Austria: Sovereign Report

Scope considers Austria one of the strongest sovereign debt issuers, well into the top tier in Europe, thanks to its wealthy, well-diversified economy without major macroeconomic imbalances. Austria pursues a prudent fiscal policy: its budget deficit has been below the Maastricht '3% to GDP' threshold for most of the last 15 years. The sovereign enjoys one of the lowest costs of funding, making debt affordability metrics very strong, and is a net creditor with a persistent current account surplus, pointing to limited exposure to market volatility.

Despite these strengths, Austria faces challenges that could weaken creditworthiness. Following the strong rebound after the 2008 crisis, its GDP growth rate has again stagnated since 2012. Though Scope expects GDP to expand in 2016, the post-crisis growth pace is likely to slow down, underpinned by the low employment growth rate owing to challenging demographics, stagnating investment, a high tax wedge and overregulated professional services. The diminishing potential GDP growth rate could delay its ability to restore fiscal flexibility and decrease public indebtedness for future economic cycles.

Public finances are not at a particular risk in the short term. However, in the medium to long term, costs implied by the ageing population could pose a serious problem. Austria is unlikely to face gradual depopulation like Germany or Italy, yet its population growth rate might slow significantly in the next five years, worsening the old-age dependency ratio and pushing up the ageing share of the population. These developments might strain the public pension pot and raise age-related budgetary expenditures, which, combined with slowing GDP growth pace, could erode future budget balances, with negative implications for public indebtedness.

Finally, Austria's public debt spikes are due largely to the crystallisation of contingent liabilities relating to the banking sector. Though the costs to repair three troubled banks have largely materialised, unresolved issues remain. In general, Austria's very high level of contingent liabilities, mostly public sector guarantees, is a concern.

Strengths

- A wealthy country with a highly diversified economy and no major macroeconomic imbalances
- Prudent fiscal policy
- Strong public-sector debt-affordability metrics with a very low cost of funding

Weaknesses

- Weakening potential GDP growth rate
- Rapidly ageing population
- High contingent liabilities with unresolved issues on ailing banks

Analyst

Ilona Dmitrieva (author)
+44 20 34570445
i.dmitrieva@scoperatings.com

Team leader

Sam Theodore
+44 20 34570444
s.theodore@scoperatings.com

Scope Ratings AG

Suite 407
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scoperatings.com
www.scoperatings.com

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Macroeconomic outlook

We expect Austria's GDP growth to accelerate to 1.6% and 1.5% in 2016 and 2017, respectively, and thus end an almost four-year period of economic stagnation since Q2 2012 (Figure 1). The economic rebound will be supported by strong domestic demand from the private sector – fuelled by favourable credit conditions, low inflation and the income tax reform – which leaves more room for household consumption. Stronger household demand will likely help investment, which will also have a positive impact on reviving exports, thanks to the growing economies of Austria's main trading partners and a weaker euro. Fiscal policy will be largely supportive owing to the moderately increasing expenditures from rising unemployment and the exceptional budgetary spending on the large, sudden inflow of asylum seekers.

Consumer prices, which are likely to stay very low in 2016 due to a strong 'dumping' effect from weak oil prices, could rise in 2017, reflecting strengthening domestic demand and the brighter prospects for the whole economy. In spite of the overall economic improvement, unemployment is expected to pick up, driven by the influx of refugees and older people increasingly willing to stay employed due to pension reform, which has reduced chances for early retirement.

Figure 1: Austria: selected economic indicators and forecasts

	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
Real GDP growth, %	-3.6	1.8	3.0	0.7	0.3	0.5	0.8	1.6	1.5	1.3
Nominal GDP (EURbn)	286	294	309	317	323	330	337	350	361	371
Nominal GDP (USDbn)	402	387	424	412	428	429	374	377	401	413
GDP per capita (USD)	48,203	46,381	50,594	49,054	50,657	50,396	43,760	43,880	46,419	47,451
Population (year-end, m)	8.3	8.4	8.4	8.4	8.5	8.5	8.6	8.6	8.6	8.7
C/A balance, % GDP	2.6	2.9	1.6	1.5	1.0	0.8	2.7	2.2	2.2	2.1
Inflation, annual avg, %	0.4	1.7	3.6	2.6	2.1	1.5	0.8	0.9	1.3	1.3
Govt balance, % GDP	-5.3	-4.5	-2.6	-2.2	-1.3	-2.4	-1.6	-1.7	-1.7	-1.7
GG gross budgetary debt, % GDP	79.7%	82.4%	82.0%	81.5%	80.9%	84.4%	86.0%	84.6%	83.7%	83.1%
Unemployment %	4.8	4.4	4.1	4.4	4.9	5.6	5.7	6.0	6.0	5.8

Source: Eurostat and Scope estimations

Diversified economy, though potential GDP growth has softened

The Austrian economy is relatively small in size, but the country is wealthy in terms of GDP per capita. It accounts for 3% of the euro area (EA) countries' output and is 28th in the world by GDP[1]. At EUR 38,500[2] its GDP per capita is almost 28% higher than the EA average. Though the size of the economy makes it vulnerable to external and internal shocks – in Austria's case, the crystallisation of a sizable amount of contingent liabilities from the banking sector – the wealth level can help mitigate shocks to a certain point by offering various options for generating tax revenue.

Austria's service-oriented economy is well diversified and does not overly rely on any particular economic activity (Figure 2). We view positively this characteristic as it indicates the economy's limited exposure to a sudden drop in budgeted revenue, which could originate from troubles in one dominant industry or service.

Though the Austrian economy is dependent on external markets, its degree of openness – measured by the ratio of exports and imports to GDP – is higher than for larger EA economies. In 2015 Austria's ratio stood at 102% versus Germany's 86.0%, France's 60.6% or Italy's 57.3%. This larger proportion makes the country more exposed to external markets. Moreover, Austria's narrow range of trading partners – in 2014, 42% of

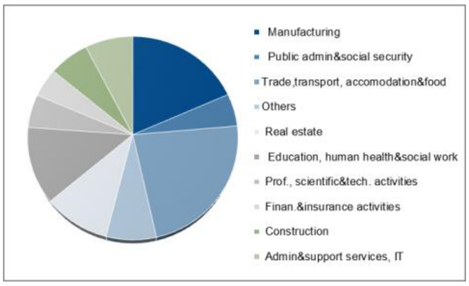
[1] In 2014, Austria's GDP stood at USD 429bn/EUR 330bn.
[2] In 2014, measured in current prices

its exports were to Germany, Italy and France – links it to the economic cycles of these countries.

Like other EA countries, Austria benefits from a favourable economic environment – in particular, low inflation, a weaker euro and a higher supply of credit. All of these are strongly influenced by the low oil prices and, from a different angle, the ECB's large asset-purchase programme since March 2015, which was extended and topped up in March 2016. The shelf life of these favourable factors is finite, however, though it is difficult to predict for how long.

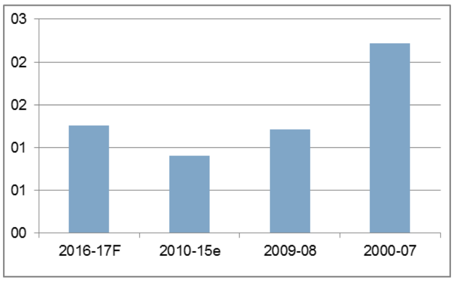
As the influence of these tailwinds starts to fade, Austria's GDP growth rate will likely revert to its potential output level. The latter, according to European Commission (EC) calculations, has softened compared to the pre-2008 crisis level, and is expected to stay below 1.3% on average in 2016 and 2017 (Figure 3). The potential growth rate is constrained by stagnant investment, especially visible since 2012, and by the low employment growth rate due to challenging demographics. The potential growth slowdown could in future limit the country's ability to regain space for fiscal manoeuvring, as it delays the reversal of indebtedness to the crisis level.

Figure 2: Austria's value-added by activity in 2014, % of total



Source: OECD

Figure 3: Average potential GDP growth, %



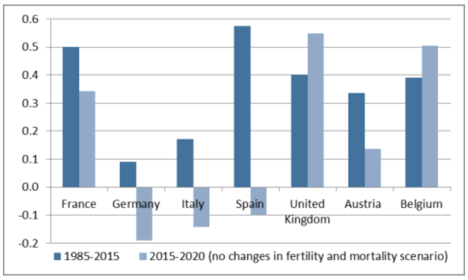
Source: AMECO, EC

Demographic challenges to economic growth, public finances under strain

According to UN forecasts, Austria is unlikely to face gradual depopulation like Germany or Italy, yet its population growth rate might slow significantly in the next five years (Figure 4). Moreover, its population growth, which is sensitive to trends in migration, is likely to depend largely on immigration (Figure 5). This could have important implications on the country's labour supply and quality, and therefore economic growth in the long run.

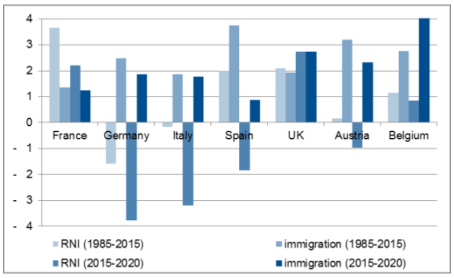
Currently, the country's labour market indicators are above EA average – in 2015 only 5.8% of the active population and about 10% of young people (under 25 years) were unemployed compared to 10.9% and 22.5% in the EA, respectively. In 2014 (latest available data) 74.2% of working-age people (20-64 years) had a job versus the EA's 68.2%. However, the below 1% average annual growth rate in employment seen over the last decade could turn negative and constrain GDP growth.

Figure 4: Average annual population growth, %



Source: UN

Figure 5: Population growth drivers



Source: UN

Note : RNI- rate of natural increase

To combat the declining employment rate, the government has been implementing measures to increase labour resources among older workers, women and immigrants. Already these have had a positive impact on the rate. In our view, however, these measures bear a certain cost.

The number of employed in the 55-64 age group has been rising thanks to pension reforms adopted in 2013 and 2014 to restrict conditions for early retirement[3]. For 2024-2033 the retirement age for women, currently at 60, will gradually increase to 65, the same as for men. Increase in full-time employment[4], though, could be challenging without improving the provision of places for childcare and long-term care, which would require additional public funding.

Austria has historically been attractive for immigrants, with their share in the population increasing by almost 50% in 2000-2014. In 2015 Austria saw a surge in asylum seekers – 90,000 people or 1% of the population – ranking it third in EU behind Hungary and Sweden for the number of refugees per 100 inhabitants. The country benefits from young and highly skilled immigrants; nevertheless, in our view, it takes time to offset the cost relating to their integration in the local labour market before their contribution to GDP and taxes visibly increases[5].

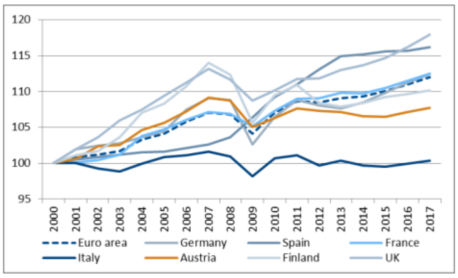
Measures to boost employment should improve the outlook on GDP growth, but the key challenge for Austria (and for most developed economies competing globally) is to ensure labour productivity is sufficient and growing. On this measure its performance has weakened, lagging behind the EA average (Figure 6). Declining productivity can be combated by more investment; this, however, has also been falling since 2012 (Figure 7), in spite of more credit and a high level of savings available in the economy to finance the investment.

[3] European Commission staff working document, country report Austria 2015, p.19

[4] While the female participation rate of 70.8% in 2013 was higher in Austria than in the EU-28 average, it is less favorable in the full-time equivalents, as the higher proportion of women in Austria employed part-time compared to the EU-28 average, EC staff working document, country report Austria 2015, p 20.

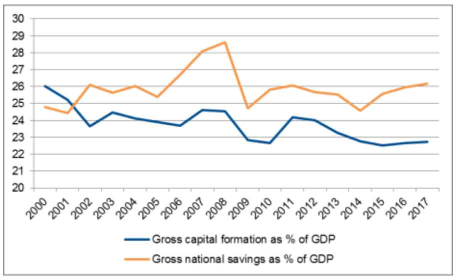
[5] Austria, 2015 Article IV consultation, IMF country report No. 16/50, p.13.

Figure 6: Real labour productivity (2000=100)



Source: AMECO, EC

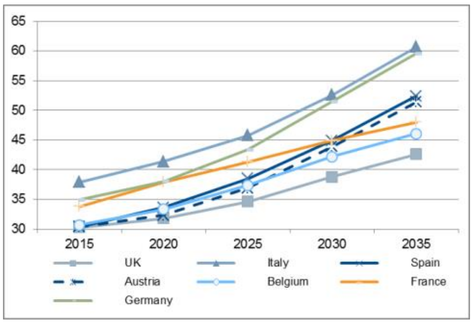
Figure 7: Gross capital formation vs savings, % GDP



Source: AMECO, EC

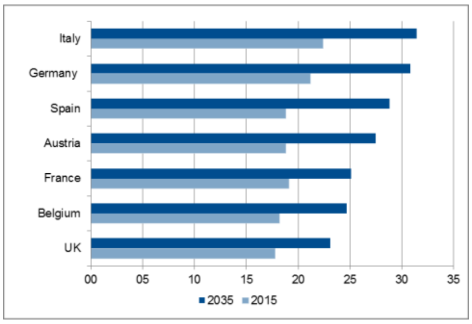
Another way that Austria's challenging demographics can impact creditworthiness is public finance. Softening population growth rates could eventually worsen the old-age dependency ratio, which, having been on par with other EU economies in 2015, might become one of the weakest by 2035 should the current demographic pattern (fertility and mortality rates) stay unchanged (Figure 8). Austria's proportion of the older population (above 65 years) – again similar to most large EU economies – could therefore pick up significantly and put it among countries with the largest share of pensioners (Figure 9). These developments might strain the public pension pot and push up old-age-related budgetary expenditures for healthcare and long-term care.

Figure 8: Old-age dependency ratio (people aged +65 per 100 population 20-64)



Source: UN

Figure 9: Population above 65, % of total



Source: UN

No major macroeconomic imbalances, but still reasons for concern

The EC's 2015 country report on Austria states its economy is currently free of major imbalances6. We consider this a positive credit factor indicating better ability to withstand potential external shocks. However, in our opinion, a lower share in the global export market, an overregulated professional services and the rapid increase of housing prices could pose certain concerns.

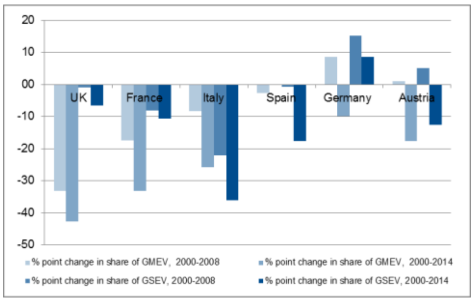
Export market share sees decline, but less so than in other large EU economies

Austria is among the EU economies which saw its global export share reduce, both in merchandising and services, though the reduction was not as deep as for other economies (Figure 10). The loss of market share, in our opinion, is to do with the country's weakening competiveness, as measured by the real labour unit cost (RULC). Figure 11 shows that Austria, relatively competitive prior to 2012, started losing ground with its labour costs going up. Nevertheless, according to the EC, following the peak in

[6] Commission staff working document, Country report Austria 2015, p.3

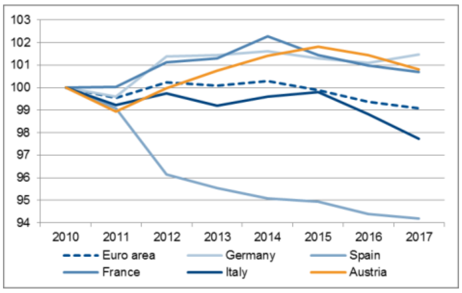
2015, RULC is expected to gradually slide down in 2016 and 2017 on the back of the tax wedge reform implemented by the government this year.

Figure10: Change in global export share (relative to 37 trading partners), %



Source: Eurostat, global merchandise export value (GMEV), global service export value (GSEV), for Austria the base year for comparison is 2006

Figure11: RULC: total economy

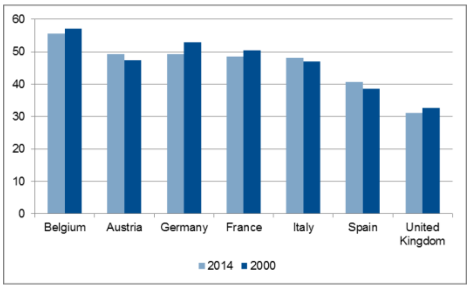


Source: AMECO, EC, real unit labour cost (RULC) equals ratio of compensation per employee to nominal GDP per person employed

Austria's labour cost is pushed up by one of the highest tax wedges among EU countries. The tax wedge is the difference between before- and after-tax wages (Figure 12). Labour taxes include personal income tax, social security and payroll taxes, in particular, contribution to the family burden equalisation fund and municipal taxes.

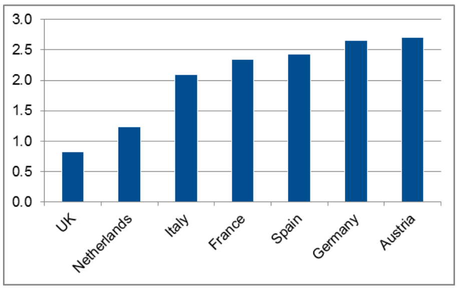
The current government, recognising the damaging effect of high labour taxes on cost competiveness, launched a comprehensive tax reform to re-modulate both tax brackets (their number will move up from three to six) and personal income tax rates. In particular the entry level of personal income tax was reduced from 36.5% to 25%, whereas the taxable income for the 50% bracket was increased from EUR 60,000 to EUR 90,000. In spite of the reduction in the labour income tax, the social contribution tax for both employers and employees is still one of the highest among OECD countries[7]. Given the upward trend in public sector indebtedness, however, the government is likely wary of further tax cuts. That said, switching taxes from labour, which hampers economic growth, to consumption and wealth remains an option.

Figure 12: Average tax wedge, %



Source: OECD, single person at 100% of average earnings, no child

Figure 13: Regulations in professional service as of 2013 (6 is most regulated)



Source: OECD, professional services indicators cover entry and conduct regulation in the legal, accounting, engineering, and architectural professions.

Another hurdle which could weaken competitiveness is overregulation in professional services (Figure 13). Austria has one of the highest entry barriers among EU economies for this non-tradable type of activity. Moreover, these services employ a significant amount of people. According to a recent EU survey, 22% of the Austrian labour force can

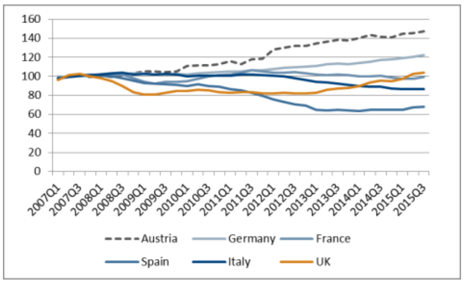
[7] Austria, selected issues, IMF country report No. 16/51, p.5

be considered as working in a regulated profession[8]. The economic importance of professional services is amplified by its influence on the international competiveness of tradable sectors. High prices for the services, coupled with a high labour cost, squeeze margins in tradable activities.

Despite rising housing prices, no evidence of a bubble

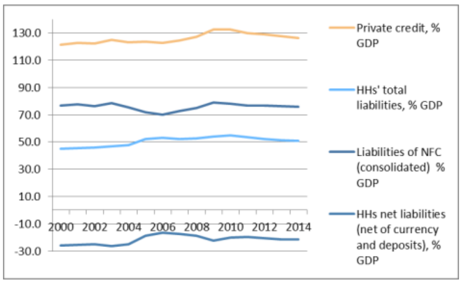
Since 2007, nominal residential housing prices went up by almost 50%, the highest rise among EU countries (Figure 14). However, in our opinion, this surge in prices does not point to overheating in the market. Firstly, the Austrian house market is catching up with the EA countries. In 2001-2007, while residential house prices in Austria stagnated, these grew in the EA countries by 7% a year on average. But in 2008-2014 this trend reversed: house prices in the EA collapsed (-2.25% on average), while the Austrian market grew by 3.3%. Moreover, since Q1 2014 the growth pace in Austria's residential house prices moderated together with the credit to households as well as household debt (Figure 15). Secondly, housing bubbles typically require both rising prices and a deterioration in lending standards, which is not currently the case in Austria[9]. Finally, households' net liabilities have been constantly negative, indicating a high level of assets, i.e. existence of strong buffers for debt repayments. In addition, indebtedness of non-financial corporations (NFCs) remains moderate, and has gradually been deleveraging since 2010.

Figure 14: Residential nominal property prices, new and existing dwellings



Source: ECB

Figure 15: Private debt vs private credit, % GDP



Source: Eurostat, HHs – households

Rising public debt driven mostly by support to banking sector

Austria's government direct debt has been rising since 2000. It increased especially rapidly since the end of 2007 when it was 64.8% of GDP, to end 2015 at an estimated 86.0% (Figure 16). Importantly, the budget deficit has not been the main debt-raising factor, as Austria has kept a strong grip on its budget balance, only occasionally exceeding the 3% Maastricht threshold in the last 15 years.

The surge in debt is due mainly to financial support provided to troubled Austrian banks hit by the 2007-2008 crisis; though worsened by the slower GDP growth rate, especially after 2012. According to the EC, by the end of 2015 Austria's public debt as a percentage of GDP would have been almost 10% lower – almost similar to Germany's – if the support to the banking sector was excluded10.

Between 2008 and 2013 the government gave guarantees to seven credit institutions, three of which failed to overcome post-crisis problems. These three banks were fully or partly nationalised, with the government transferring non-marketable assets to

[8] EC staff working document, country report Austria 2016, Brussels, 20.02.2016, p.66

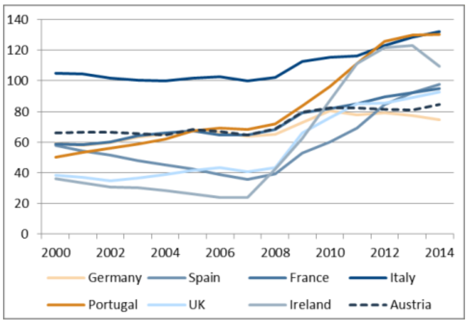
[9] According to the EA bank lending quarterly survey conducted by OeNB in Q4 2015, credit standards of approved loans and credit lines to enterprises have been largely unchanged in last two quarters of 2015, credits standards to households have even tightened slightly in Q4 2015. EA bank lending survey – Austrian results, Bank of Austria

[10] Country report Austria 2016, EC, p.36

defeasance structures for a gradual wind-down. The balance sheet of these structures is included in government debt, which should decline as the impaired assets are progressively divested. Over 2009-2015 the net cost to the public sector, which arose exclusively from these three institutions, amounted to EUR 13.5bn (4% of 2015 GDP)[11].

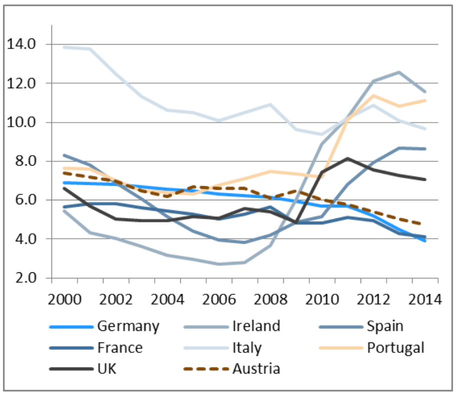
By the end of 2015 the crystallisation of liabilities related to former OEVAG and Kommunalkredit on the government balance sheet seemed largely complete, whereas uncertainties remain over HETA (the defeasance structure of the former Hypo Alpe Adria, HAA). This is mainly due to the deficiency guarantee by the Austrian state of Carinthia over HAA's liabilities, evaluated at roughly EUR 11bn. The Austrian Financial Market Authority (FMA), also the country's resolution authority, imposed a moratorium on HETA's liabilities until 31 May 2016, and launched an independent evaluation of its assets. The evaluation can lead to a higher or lower impact on public finances than expected, whereas the use of the bail-in measure would reduce the cost. What remains unclear is how the resolution authority will deal with Carinthia's guarantee.

Figure 16: Gross government direct debt of selected EU countries, % GDP



Source: Eurostat

Figure 17: Interest payments as % of budget revenues



Source: Eurostat

High debt affordability unaffected by rising indebtedness

In spite of Austria's rising indebtedness, its debt affordability remains high. The interest payment-to-budget revenue ratio was a low 4.8% in 2014, almost similar to that of Germany and France (Figure 17). This is due to two factors: The first is a very low funding cost of Austria's government debt – at the end of February 2016 its 10-year bond yielded only 0.39% against Germany's 0.13% and France's 0.48%. The second, as highlighted above, is the inclusion in government accounts of impaired assets from financial defeasance structures, which do not cause interest payments[12]. Apart from that, the Austrian government's direct debt, though increasing, remained second lowest after Germany among larger EU economies at the end of 2014 (Figure 16).

Low risks to fiscal sustainability in near future, but can rise in medium term

In our opinion, the reversal of Austria's public debt to the pre-crisis level, let alone the alignment with the 60% to GDP Maastricht threshold, will likely be prolonged and subject to a number of risks. Meanwhile, reduced fiscal buffers leave the country more exposed in future to adverse conditions and shocks.

[11] The same, p.31
[12] Country report Austria, EC, p. 29

According to the 2016 draft budget, which sets budgetary and debt parameters for 2016-2017, and the 2015 stability programme outlining medium-term objectives (MTO), Austria intends to gradually decrease its budget deficit and keep it well within the 3% budget-deficit threshold (Figure 18). This policy could gradually reduce debt – provided the GDP growth rate outpaces the budget deficit. In our view, however, within the next four years this strategy will still not bring indebtedness back to the pre-crisis level.

Figure 18: Budget balances and gross government debt projections

% of GDP	2015	2016	2017	2018	2019
SP: headline budget balance	-2.2	-1.6	-1.3	-0.9	-0.5
SP: structural budget deficit	-0.9	-0.8	-0.9	-0.7	-0.6
SP: gross GG debt	86.8	85.7	84.1	82.2	79.7
DBP: headline budget balance	-1.9	-1.4	na	na	na
DBP: structural budget deficit	-0.5	-0.5	na	na	na
EC: headline budget balance	-1.6	-1.7	-1.7	na	na
EC: structural budget deficit	-0.3	-1.0	-1.4	na	na
EC: GG gross debt	85.9	85.1	84.0	na	na

Source: SP – 2015 stability programme, DBP – draft budgetary programme for 2016, EC – European commission, GG – general government,

Moreover, according to the EC, the Austrian government's budget and debt targets for 2016 and 2017 are exposed to downside risks, which could widen not only headline but structural[13] budget deficits. The major short-term risk is the materialisation of expenditure savings and extra tax revenue, intended to make up for the budgetary revenue shortfall resulting from the tax reform in 2016. According to the government's calculations the reform will cost the budget EUR 5.2bn (1.5% of GDP).

The cost is expected to be covered in large part by measures to fight tax fraud, reduce state subsidies and reform public administration, as well as the second-round effects of tax reform associated with higher GDP. Crystallisation of budget savings through these measures is far from guaranteed. In addition, spending on refugees, estimated at around 0.08% of GDP in 2015, is likely to double in 2016. In its projections of the structural deficit in Austria, the EC considers this expenditure as permanent rather than a one-off, thus having negative implications for the structural deficit.

All in all, with lower gross debt and structural budget balances than most EA economies, Austria's public finances are not at a particular risk in the short term. However, in the medium term the costs implied by the ageing population (Figures 8 and 9) could pose a more serious fiscal risk.

According to the OECD, Austria's budgetary expenditure structure in 2013 was one of the least flexible, with social-protection spending[14] – very difficult to cut in an economic downturn – accounting for almost 42% of the total. By this measure Austria is much higher than the OECD average (35.7%) and on par with Germany and France. More than half of these expenses relate to the ageing population.

Among the EA countries, Austria has one of the highest ratios of public pension cost to GDP (Figure 19) and is well above EA average. Austria's public pension ratio could also outpace France's beyond 2030, and eventually Italy, assuming policies remain unchanged. For Austria, its unfavourable demographics are compounded by its generous

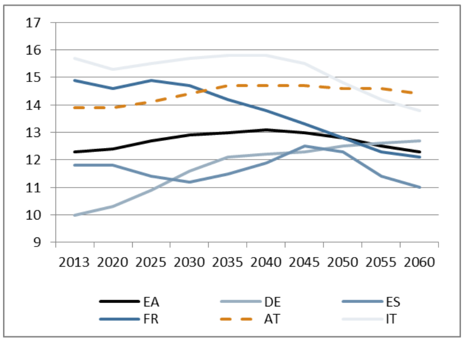
[13] Structural budget deficit eliminates impact of cyclical and temporary measures and is related to the potential GDP. Structural budget balance indicates the trend which the headline budget balance reverts to, once temporary measures are excluded and GDP converges to its potential level.
[14] Social protection expenditures include mostly old age, family, unemployment, sickness and disability benefits.

pension replacement ratios[15] and the relatively low effective retirement ages of men and women.

Despite the government's measures to curb the rising costs of public pensions, the power of the pensioners' lobby cannot be ignored, with its influence already leading to years-long delays in state pension reforms. Taking that into account, we are wary that pension reforms might be scaled down and, if implemented, contribute insufficiently to reducing the unfunded pensions' gap with its negative impact on budgetary balances and public debt.

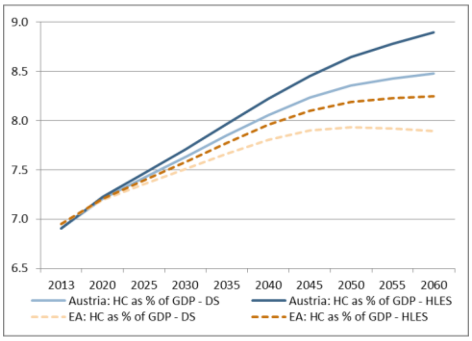
Healthcare spending, which was at EA average in 2013, could overshoot this level beyond 2020, driven by effects of ageing and escalating healthcare costs in the last years of life (Figure 20). According to IMF estimates, expected decline in the gross public debt trajectory could reverse beyond the mid-2020s, driven by age-related and other health spending, such as long-term care, and could reach about 130% of GDP by 2060[16].

Figure 19: Gross public pensions, % of GDP



Source: The 2015 Ageing report, EC

Figure 20: Healthcare spending under different scenarios, % of GDP



Source: The 2015 Ageing report, EC, HC – healthcare spending, DS – demographic scenario, HLES – high life expectancy scenario

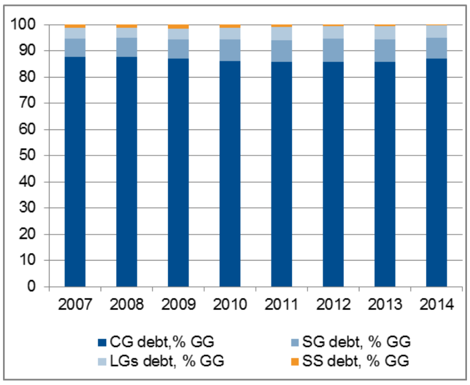
Low liquidity risk from central government debt, but high share of non-resident holdings

The lion's share of the Austrian general government debt is issued at federal level (Figure 21), indicating its importance in the country's budgetary system, as measured by its share in total budgeted revenue and expenditures – 65% and 53% at YE 2014, respectively. The federal government's debt profile appears sound.

At YE 2015 the average maturity of the federal debt portfolio was 8.39 years and the proportion of short-term debt did not exceed 10%, limiting the government's exposure to rollover risk[17]. Besides, almost 95% of outstanding debt bears fixed rates, thus minimising shocks to debt servicing costs. At the same time, the share of non-residents holding Austrian public debt was the highest among EA economies, potentially exposing it more to volatile market sentiment (Figure 22).

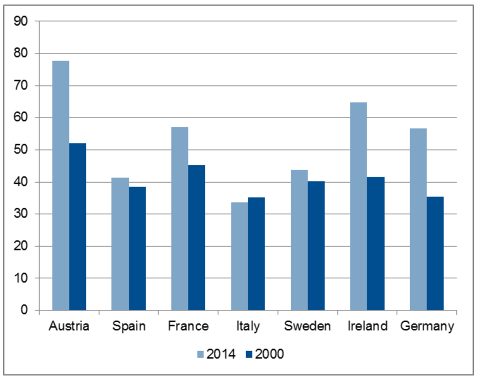
[15] Pension replacement ratio compares the amount of pension with the average wages and salaries.
[16] Austria, selected issues, IMF country report No.16/51, p.19.
[17] Investor information – February 2016, Austrian treasury

Figure 21: Outstanding debt by the layers of government, % GG



Source: GG general government, CG – central government, SG – state government, LGs – local governments, SS – social security fund

Figure 22: Government debt held by non-residents at YE 2014, % of total (Maastricht definition)



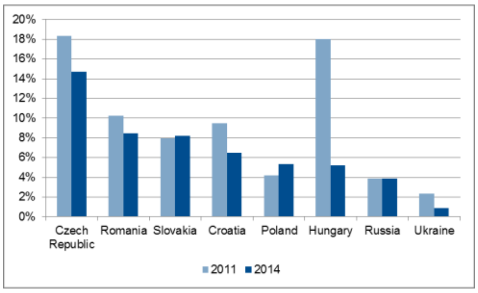
Source: ECB, Ireland – 2014 compared with 2001

Contingent liabilities from banks moderate, but uncertainties persist

We highlight a moderation of risk relating to the potential materialisation of contingent liabilities from the banking sector, as the EU Bank Recovery and Resolution Directive (BRRD) has been transposed into the national law, limiting state involvement in bailing out banks. Also, we note the fairly advanced stage of the restructure and reorganisation of nationalised Austrian banks.

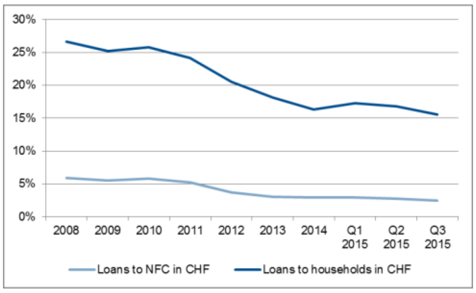
At the same time, risks to the financial stability of the sector persist. Firstly, while capitalisation of Austrian banks continues to improve, profitability is strained by low domestic interest rates, as well as the large, albeit diminishing (Figure 23), exposure to volatile markets in Central and Eastern Europe (CEE), and the shrinking economies of Russia and Ukraine. Secondly, there is significant, though also diminishing, exposure to FX lending, especially in the Swiss franc (Figure 24); should this currency continue to appreciate, Austrian banks could suffer, especially those exposed to Central, Eastern and South-eastern European (CESEE) countries.

Figure 23: Austrian banks' exposure to CESEE countries, % of total assets



Source: BIS

Figure 24: Share of CHF loans in Austrian banks' total assets, %

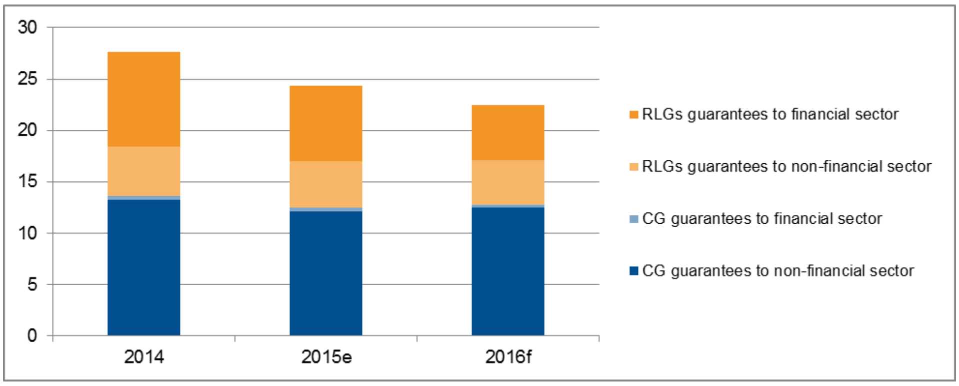


Source: BIS

Large, though declining, public guarantees could pose risk for general government

By the end of 2015 the amount of guarantees issued by the Austrian government, excluded from outstanding debt under the Maastricht definition, stood at 24.3% of GDP, down from 27.6% at the end of 2014. This is by far one of the largest amounts of guarantees issued by any EA country. As shown in Figure 25, guarantees to non-financial companies dominate at the central government level, while regional and local governments issue more to financial institutions.

Figure 25: Guarantees issued by all level of governments, % of GDP



Source: Austrian draft budgetary plan 2016, p.19, RLGs – regional and local governments, CG – central government

Guarantees related to EA rescue funds manageable

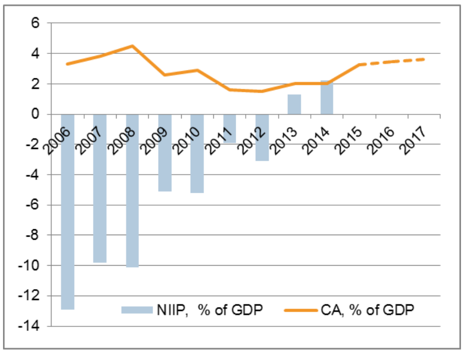
The EA-related obligations include Austria's guarantees and callable capital in the European Stability Mechanism (ESM), European Financial Stability Facility (EFSF) and European Financial Stability Mechanism (EFSM), which were set up to rescue troubled EA economies. Through these three facilities, when measured by drawdown or disbursed loans, Austria's total exposure to weaker EA economies as of January 2016 is a manageable 2.2% of the 2015 GDP The Greek exposure alone accounts for 1.1% of GDP (or 52% of the total), with the rest distributed among Spain, Cyprus, Portugal and Ireland. The economic rebound, especially strong in Spain and Ireland, has somewhat eased concerns over the rescued countries.

Low external vulnerability risk

Austria's exposure to external shocks appears to be limited: the country does not depend on external capital to support its current account (CA). On the contrary, Austria's CA, consistently in surplus since 2002, has not only improved but has turned net international investment position (NIIP) into a positive balance (Figure 26). Since 2013 Austria has become a net creditor, placing it second among larger EA economies for a positive, albeit modest, NIIP (Figure 27).

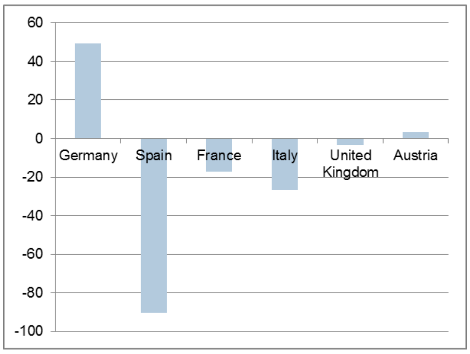
The CA surplus has moderated since 2011, driven by the low growth of Austria's main export markets as well as a decline in cost competiveness, especially when compared with EA trading partners. We expect the CA to strengthen in the near future and to have positive implications on NIIP. Improvement is likely to be supported by low prices for imported fuel (fuel and mining products were 10% of Austria's imports in 2014) and economic recovery in the country's main trading partners.

Figure 26: Austria: CA and NIIP, % of GDP



Source: Eurostat; CA – current account, NIIP – net international investment position; forecasts based on EC AMECO data

Figure 27: NIIP for selected countries in 2015, % of GDP (to be replaced with the one in the excel file)

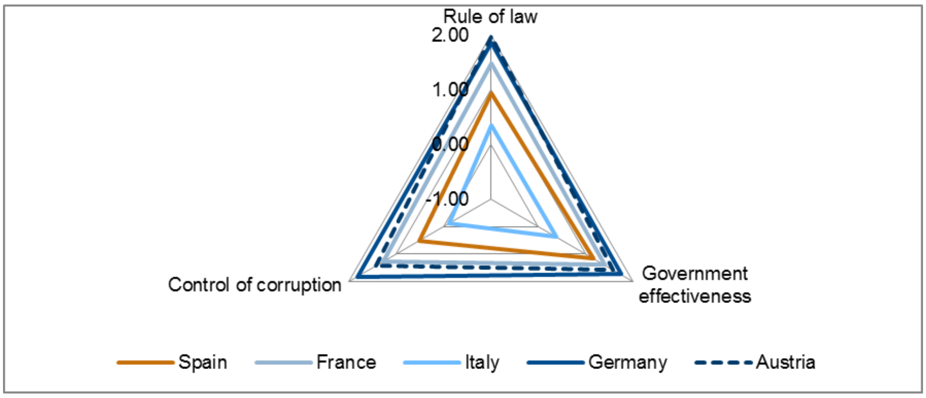


Source: Eurostat

Creditor-friendly government institutions

Austria scores very high on the World Bank's "World Governance Indicators" for government effectiveness (1.57), rule of law (1.96) and control of corruption (1.44). The quality of government institutions, especially for rule of law, is close to the maximum score, making Austria stronger than other EA countries except for Germany (Figure 28). Strong government institutions facilitate a friendly environment for creditors and support the sovereign's strong willingness to repay debt.

Figure 28: Worldwide Governance Indicators, the World Bank; ranging from -2.5 (worst) to 2.5 (best)



Source: WB

I. Appendix: Austria: Fiscal accounts and debt, % GDP

	2009	2010	2011	2012	2013	2014	2015
General government *							
Revenue	48.8	48.3	48.2	48.7	49.5	49.8	50.0
o/w social security contribution	15.1	14.9	14.9	14.9	15.2	15.4	15.5
Expenditure	54.1	52.7	50.8	50.9	50.8	52.2	51.9
o/w interest payments	3.1	2.9	2.8	2.6	2.5	2.4	2.3
o/w social transfers other than in kind	19.2	19.4	18.7	18.8	19.2	19.4	19.6
Primary balance	-2.1	-1.5	0.3	0.5	1.2	0.0	0.5
Overall balance	-5.3	-4.4	-2.5	-2.2	-1.3	-2.4	-1.9
General government gross debt	79.7	82.3	82.1	81.5	80.8	84.4	86.0
% of general government revenue	163.4	170.4	170.1	167.3	163.3	169.6	176.9
							Central Government **
Revenue	32.1	31.5	31.8	32.1	32.6	32.8	n.a.
Expenditure	36.4	34.9	34.1	34.3	34.0	35.3	n.a.
o/w interest payment	2.9	2.7	2.5	2.4	2.3	2.2	n.a.
Primary balance	-1.4	-0.7	0.2	0.3	0.9	-0.3	n.a.
Overall balance	-4.3	-3.4	-2.3	-2.2	-1.4	-2.5	n.a.
Central government gross debt	n/a	n/a	73.5	73.7	73.2	77.3	n.a.
% of central government revenue	n/a	n/a	231.6	229.2	224.6	235.9	n.a.
Memo							
Nominal GDP,EUR bn	286.2	294.6	308.6	317.1	322.9	329.3	337.3

Sources: Ministry of Finance, EC, Eurostat, Central Bank, Scope estimates

* including Central, state and local governments and social security fund

** excluding social security fund

For Austria 2015 budget figures are based on draft budgetary programm

II. Austria: selected economic and financial data

	2009	2010	2011	2012	2013	2014	2015
Economy and Institution							
Real GDP growth, %	-3.8	1.9	2.8	0.8	0.3	0.4	0.9
Total Population, td	8341.5	8361.1	8388.5	8426.3	8477.2	8543.9	8620.8
CPI, % y/y	0.4	1.7	3.6	2.6	2.1	1.5	0.8
GDP per capita at the market rate, EUR	34300.0	35200.0	36800.0	37600.0	38100.0	38500.0	39100.0
Unemployment rate, %	4.8	4.8	4.6	4.9	5.4	5.6	5.7
GDP per capita on PPP basis, USD	40989.6	42145.9	44162.6	45112.5	45788.8	46420.1	47188.5
Size of the economy, share in the world's GDP	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Openness of the economy, % GDP	86.8	98.7	104.8	105.0	103.5	102.7	102.3
Domestic savings ratio, % GDP	25.5	25.0	25.0	25.3	25.5	26.1	26.6
Gross national savings ratio, % GDP	23.7	24.7	24.8	24.5	24.0	n.a.	n.a.
Real GDP volatility, %	2.0	2.0	2.0	2.0	2.0	2.0	2.1
Control of corruption index	1.8	1.6	1.4	1.3	1.5	1.4	n.a.
Rule of law index	1.8	1.8	1.8	1.8	1.8	2.0	n.a.
Government effectiveness	1.7	1.8	1.6	1.6	1.6	1.6	n.a.
Real labour productivity (2010=100)	99.1	100.0	101.4	101.1	100.5	100.2	100.5
Nominal labour unit cost (2010=100)	99.9	100.0	100.7	103.7	106.4	108.7	110.2
Real effective exchange rate*	101.0	97.6	98.0	96.3	98.3	99.9	n.a.
Banking sector							
Banking sector size (assets, %GDP)	413.0	387.2	351.8	376.9	350.6	336.8	378.2
Bank loans % of deposits	139.7	145.6	148.8	148.8	148.8	148.8	165.6
External vulnerability							
Current account, % GDP	2.6	2.9	1.6	1.5	2.0	1.9	2.6
Gross external debt, % GDP	203.9	204.8	199.9	196.0	184.9	184.9	n.a
Net external debt, % GDP	20.7	28.2	24.1	25.8	20.2	20.1	19.5
International investment position, % GDP	-5.1	-5.2	-1.9	-3.1	1.3	2.2	3.2

*Based on CPI against 42 trading partners

Scope Ratings AG

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Rüsterstraße 1
D-60325 Frankfurt

Phone +49 69 97944 754

Paris

21, Boulevard Haussmann
F-75009 Paris

Phone +33 1 53 43 29 89

London

Suite 407
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

info@scoperatings.com
www.scoperatings.com

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