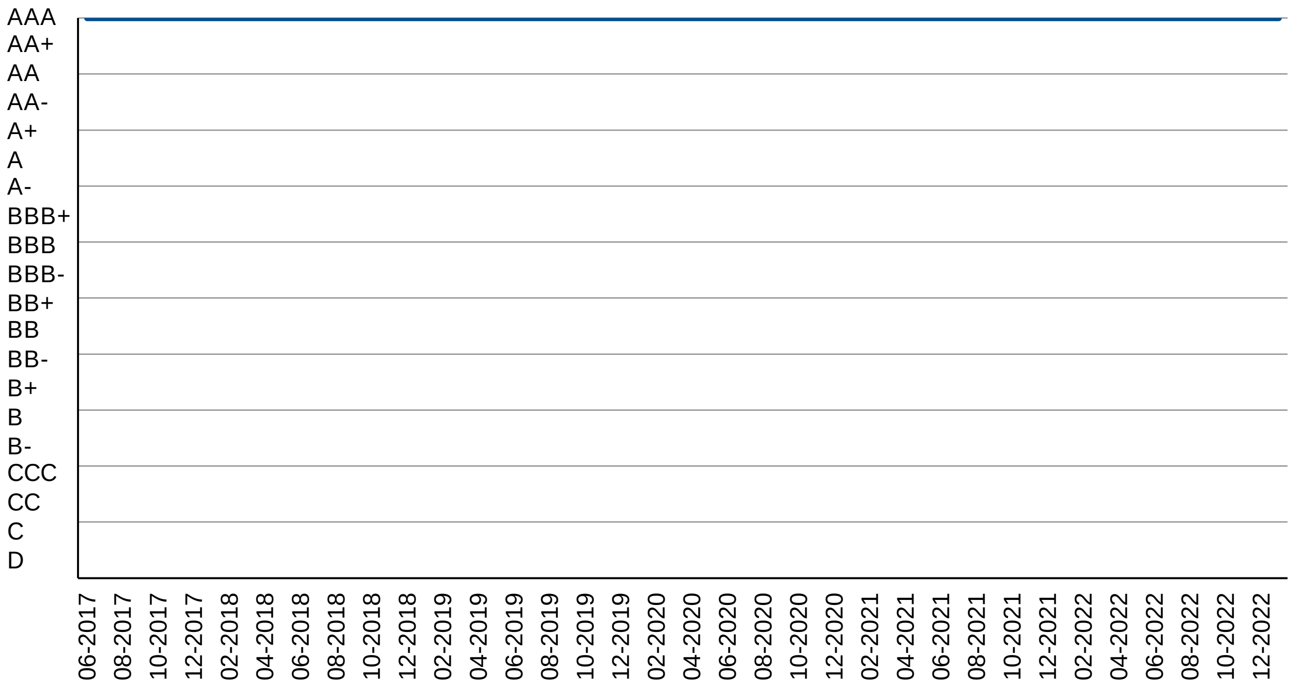
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or adjacent categories, with Scope's core variable scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Belgium
Finland
United Kingdom

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the core variable scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021
Domestic economic	**GDP per capita, USD '000s**	IMF	47.3	51.3	50.2	48.6	53.3
	Nominal GDP, USD bn	IMF	417.1	455.4	445.1	432.9	477.1
	Real growth, %	IMF	2.3	2.5	1.5	-6.7	4.6
	CPI inflation, %	IMF	2.2	2.1	1.5	1.4	2.8
	Unemployment rate, %	WB	5.5	4.9	4.5	5.4	6.3
Public finance	**Public debt, % of GDP**	IMF	78.6	74.0	70.6	83.3	82.9
	Interest payment, % of revenue	IMF	3.0	2.5	2.1	1.9	1.5
	Primary balance, % of GDP	IMF	0.6	1.4	1.6	-7.1	-5.2
External economic	**Current account balance, % of GDP**	IMF	1.4	0.9	2.1	1.9	-0.5
	Total reserves, months of imports	IMF	1.1	1.0	1.1	1.5	1.4
	NIIP, % of GDP	IMF	4.5	5.8	14.5	12.4	14.2
Financial stability	**NPL ratio, % of total loans**	IMF	2.4	1.9	1.6	1.6	-
	Tier 1 ratio, % of risk-weighted assets	IMF	14.4	15.3	15.7	15.4	16.7
	Credit to private sector, % of GDP	WB	84.1	84.4	85.9	92.8	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	149.2	139.3	141.1	136.9	136.6
	Income share of bottom 50%, %	WID	22.4	22.2	22.0	22.0	22.0
	Labour-force participation rate, %	WB	76.3	76.6	76.9	-	-
	Old-age dependency ratio, %	UN	27.8	28.1	28.4	28.8	29.4
	Composite governance indicators*	WB	1.5	1.5	1.4	1.4	1.4

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 2 February 2023	17

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