Republic of Austria
Rating Report

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 a wealthy, highly diversified economy, with a strong recovery from the Covid-19 crisis underway. Repercussions from the war in Ukraine weigh on the near-term outlook, but we still expect robust growth this year.

Strong external position: Austria holds 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, allowing 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. This put the sector in a good position to absorb the shock from the Ukraine conflict, although the shock will likely weigh on the profitability of exposed banks.

Debt profile and market access: Austria benefits from a favourable debt profile, with a very long average maturity and low interest rates. Its funding strategy is supported by the ECB's accommodative monetary policy, including asset purchases.

Rating challenges include: i) a high public debt stock relative to peer levels; 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 scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic economic risk		35%	aaa		0	
Public finances risk		25%	aa-		0	
External economic risk		10%	a-		+1/3	
Financial stability risk		10%	aaa		+1/3	AAA
ESG risk	Environmental risk	5%	aaa		0	
	Social risk	5%	bbb+		0	
	Governance risk	10%	aaa		0	
Overall outcome		aa+		+1	+1	

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 Scope's 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

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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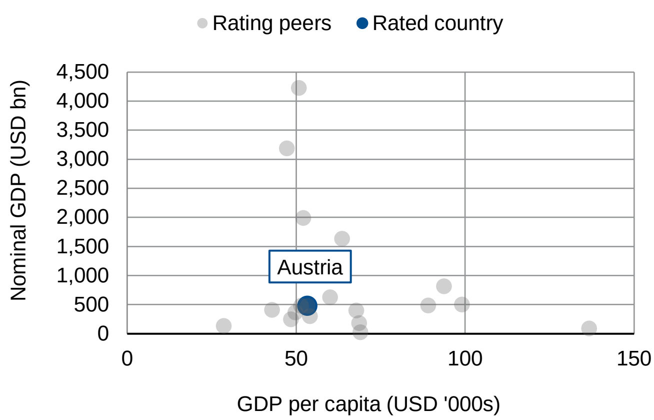
Domestic Economic Risks

- **Growth outlook:** After experiencing one of the sharpest economic contractions among peers with AAA-ratings in 2020 (negative 6.7% real GDP growth), the Austrian economy recovered by 4.8% in 2021. A new round of Covid-19 restrictions caused a dip in output in Q4 2021 (negative 0.8% growth QoQ). However, this was followed by a strong rebound during the first two quarters of 2022 (6.7% YoY on average), largely driven by a rebound in manufacturing and tourism. We expect growth momentum to slow down significantly during the rest of the year in the wake of the Ukraine war. Disruptions in global supply chains will weigh on manufacturing activity, declining real incomes from accelerating price pressures will weigh on private demand, and an expected slowdown among Austria's key trading partners will slow export growth. These headwinds will only be partially mitigated by a recovery in international tourism and government support measures. Still, we expect real growth to remain relatively robust this year at 3.5% (representing a revision of negative 0.7 pp from our February 2022 estimate) before slowing to 1.5% in 2023 (revision of negative 0.8 pp).
- **Inflation and monetary policy:** Like peers, Austria's inflation (HICP) has accelerated markedly in recent months, rising to 8.7% YoY (estimate) in June 2022. While this acceleration predominantly reflects external factors, namely rising global energy and food prices, domestic price dynamics have picked up as well, with the core inflation rate rising to 4.9% in the context of a very tight labour market. The Austrian National Bank (OeNB) expects HICP inflation to average 7.0% this year before moderating to 4.2% in 2023.
- **Labour market:** The unemployment rate, as defined by Eurostat, declined to 4.3% (seasonally adjusted) in June 2022, below its pre-crisis level. The job vacancy rate has increased steadily at the same time to 4.7% in Q1 2022 (up 1.7 pp from end-2019), one of the most elevated rates in the EU, while the number of unfilled vacancies stands at an all-time high. This reflects increasingly acute recruitment difficulties and skills shortages, which represent a significant hindrance to the long-term growth outlook. The Austrian government recently passed a reform of the 'red-white-red card' residence scheme aimed at facilitating how immigrants enter the labour market, including a relaxation of minimum wage and language skills requirements.

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

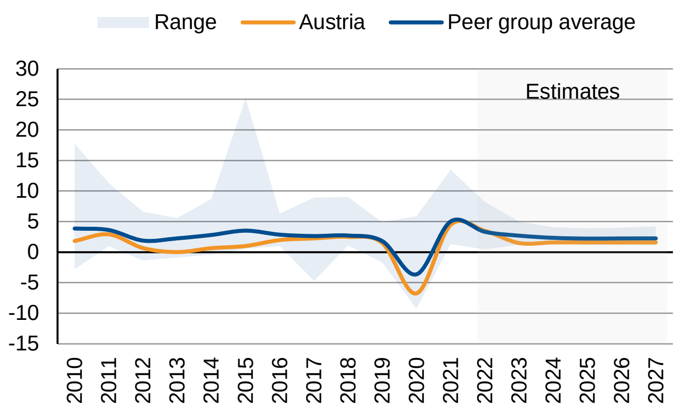
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential, in line with peers
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macroeconomic stability and sustainability	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

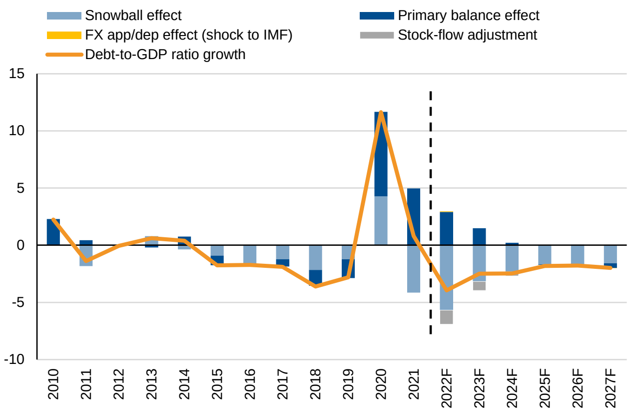
Public finance risks

- **Fiscal outlook:** Austria generated steady primary surpluses before 2020, averaging close to 1% per year over 2015-19. After dipping to 8.1% of GDP in 2020, the headline budget deficit improved to 5.9% in 2021 thanks to the rebound in economic activity. Strong nominal growth will drive a further recovery in fiscal revenue this year, while pandemic-related expenditure will decrease significantly. Net government borrowings nearly halved in 2022 H1, reflecting this positive momentum. The government has rolled out a number of fiscal measures aimed at alleviating the impact of inflation on the private sector. Amounting to EUR 32.7bn (7.5% of GDP) to be disbursed over 2022-26, these measures include structural changes that will durably impact the government revenue base, such as the indexation of tax brackets and social benefits payments to inflation. We expect the headline budget deficit to decrease to 3.9% of GDP this year before further declining in subsequent years to around 0.5% in 2027.
- **Debt trajectory:** After a period of steady decline, the government debt-to-GDP ratio increased by about 12 pp between 2019 and 2021 to 82.8%. We expect it to decrease to 78.9% this year on the back of still-robust GDP growth. It should then gradually decline to slightly below 70% by 2027, below its pre-pandemic level of 70.6% in 2019. Adverse demographic trends represent a significant long-term challenge for debt sustainability and the country's long-term growth outlook. Austria's pension spending is among the highest in the OECD, representing more than 13.3% of GDP in 2019. Under a 'no policy change' scenario, the European Commission expects the total cost of ageing to rise from its already elevated level of 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 (10.6 years) and low interest payments (0.85% of GDP in 2021). Like peers, however, Austria's funding costs have increased in recent months, to 2.1% on average in June 2022 from 0% one year earlier for the 10-year yield. Gross financing needs are expected to remain stable at an elevated level of about EUR 60bn-65bn in 2022. In May, the Austrian government issued an inaugural 27-year green bond that was 6.8 times oversubscribed, reflecting the treasury's strong market access.

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

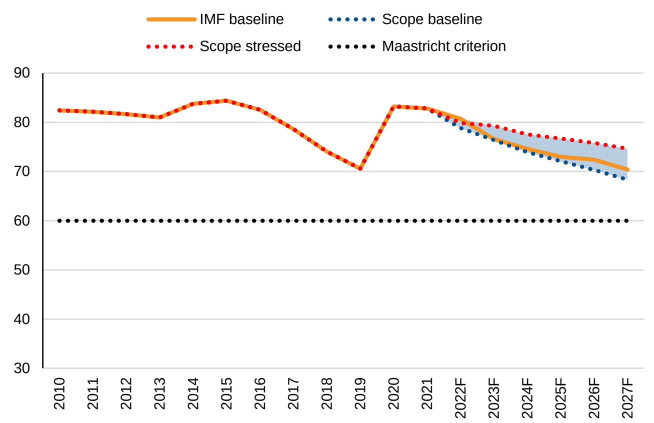
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Appropriate budgetary response to Covid-19 crisis; pre-crisis budget surpluses; elevated need for medium-term fiscal consolidation
	Debt sustainability	Neutral	0	Elevated public debt level relative to peers, declining projected debt trajectory
	Debt profile and market access	Neutral	0	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

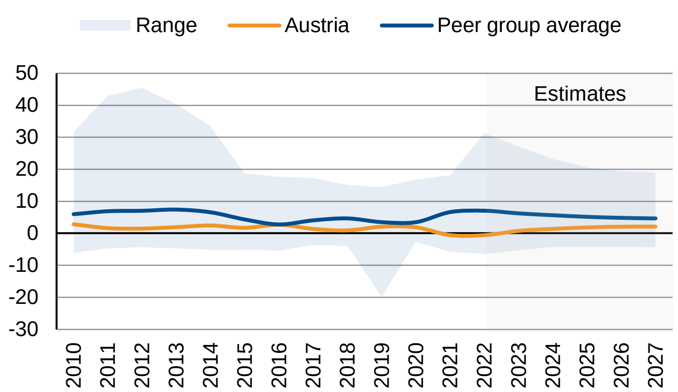
External economic risks

- **Current account:** Following a period of steady current surpluses averaging around 2% of GDP per year over 2010-19, Austria registered a current account deficit of 0.5% of GDP in 2021 primarily owing to the pandemic's impact on tourism exports. The release of pent-up demand coupled with high energy prices boosted imports, leading to a deficit in the goods trade balance (0.4% of GDP). Going forward, we expect the current account balance to recover, albeit gradually. The recovery in tourism receipts will support strong services exports growth while a weaker growth outlook among Austria's key trading partners in the wake of the war in Ukraine will weigh on external demand. Direct trade exposure to Russia is marginal at 1.2% of total exports in 2021, having decreased significantly since the annexation of Crimea.
- **External position:** Austria benefits from a comfortable positive net international investment position, albeit a more modest one than peers, at 18% of GDP in the four quarters to Q1 2022. The level of external debt is moderate at about 156% of GDP. The composition of external debt has improved significantly, especially with regard to the external indebtedness of the banking sector, which more than halved over 2010-20 as a share of GDP. The maturity structure is favourable, with only around 29% of liabilities falling 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*

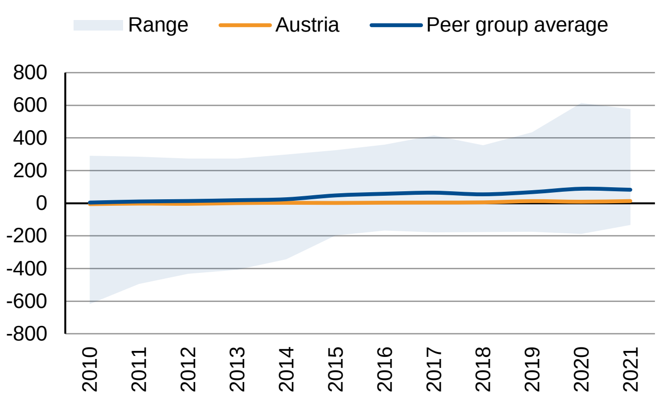
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Current account resilience	Neutral	0	Diversified, competitive export sector; recurrent current account surpluses
	External debt structure	Strong	+1/3	Low gross and short-term external debt
	Resilience to short-term shocks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

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings GmbH

Financial stability risks

- **Banking sector:** The Austrian banking sector weathered the Covid-19 shock well, retaining robust capital and liquidity buffers throughout the crisis. Robust loan growth and a sharp decline in the cost of risk drove a rebound in profitability in 2021, bringing the aggregate return on equity to 6.6% in Q1 2022 from a bottom of 2.1% in Q1 2020. This is still below the pre-pandemic average, however (8.6% over 2015-19). The NPL ratio declined to 1.8% in Q1 2022 from 2.3% at end-2019, and foreign currency loans continued to decline (5.5% of total loans in 2021). The Ukraine conflict will weigh on profitability in the medium term, largely due to the significant exposure of Austrian banks to CESEE countries. Subsidiaries in Russia, Ukraine and Belarus account for nearly 10% of aggregate sector profits.

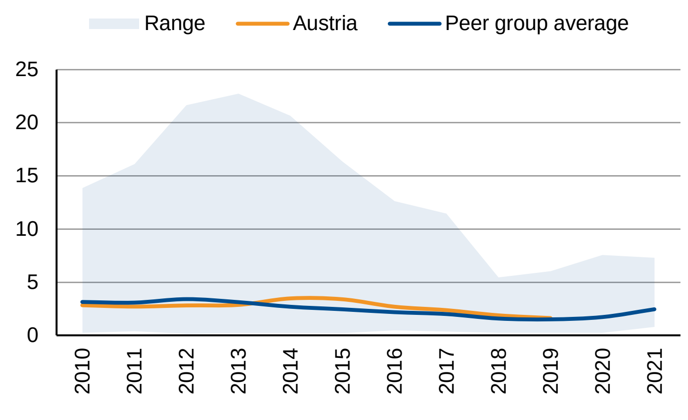
- **Private debt:** Private sector debt increased moderately during the pandemic to about 153% of GDP as of Q4 2021 (up 11 pp from end-2019), largely driven by denominator effects, but remains below most highly rated peers. Credit to non-financial corporates accelerated recently, growing by an average of 8.4% (YoY) during the first five months of 2022. Loans to households have grown as well (up 6% YoY in May 2022), driven by housing loans in the context of still-favourable lending conditions and rising real estate prices. Debt-to-income ratios have increased somewhat since the onset of the pandemic to 93.6% at end-2021, but they remain well below the euro area average. The share of variable-rate household loans is elevated at 42% of outstanding loans, representing a significant risk exposure in a rising interest rate environment.

- **Financial imbalances:** Housing prices have risen sharply throughout the pandemic, increasing by about 27% between end-2019 and Q1 2022. This is 8 pp above the EU average but broadly in line with highly rated peers. Austria's central bank estimates residential property prices are overvalued by about 34% as of 2022 Q1, indicating signs of an overheated market. After a period of strong growth, residential construction activity is expected to slow down this year amid high construction costs while rising interest rates weigh on demand. The Austrian government introduced legally binding lending standards to address related risks, including maximum loan durations and minimum down payments.

Overview of Scope's qualitative assessments for Austria's *Financial Stability Risks*

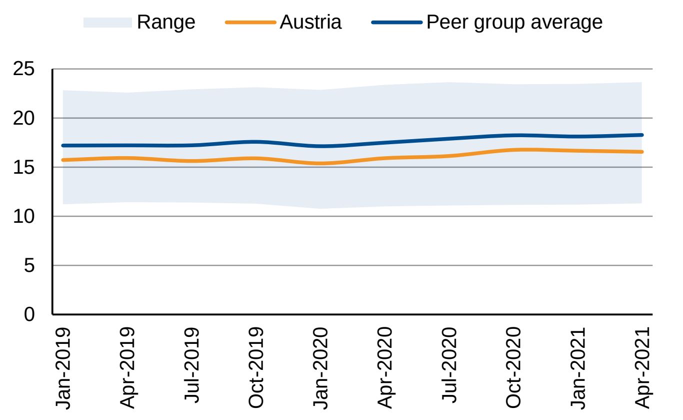
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Adequate banking-system capitalisation, comfortable liquidity, low NPLs, significantly lowered exposure to foreign currency-denominated loans in CESEE countries
	Banking sector oversight	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

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



Source: World Bank, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG risks

- **Environment:** The outbreak of the Ukraine war has significantly raised energy security risks for Austria due to the country's elevated reliance on Russian energy imports, which cover 80% of its natural gas consumption (versus an EU average of 44%). Natural gas represents about 22% of the energy mix and primarily serves the needs of the industrial sector. Mitigants include the country's ample gas storage capacities, which cover about 54% of Austria's annual consumption as of 6 August 2022. Despite the high share of renewables already in its total energy mix (36% as of 2021), Austria will need further policy action to meet its goal of climate neutrality by 2040. Implementation of the carbon tax was recently postponed from July to October 2022 as part of the government's anti-inflation measures.

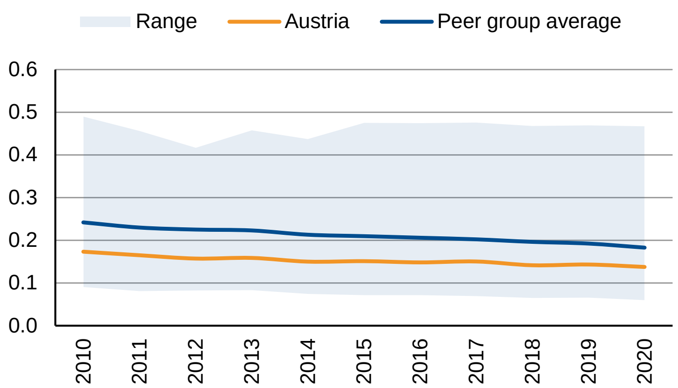
- **Social:** Austria scores highly on the European Union's social scoreboard indicators, with relatively low-income inequality and a low share of people at risk of poverty or social exclusion (17.3% vs the eurozone average of 21.9%). Despite strong performance overall, the Austrian labour market is 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 risks*

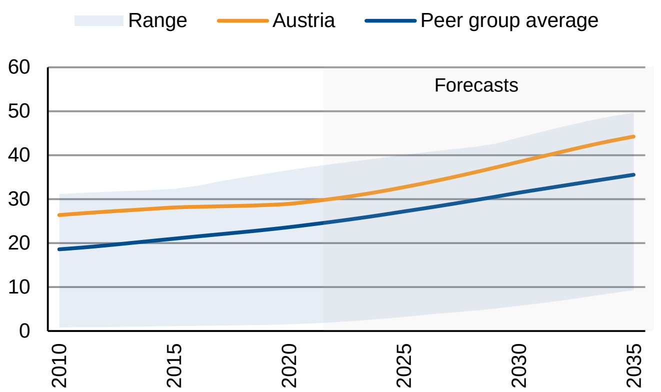
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental risks	Neutral	0	A high share of renewables now and ambitious decarbonisation targets by 2030; however, a significant gap remains in a 'no policy change' scenario
	Social risks	Neutral	0	Strong social safety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

CO_2 emissions per GDP, $mtCO_2e$



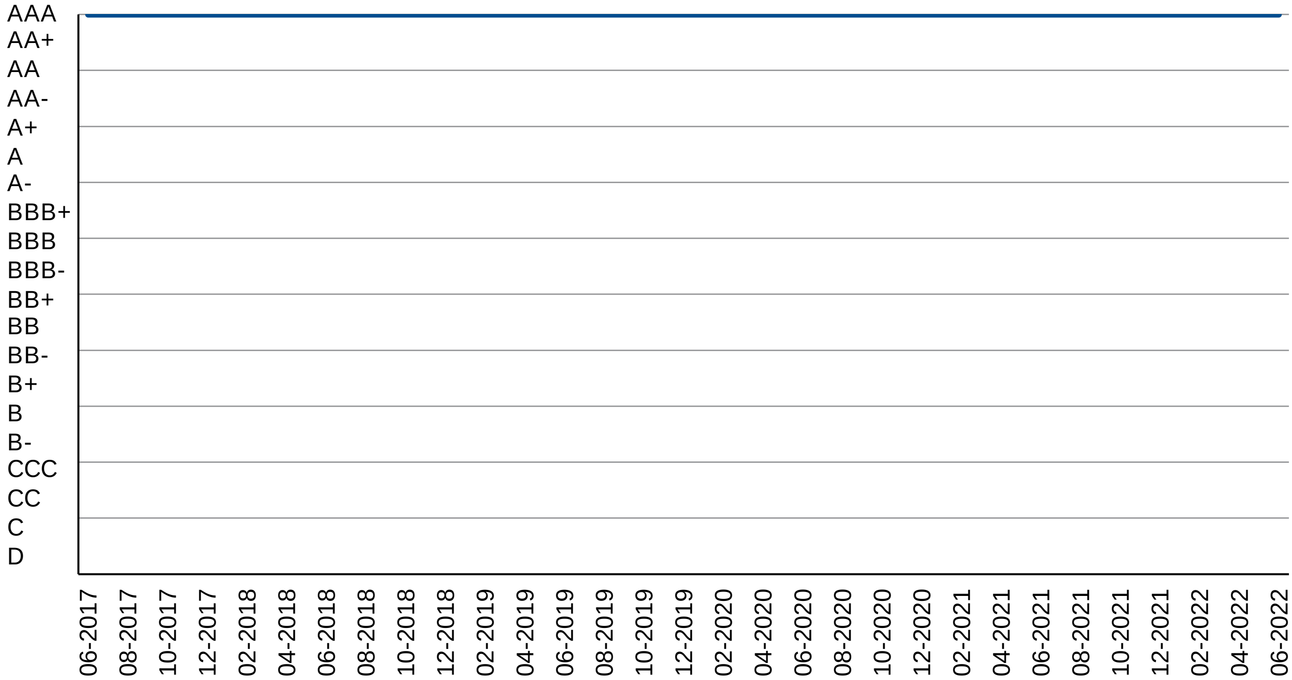
Source: European Commission, Scope Ratings

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*
Denmark
Estonia
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland

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

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the core variable scorecard (CVS).

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	45.3	47.3	51.3	50.2	48.6	53.4	53.4	57.4
Nominal GDP, USD bn	395.7	417.1	455.4	445.1	432.9	477.4	479.8	518.8
Real growth, %[1]	2.0	2.3	2.5	1.5	-6.7	4.5	3.5	1.5
CPI inflation, %	1.0	2.2	2.1	1.5	1.4	2.8	5.6	2.2
Unemployment rate, %[1]	6.5	5.9	5.2	4.8	5.4	6.2	4.7	4.7
Public Finance Risk								
Public debt, % of GDP[1]	82.5	78.6	74.0	70.6	83.2	82.8	78.9	76.4
Interest payment, % of government revenue	3.4	3.0	2.5	2.1	1.9	1.8	1.2	1.1
Primary balance, % of GDP[1]	0.1	0.6	1.4	1.6	-7.4	-5.0	-2.9	-1.5
External Economic Risk								
Current account balance, % of GDP	2.7	1.4	0.9	2.1	1.9	-0.6	-0.6	0.8
Total reserves, months of imports	1.2	1.1	1.0	1.1	1.6	1.4	-	-
NIIP, % of GDP	3.9	4.5	5.8	13.6	10.0	14.1	-	-
Financial Stability Risk								
NPL ratio, % of total loans	2.7	2.4	1.9	1.6	-	-	-	-
Tier 1 ratio, % of risk-weighted assets	14.5	15.6	15.6	15.9	16.8	16.6	-	-
Credit to private sector, % of GDP	83.2	84.1	84.3	85.8	93.3	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	148.2	150.3	141.5	143.2	137.5	-	-	-
Income quintile share ratio (S80/S20), x	5.0	4.7	4.9	4.8	-	-	-	-
Labour force participation rate, %	76.2	76.3	76.6	76.9	-	-	-	-
Old-age dependency ratio, %	28.3	28.4	28.5	28.7	28.9	29.5	30.1	30.9
Composite governance indicator[2]	1.4	1.5	1.5	1.5	1.4	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 11 August 2022	13.9

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