Republic of Austria
Rating Report

SCOPE **AAA** NEGATIVE 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
- Still-high dependence on Russian gas imports

Rating rationale:

Wealthy, resilient, diversified economy: The Republic of Austria's (Austria) 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 in 2023, in the context of weak real income dynamics 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 and energy shocks well. Capital and liquidity buffers are robust, asset quality continues its improving 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, including Russia, 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; ii) sensitivity to geopolitical event risk given the high reliance on Russian energy imports and iii) 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 – Weight	Quantitative – Indicative rating	Reserve currency – Notches	Qualitative* – Notches	Final rating
Domestic Economic Risk		35%	aa	EUR [+1]	+1/3	AAA
Public Finance Risk		20%	aa-		+1/3	
External Economic Risk		10%	bbb		+2/3	
Financial Stability Risk		10%	aaa		+1/3	
ESG Risk	Environmental Factors	5%	aa-		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 Negative Outlook reflects our view that risks to the ratings are tilted to the downside.

Positive rating-change drivers

- Growth prospects strengthen substantially
- Improvement in fiscal outlook

Negative rating-change drivers

- Growth prospects continue to weaken
- Fiscal outlook worsens materially
- Risks re-emerge in the banking sector

Ratings and Outlook

Foreign currency

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

Local currency

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

Lead Analyst

Julian Zimmermann
+49 69 6677389-89
j.zimmermann@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

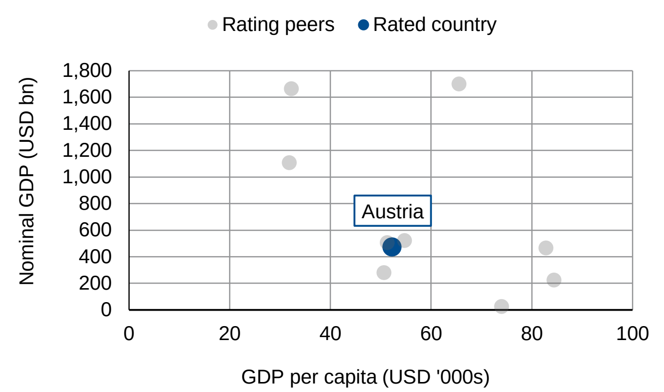
Domestic economic risk

- **Growth outlook:** The Austrian economy grew robustly in the first half of 2022, driven by a post-pandemic rebound and a recovery in tourism. Growth momentum decelerated in the second half of the year, as real incomes declined due to high price pressures, in turn weighing on private demand. Quarterly growth turned negative in the final quarter of 2022 (-0.1% QoQ), before improving slightly to 0.1% in Q1 2023. We expect growth to remain subdued over the medium term, in a context of persistent inflation, heightened uncertainty and tightening funding conditions. It should then pick up next year, as decelerating price dynamics and improving real wage growth allow for a recovery in private consumption. After reaching 5.0% in 2022, we expect growth to decelerate to 0.2% this year, before picking up to 1.5% in 2024 and 1.7% in 2025, and returning to an estimated potential of 1.5% in subsequent years.
- **Inflation and monetary policy:** After peaking at 11.2% YoY in January 2023, headline consumer price index inflation has been gradually declining in recent months, down to 8.0% in June (flash estimate), thanks to declining energy and food commodity prices and favourable base effects. It however remained elevated and above the euro area average in recent months, with the disinflation process having started later than for most peers. We expect headline inflation to continue declining over the medium term, though the decrease in core inflation (8.6% YoY in May) should be more gradual, in line with expected, persistent service-sector inflation resulting from robust wage increases and the recovery of tourism. The deceleration in price dynamics will be supported by the tightening of the ECB's policy stance, following rate hikes totalling 375bps since July 2022 and an acceleration in the pace of quantitative tightening.
- **Labour market:** The unemployment rate is low, at 4.6% as of May 2023, despite the economic slowdown. While employment growth has slowed in recent months, the employment and job vacancy rates (respectively at 74% and 4.7% as of Q1 2023) stand at historically elevated levels, signalling resilient labour market dynamics and persistent labour market tightness. This has contributed to robust wage increases, which have however been outpaced by consumer prices, resulting in declining real wages. Acute recruitment difficulties and skills shortages constitute material challenges to the long-term growth outlook.

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

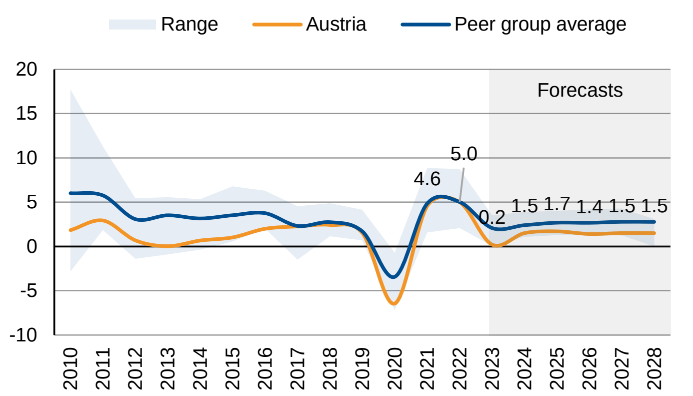
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Growth potential of the economy	Strong	+1/3	Robust growth potential compared to peers
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank
	Macro-economic stability and sustainability	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

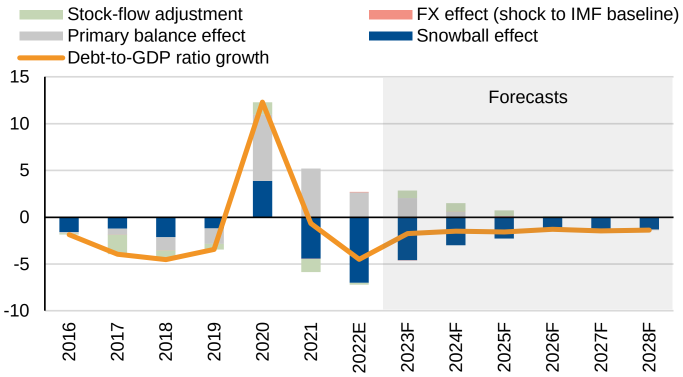
Public finances risk

- **Fiscal outlook:** The Austrian government's fiscal track record is robust, having achieved average primary fiscal surpluses of close to 1% over 2015-19. After dipping to 8.0% of GDP in 2020, the general government (GG) fiscal deficit had improved to 3.2% of GDP by 2022, thanks to a rebound in economic activity and the rise in revenues from income-based and value added taxes. The continued government support measures aimed at cushioning households and businesses from inflation, including an electricity price brake, abolishment of tax bracket creep from 2023 and social benefits payments (totalling around EUR 21bn, or 4.5% of GDP, over 2022-23 according to WIFO) as well as an increase in military spending will have a lasting impact on the federal government budget and slow the fiscal consolidation process. We expect the GG fiscal deficit to moderate to 3.0% of GDP in 2023, before stabilising at around 1.2% of GDP on average over 2024-28.
- **Debt trajectory:** The GG debt-to-GDP ratio declined by 4pp in 2022 to 78.4%, on the back of robust nominal growth. It is expected to remain on a gradual declining trend over the coming years, edging below its pre-pandemic level of 70.6% by 2028, amid declining primary deficits and despite a moderate uptick in interest payments. Adverse demographic trends represent a significant long-term challenge for debt sustainability and the country's long-term growth outlook. The European Commission expects total cost of ageing to rise from 26.7% of GDP in 2019 to 29.1% in 2030 – the third highest level in the EU.
- **Market access:** The Austrian federal government benefits from a favourable debt structure, with a high average maturity (11.7 years as of May 2023) and no foreign-currency exposure. Interest expenditure is moderate, at an expected 1.1% of GDP in 2023. After rising sharply since H2 2021, amid high inflation and tightening monetary policy, funding costs have stabilised in recent months, with the secondary-market yield on 10-year government bonds averaging at 3% since the beginning of the year. Federal government gross bond issuance is expected at around EUR 45bn in 2023 (around 9% of GDP), stable from the previous year.

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

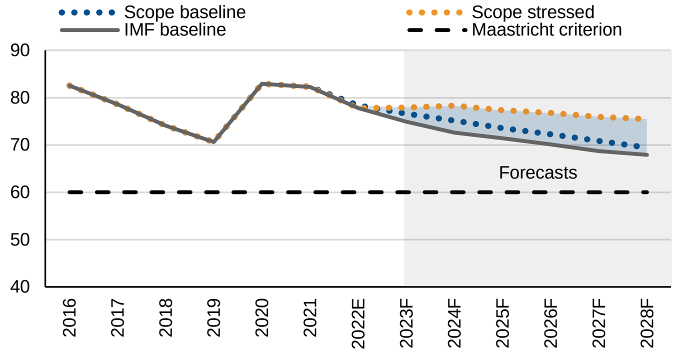
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Sizeable budgetary response to Covid-19 and energy crises; pre-crisis budget surpluses; gradual medium-term fiscal consolidation
	Debt sustainability	Neutral	0	Elevated public debt level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

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

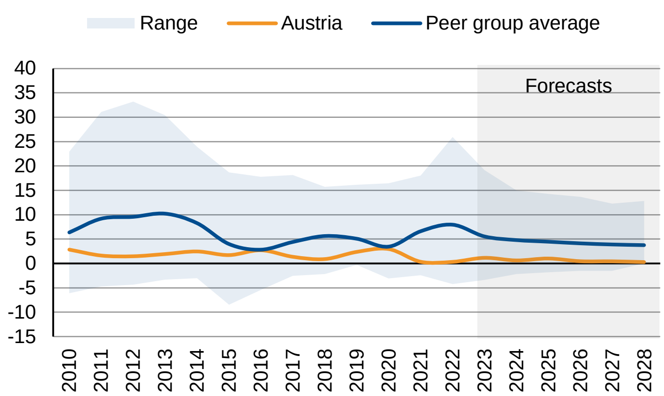
External economic risk

- **Current account:** Following a period of comfortable, steady surpluses averaging 1.8% of GDP over 2015-19, the current account balance surplus increased to 3.0% of GDP in 2020, before weakening to around 0.5% of GDP on average over 2021-22, amid lower international tourism receipts and a small deficit in the goods trade balance in a context of strong domestic demand, soaring nominal energy imports and global supply chain disruptions. After edging up to 0.7% of GDP in 2022, we expect the current account surplus to remain on an improving trend over the coming years, thanks to the continued rebound in tourism exports and a moderation in global energy prices. At the same time, 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 14.6% of GDP in Q4 2022. The level of external debt is moderate and stable at 149% of GDP. Its composition is favourable, being primarily comprised of public sector liabilities (46% of total) and under a third of liabilities due within one year. The share of banking sector liabilities in total external debt has declined steadily over recent years, from 39% to 28% of the total over 2013-22.
- **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*

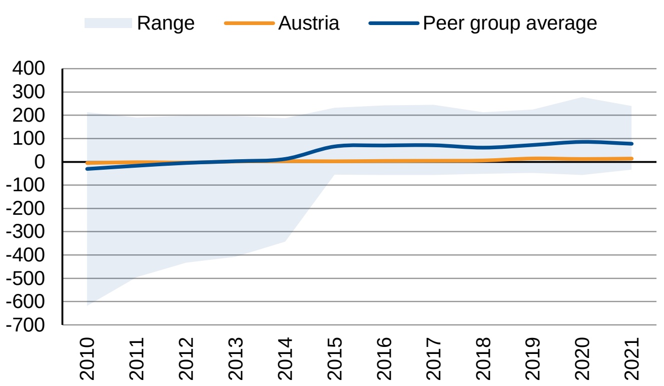
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Current account resilience	Strong	+1/3	Diversified, competitive export sector; recurrent current account surpluses
	External debt structure	Strong	+1/3	Low gross and short-term external debt
	Resilience to short-term 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

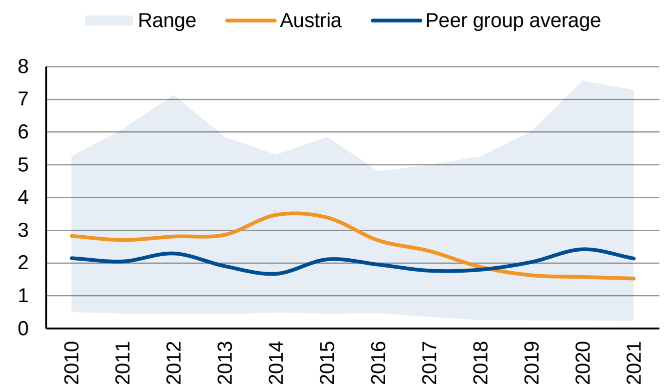
Financial stability risk

- **Banking sector:** The resilience of the Austrian banking sector is underpinned by sound capitalisation and profitability metrics, as reflected in aggregate Tier-1 capital and return on equity ratios of 16.7% and 12.8% respectively as of Q4 2022. The NPL ratio stood at 1.8% as of Q4 2022, down from 2.3% at end-2019. Higher interest rates are supporting interest margins, in particular thanks to the elevated stock of variable rate loans, although they are also weighing on credit demand. Adverse real disposable income dynamics and decelerating economic activity could weigh on asset quality, though this should be in part offset by government support measures. The significant exposure of Austrian banks to CESEE countries, including Russia, adds a degree of uncertainty to the outlook, although the comfortable capitalisation, liquidity and funding levels of subsidiaries constitute buffers against a potential increase in credit risk.
- **Private debt:** Private sector debt is moderate, at 121.6% of GDP as of Q4 2022, well below the euro area aggregate level and most highly rated peers. Household credit growth has sharply decelerated in recent months, primarily driven by weaker mortgage lending growth, in a context of rising interest rates and tightening lending standards. A large share of variable-rate loans, representing half of new euro-denominated loans in 2022 for residential real estate loans and 86% for corporate loans on average over the last ten years, represents a significant risk exposure in a rising interest rate environment. Lending to non-financial corporates has moderated as well, all the while remaining above pre-pandemic averages.
- **Financial imbalances:** After a protracted period of strong growth, price pressures on residential real estate have eased in recent months, increasing by 1.1% YoY in Q1 2023, down from 5.2% in the previous quarter, and below pre-pandemic averages. Residential construction activity is expected to slow down over the medium-term, in view of high building costs and rising interest rates. To address risks associated with elevated housing prices, supervisory authorities took preventive action to foster the resilience of the banking system against systemic shocks. These measures include legally binding standards on maximum maturities, and loan-to-value and debt service-to-income ratios.

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

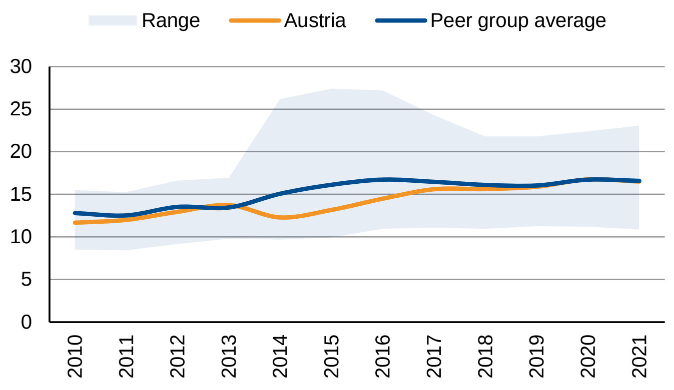
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Adequate banking-system capitalisation, comfortable liquidity, low NPLs, significantly lowered exposure to foreign currency-denominated loans in CESEE countries
	Banking sector oversight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

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

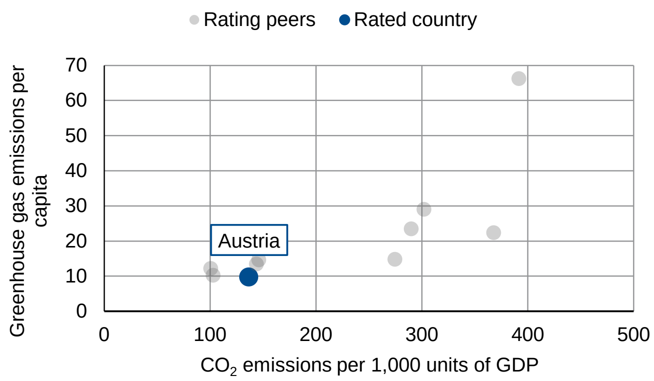
ESG risk

- **Environment:** Despite a high share of renewables in its total energy mix (gross inland consumption) at 34% as of 2021, Austria remains reliant on fossil fuels, particularly imported oil (35%) and natural gas (23%). Supply risks related to the country's high dependence on Russian energy imports, which covered 79% of its natural gas imports before the outbreak of the war in Ukraine, were reduced to 57% on average in 2022 and 64% in April 2023, but remain above levels for peer sovereigns that have (almost) fully reduced Russian energy import dependence. The Austrian government is currently not on track to meet its goal of climate neutrality by 2040 but has taken a number of measures towards achieving its goal, 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. Total tourism contributes about 7%-8% to annual GDP, with around half relating to the winter season.
- **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 (17.5% versus the EU average of 20.7%). Despite strong performance overall, the Austrian labour market is characterised by significant employment gaps for certain groups. For instance, participation rates for women and elderly workers compare poorly to other highly rated peers. 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*

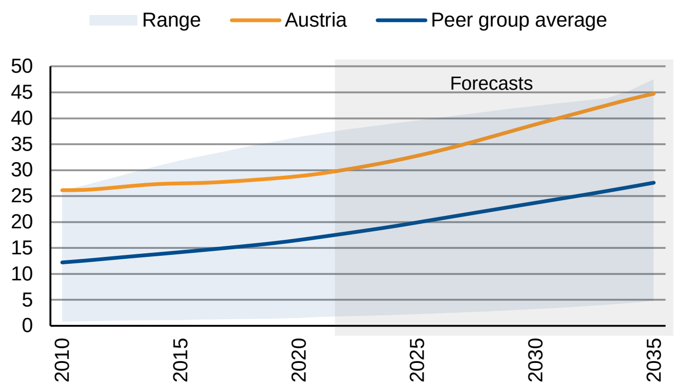
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Environmental factors	Neutral	0	A high share of renewables now and ambitious decarbonisation targets by 2030; however, a significant gap remains in a 'no policy change' scenario
	Social factors	Neutral	0	Strong social 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, $mtCO_2e$



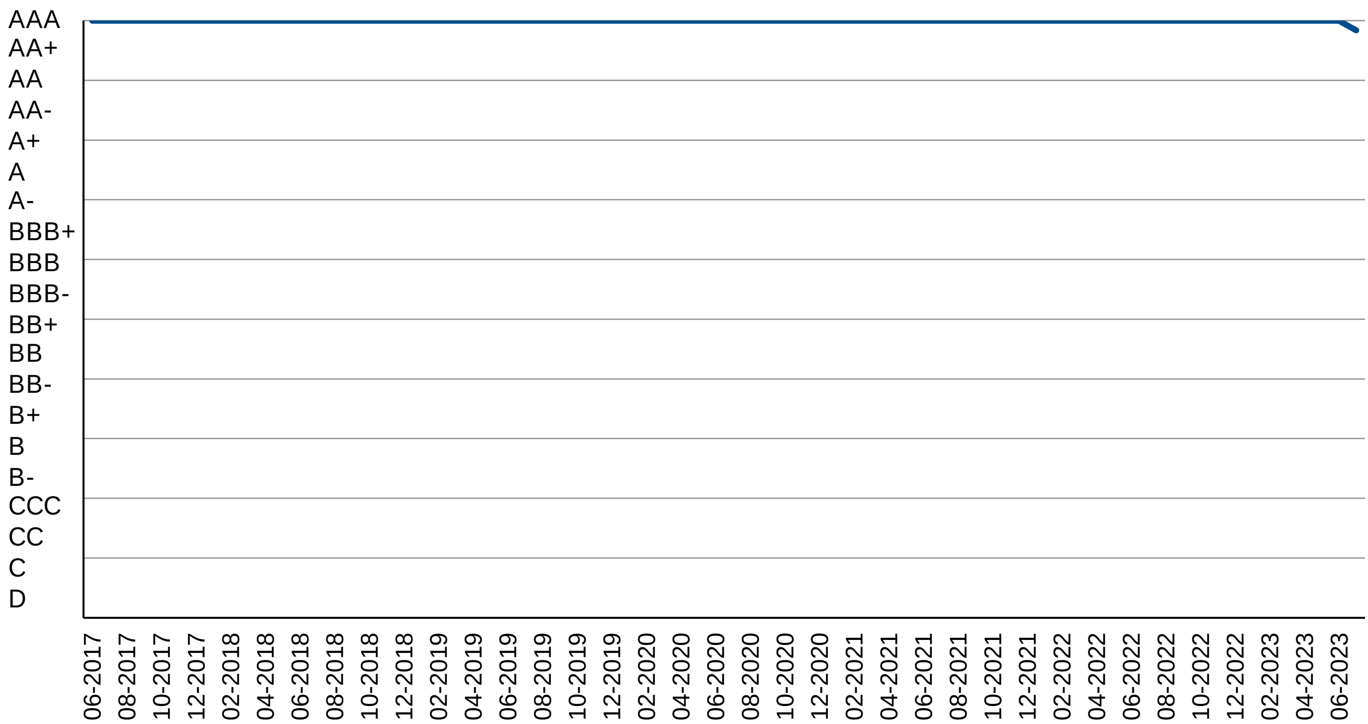
Source: European Commission, Scope Ratings

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*
Finland

*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	2018	2019	2020	2021	2022
Domestic Economic	GDP per capita, USD '000s	IMF	51.2	50.2	48.9	53.5	52.3
	Nominal GDP, USD bn	IMF	455.2	444.7	434.9	480.7	471.7
	Real growth, %	IMF	2.4	1.5	-6.5	4.6	5.0
	CPI inflation, %	IMF	2.1	1.5	1.4	2.8	8.6
	Unemployment rate, %	WB	4.9	4.5	5.4	6.2	-
Public Finance	Public debt, % of GDP	IMF	74.1	70.6	82.9	82.3	77.8
	Net interest payment, % of revenue	IMF	2.5	2.1	1.9	1.5	1.3
	Primary balance, % of GDP	IMF	1.4	1.6	-7.1	-5.2	-2.7
External Economic	Current-account balance, % of GDP	IMF	0.9	2.4	3.0	0.4	0.3
	Total reserves, months of imports	WB	1.0	1.1	1.5	1.4	-
	NIIP, % of GDP	IMF	5.8	14.5	12.3	14.1	-
Financial Stability	NPL ratio, % of total loans	IMF	1.9	1.6	1.6	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	15.3	15.7	15.4	16.7	-
	Credit to the private sector, % of GDP	WB	84.4	85.9	92.8	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	139.3	141.1	136.9	136.6	-
	Income share of bottom 50%, %	WID	22.2	22.0	22.0	22.0	-
	Labour-force participation rate, %	WB	76.6	76.9	-	-	-
	Old-age dependency ratio, %	UN	28.1	28.4	28.8	29.4	30.1
	Composite governance indicators*	WB	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 3 July 2023	15bps

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 8295 8254

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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