Creditreform Sovereign Rating

Creditreform Rating

| Rating Object | Rating Information | |
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| REPUBLIC OF AUSTRIA | Assigned Ratings/Outlook: **AA+ /stable** | Type: Monitoring, unsolicited with participation |
| Long-term sovereign rating<br>Foreign currency senior unsecured long-term debt<br>Local currency senior unsecured long-term debt | Initial Rating Publication Date:<br>Rating Renewal:<br>Rating Methodologies: | 29-07-2016<br>16-04-2021<br>"Sovereign Ratings"<br>"Rating Criteria and Definitions" |

## Rating Action

Neuss, 16 April 2021

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

## Key Rating Drivers

1. Short-term prospects are dim amid a third infection wave and a likely further contraction in Q1, leading us to assume a rather moderate recovery this year, followed by a stronger pick-up in real GDP in 2022; while we expect the pandemic-related drag on medium-term growth to be temporary, the outlook for the pivotal tourism industry remains challenging
2. Despite the substantial fallout entailed by the Covid-19 pandemic, long-standing key strengths such as Austria's prosperous, highly diversified, and competitive economy, as well as flexible labor markets and sizeable buffers in NFC and household balance sheets, remain in place and should lay the foundation for the economic recovery
3. Very strong institutional set-up, also benefiting from substantial advantages from EU/EMU membership; we deem policy-making as sound and responsive to structural challenges, evidenced not only by the crisis response but also authorities' efforts pertaining to greening the economy and fostering inclusive growth
4. Collapsing economic growth and a high primary deficit saw the public debt ratio soar to elevated levels and will, together with a prospective further rise this year, result in a reversing debt trend; while it should take some time to bring debt-to-GDP down to pre-pandemic levels, a high and increasing debt affordability, a favorable debt profile owing to prudent debt management, and a proven track record of fiscal prudence limit fiscal risks, also attributable to elevated public guarantees and demographics over the longer term
5. Covid-19 provided a significant shock to Austria's external trade, in particular tourism, but we see only remote external vulnerabilities; strong competitiveness and diversified exports underpin persistent current account surpluses, which should widen moderately going forward, thus further buttressing Austria's positive net international investment position

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## Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

*In our view, the Republic of Austria's very high level of creditworthiness continues to be underpinned by a strong macroeconomic performance profile. Although Austria experienced its worst recession in the post-world war II era last year, denting its otherwise stable though moderate medium-term growth, the Austrian economy is characterized by strong macroeconomic fundamentals, namely a very high level of wealth and a well-diversified and highly competitive economy. Owing to the government's swift crisis response, the pandemic's impact on Austria's well-performing labor market was broadly contained, while private sector indebtedness was kept comparatively low. These factors are likely to cushion adverse effects emanating from rising unemployment and a likely surge of insolvencies from low levels as Covid-19 measures subside. The Austrian tourism industry weathered the perfect storm created by the pandemic relatively well as compared to other European prime tourist destinations. Still, this key industry was heavily hit and prospects remain challenging.*

The Covid-19 pandemic has sent grave economic disruptions through the Austrian economy, leading to an ad hoc-decline in international trade, in particular collapsing foreign tourism, and temporarily bringing activity in manufacturing and large parts of the services sector to a standstill. While Austria had entered the corona crisis on a relatively strong footing, with real GDP having grown by 1.9% on average in 2015-19 (2019: 1.4%), its medium-term growth path was severely dented as a consequence of the pandemic and of indispensable health measures to safeguard the health of its population.

Austria's quarterly real GDP profile mirrors the epidemiological development and related measures to contain the pandemic. Following the first lockdown, which was imposed on 16 March 2020 and was gradually lifted from 14 April, total output plunged by 10.7% q-o-q, representing the steepest contraction in the post-World War II period. Economic activity rebounded sharply by 11.8% in the third quarter, owing to the lifting of most of the restrictions to public life and to government support measures. Likewise, recovering global merchandise trade and the reopening of borders supported output expansion. Nevertheless, the recovery was interrupted by ballooning infection cases amidst the second wave of Covid-19, which surpassed those seen in the first wave, thereby prompting a 'lockdown light' from 3 November, culminating in the second strict lockdown from 17 November to 6 December which was partially lifted between 7 and 25 December. Despite not being as strict as the first lockdown, and the adverse effects less severe than in Q2, real GDP declined by 2.7% in Q4.

Overall, GDP contracted by 6.6% in 2020 – in line with the euro area (EA) as a whole (-6.6%), but by far worse than in the wake of the Global Financial Crisis back in 2009 (-3.8%), and the deepest recession since WW2. The fall in total output was mainly attributable to the dramatic decline in household spending. On the back of the pandemic and related containment measures, decreasing disposable income, and the very high uncertainty, private consumption dropped by 9.6%, thus contributing 4.9 p.p. to the contraction in real GDP. After several years of strong growth (2015-19 average: 3.7%), gross fixed capital formation decreased as well, since many investments have been put on hold or cancelled altogether. Still, at -4.9%, investment activity held up

[1] This rating update takes into account information available until 13 April 2021.

relatively well in view of the severity of the recession, due to a comparatively moderate decline of construction investment (-3.3%) and the increase in intellectual property investment (+1.7%).

Trade was also hit heavily, with both exports (2020: -10.4%) and imports (-10.2%) suffering from disrupted global supply chains and production, implying a negative growth contribution of 0.5 p.p. In this vein, we have to point out that the incipient recovery in Austrian exports starting from Q3-20 was largely driven by goods exports which stood only 1.7% below the pre-pandemic level in Q4-20. By contrast, services exports still fell significantly short of the level seen at the end of 2019 (-21.9%), as the performance of services exports critically hinges on the pivotal tourism industry that contributes approx. 7.3% to the economy's total value added (2019, incl. indirect value added).

Whilst the number of overnight stays dropped by 35.9% in 2020 and tourist arrivals were almost cut in half (-45.8%), in has to be borne in mind that the declines could have been markedly higher. As compared to other prime tourist destinations, Austria fared reasonably well in Q3 (also benefiting from its geographical position in Europe), and business trips have not been prohibited during the subsequent lockdowns.

That said, the third lockdown, from 26 December to 7 February, should weigh heavily on Austria's tourism industry, adversely affecting the important winter tourism season. According to Statistik Austria data, the tourism industry suffered almost a total loss with a view of the winter season 20/21, as overnight stays declined by 95.1% y-o-y between Nov-20 and Feb-21, boding ill for Austria's real GDP growth prospects at the start of the year.

Authorities ended the strict lockdown on 8 February, and the Austrian economy has found itself in another partial lockdown phase since then. Concomitant with the gradual easing of confinement measures, economic activity has started to recover again, as illustrated by the weekly GDP indicator compiled by the Austrian central bank (OeNB). However, the GDP gap still posted at 3.5% in week 13 (29 March – 4 April), mainly due to private consumption and tourism exports. We thus expect that Austria has slid into another technical recession, assuming another contraction in this year's first quarter. To be sure, the adverse impact of the restrictive measures in Q1 should be less severe than during the previous lockdown phases, as corporates and household have increasingly adapted to confinement. Also, merchandise exports and investment activity is significantly less affected.

We expect the economy to return to growth from Q2-21, and the recovery to take hold in the second half of the year alongside a vaccine-driven normalization. Until the vaccines are widely available, authorities may be forced to impose local lockdowns going forward. While we do not factor in a fourth strict national lockdown at the current juncture, a significant tightening of restrictive health policy measures cannot be ruled out. In the eastern part of Austria (Vienna, Lower Austria) a more restrictive stance has been in place since 1 April, prospectively until 2 May.

Infection cases have been increasing since entering the partial lockdown phase: The 14-day cumulative infection rate rose to 491.5 in week 13 (week 6: 212.4). At the same time, the Austrian health system appears to be well placed to cope with the pandemic by international comparison, and authorities have administered a rigorous testing scheme. As underscored by recent ECDC data, Austria has one of the highest testing rates in Europe (3rd in EU-27), but a very low positivity rate (3rd in EU-27). As of 13 April 2021, roughly 20.7% of the population have received a

first dose, and 8.6% of population was fully vaccinated, both relatively high by European standards.

In any event, we deem progress in the vaccination campaign as instrumental for the Austrian economy to enter a firm growth trajectory, allowing restrictions to public life to be lifted. Against the backdrop of the weak start into the year and the gradual unwinding of confinement measures in tandem with a growing vaccine coverage through the remainder of the year, we expect a rather moderate recovery in 2021, with real GDP growth coming in at 2.2%, before accelerating to 4.9% in 2022. We have to emphasize that any forecast remains subject to abnormal high uncertainty, essentially in view of new strains of the virus, and is ultimately dependent on the epidemiological situation and vaccination progress.

The recovery will be driven by domestic demand, essentially through private consumption. As in other economies, household spending should increase due to the gradual unwinding of confinement measures and the release of pent-up demand, although uncertainties remain concerning to what extent households will choose to run down their accumulated savings. Judging by latest Statistik Austria data, the savings ratio leaped from 8.2% in 2019 to 14.5% in 2020, whilst OeNB reckons that around 80% of savings accumulated during the crisis were forced savings, together pointing towards a sizable pool of funds which could be spent. Consumption should also be facilitated by improving consumer sentiment - which in March reached its highest level since the outbreak of the crisis - and government measures providing relief for private households (namely the income tax reform, which came into effect as of 1 January 2021), as well as the recent pension adjustment 2021.

We expect to see positive employment growth, whereas unemployment should begin to recede from next year on (see below). Thus, labor market developments should be conducive to consumption growth, also buttressed by government measures, most notably via the furlough scheme (Corona-Kurzarbeit) which has been extended to 30 June 2021. According to Ministry of Labor data (BMA), furlough applications stood at 486,869 at the end of March 2021, up from 82,139 in October, but well below the peak of roughly 1.31mn seen last May.

Against the backdrop of gradually dissipating uncertainty, corporate investment activity is likely to recover, supported by persistently low funding costs and by increasing external demand on the back of the faster global trade. Moreover, government measures to incentivize investment should aid investment growth, e.g. envisaged plans for investment subsidies up to EUR 2bn by 2024 and the possibility of diminishing balance depreciation. As illustrated by soft data, economic sentiment among Austrian economic agents seems rather upbeat, with March's data already surpassing the pre-pandemic level of Feb-20, and new orders (Q1-21) in the industrial sector equally hinting at brighter prospects ahead (both Eurostat). We also expect gross fixed capital formation to benefit from higher public investment, as the government plans to ramp up green investments as well as spending in digitalization, defense, and education. In this vein, Austria should benefit from Next Generation EU (NGEU). For the period 2021-26, Austria should receive roughly EUR 2.995bn in terms of grants (0.8% of 2019 GDP). We think that EU funds may provide some boost for investment from the second half of 2021 if they are quickly absorbed.

The picture is somewhat mixed regarding foreign trade going forward. As to services exports, prospects remain challenging, as we expect to see only a partial recovery of Austria's key tourism industry this year. With the rollout of vaccines picking up, so should tourism – significantly raising services exports in H2-21, contingent on vaccination progress in the countries of origin so that constraints on the demand-side will be lifted. Goods exports are likely to continue their

recovery begun in mid-2020, in line with the prospective recovery in all of Austria's main trading partners. In this context, Austrian exporters should benefit from the dynamic recovery in the United States, which envisaged a massive fiscal impulse under the new Biden administration, and was the second most important export partner in 2020 (share 6.3%). Growth in exports should slightly outpace equally vivid import growth, leading to a moderately positive growth contribution of net trade.

Thanks to a swift and extensive policy response to safeguard jobs, limit household income losses, and maintain liquidity in the corporate sector, persistent output damages in the overall economy over the medium to longer term should be averted, although some more tangible scarring effects in the most heavily hit sectors (consumer-facing services, HoReCa) cannot be entirely ruled out. Authorities implemented, inter alia, a new short-time work scheme building on the already existing labor market instrument (Corona-Kurzarbeit), fixed cost subsidies for businesses, a hardship fund for self-employed workers, child bonuses, tax deferrals, and loan moratoria. Furthermore, there are sizable loan guarantees financed by the Corona Help Fund. Whilst the huge implied costs have important ramifications for the fiscal side (see below), we view the decisive government action as key to laying the foundation for a quick recovery in the aftermath of the corona crisis.

At this stage, bankruptcies are likely to pick up from the second half of this year, as the short-time arrangement, the deferral of taxes and social contributions, as well as the suspension of the obligation to file for insolvency have all been prolonged to the end of June 2021. We thus believe that the number of insolvencies will inevitably rise at some point in time as the support measures will be scaled back, but from low levels. Due to the exceptional support measures, the number of insolvencies has plummeted from a low 5,235 to 3,063 in 2019-20 (-41.5%, 2009: 7,076; Creditreform data). Nevertheless, non-financial corporations' (NFCs) debt sustainability should be monitored going forward, although these appear to have some room for maneuver, owing to significant deleveraging effort in the run-up to the corona crisis. NFC debt jumped to 81.0% of GDP in Q3-20 (Q3-19: 74.4%), its highest level since Q3-12, but is rather moderate from a European angle. At the same time, net debt-to-income should have risen considerably last year, while being broadly on par with the euro area average in 2019 (287%, EA: 283%).

The Austrian labor market certainly has not been left unscathed by the health and economic crisis, but remains robust, supporting our view of labor market conditions being a credit strength of Austria. At the onset of the pandemic, quarterly LSF-adjusted unemployment posted at its lowest level since 2011 (Q4-19: 4.4%). After leaping from 4.5% to 6.0% between February and June 2020, it has stabilized since then, totaling 5.7% at the beginning of 2021 – well below the euro area average (Feb-21: 8.3%). In addition, labor participation has already recovered, reaching a historical high in Q3-20 (77.1%, 15-64yrs; EA: 73.2%).

We take the view that other credit positive fundamentals continue to apply as well, despite the grave recession in 2020 and the above-mentioned uncertainties regarding the near-term outlook. Thus, Austria remains among the wealthiest member states in the EU, with GDP per capita amounting to USD 55,218 in 2020 (IMF Data, PPP terms), well above other AA-peers in our rating universe, and even standing close to AAA-rated Germany (USD 54,076) and the Netherlands (USD 57,534). What is more, income dispersion remains comparatively low, as the Gini coefficient of equalized disposable income amounted to 27.5 (third lowest in EU-27, 2019).

High per capita incomes are partly driven by Austria's high degree of productivity and competitiveness. Latest available Eurostat data for 2019 underlines that its economy is highly productive, as nominal labor productivity per person stood 15.4% above the EU-27 average, one of the highest readings in Europe. There have been no updates on two of our preferred metrics on competitiveness last year, meaning that Austria ranks 27th rank out of 190 economies evaluated by the World Bank with a view to its business environment, and occupies rank 21 (out of 141 economies) in the World Economic Forum's (WEF) global competitiveness index –in line with other AA-rated sovereigns. Meanwhile, the WEF paints a benign picture in its assessment of the country's transformation readiness. Based on eleven pillars, Austria performs rather well in seven of those eleven pillars. Accordingly, its global export market share has followed an upward trajectory since reaching its trough in 2012, now equating to 1.01% in 2019, mainly driven by services exports.

Furthermore, the Austrian economy remains characterized by a high level of diversification. Our diversification ratio (services-to-industry) stood at 2.4 in Q4-20 (EA: 2.9), with an industry share (manufacturing and construction) of 21.5% of total gross value added (EA: 19.7%). By the same token, Austria's export base remains diversified across regions and products, as illustrated by a 6th place in UNCTAD's product concentration index for instance.

## Institutional Structure

*The sovereign´s very strong institutional conditions remain a key credit strength. While we see its institutional structure as reinforced by sound fiscal and financial policy frameworks, the sovereign continues to benefit significantly from membership in multi- and supranational structures, in particular the European Union and the European Monetary Union. As regards the latter, Austria draws extensive benefits from the euro as a reserve currency, and the European Central Bank's (ECB) highly credible, accountable, and at present very accommodative monetary policy. Austrian HICP inflation, wages, and MFI interest rates have been closely aligned with the euro area over the last decade.*

Our assessment is mainly backed by the World Bank's Worldwide Governance Indicators (WGI), which are among our preferred indicators in terms of evaluating the state and evolution of a sovereign's institutional structure. Indeed, the latest WGI vintage continues to attest to the sovereign's very high institutional strength, as the strong scores have remained broadly unchanged. Austria thus compares favorably to the median of our AA-rated universe, and outperforms the respective euro area (EA) averages by a wide margin.

Judging by the WGI government effectiveness, the sovereign has improved with a view to the perceived quality of public services and policy formulation/implementation, which we deem particularly important, climbing to a relative rank of 18 out of 209 economies, up from rank 20 a year before (EA median: rank 35). Moreover, Austria's performance remains strong concerning the WGI voice and accountability (rank 14/209), which serves as a proxy for freedom of expression, association as well as media (EA: 26).

The quality of the judicial system, as well as the quality of contract enforcement and property rights, remain persistently very high, as Austria ranks 7th out of 209 economies (EA: rank 33) and has constantly stood among the top ten countries since the inception of the WGI Rule of Law. This finding is confirmed by the European Commission's Rule of Law Report (September 2020), further noting that the government nevertheless remains dedicated to further improving

standards and procedures, e.g. the alignment of recruitment standards for ordinary and administrative courts, or the enhancement of the already advanced digitalization of the judicial system. In the same vein, the government further increased resources for the justice system via the budget 2021 to ensure an efficient judiciary.

While moving fairly high at rank 20 when it comes to the perceived extent to which public power is exercised for private gain (EA: rank 42), the compliance report recently published by GRECO (4th evaluation round) hints at some room for improvement, concluding that the overall level of compliance with its recommendations remains rather unsatisfactory. Essentially, progress should be achieved with regard to gaps in the transparency of the legislative process, the establishment of a code of conduct of MPs, and the selection of judges and prosecutors. Having said that, we note that the Austrian Council of Ministers presented a new code of conduct for public officials, geared towards the combat of corruption, in November 2020. Furthermore, the government agreed on the introduction of an independent federal prosecutor in February 2021.

More generally, we have to reiterate that we view the government's policy-making as predictable and responsive to structural challenges at hand. To be sure, the authorities had to deal with the consequences of the Covid-19 pandemic and responded, in our view, timely and adequately by implementing the necessary measures. Still, we have observed reform progress since our last review. In this context, two reforms regarding the insolvency law and attachment law (Exekutionsrecht) shall enter into force as of July 2021. Whilst changes to the attachment law are geared towards a more efficient enforcement of claims against companies, the proposed changes in insolvency law aim at enabling debtors to restructure effectively at an early stage to limit unnecessary liquidation of viable enterprises, ultimately relating to the implementation of the EU directive on restructuring and insolvency.

The government has decided on a staggered pension adjustment and increasing smaller and medium-sized pensions as of 2021, thereby permanently increasing pension payments. What is more, policy-makers adopted a reform which introduces the so-called "early starter bonus" (Frühstarterbonus), which will replace the provisions regarding the deduction-free early retirement (Hacklerpension). From 2022, an early retirement at the age of 62 shall only be possible with a deduction of 4.2% p.a. Instead, it is planned that early retirees will receive additional pension payments for every month they have worked before the age of 20.

We note that the government envisaged a raft of economic policy measures in its budget 2021 which aim at fostering Austria's underlying growth and enhancing the economy's competitiveness. To tackle structural labor market challenges, authorities established the so-called Corona Labor Foundation (Corona-Arbeitsstiftung), geared towards providing funds for active labor market policies for re-integration of unemployed workers and re-/upskilling. In addition, public investment in the fields of education, R&D, public infrastructure, digitalization, and greening the economy, shall be significantly ramped up.

As regards greening the economy, Austria has set the target to reach net carbon neutrality by 2040, as agreed in National energy and climate plan (NEPC). It is noteworthy that the Council of Ministers approved a new law for the expansion of renewable energies (EAG, Erneuerbaren Ausbau Gesetz) on 17 March 2021, which is envisaged to come into effect 1 July 2021. The stipulated aim is to increase the share of renewable electricity sources to 100% by 2030. More wind power and photovoltaics in particular are expected to provide the necessary impetus. Hydroelectric power, which currently accounts for 60 percent of the total, is also to be further strengthened.

We have to highlight that Austria's ambition to become a leader in sustainability is underscored by the fact that the country already performs well in terms of a responsible, i.e. sustainable use of energy sources. Austria displays the highest share of renewable energy sources used for electricity in the EU in (2019: 75.1%), and the fifth highest share of energy from renewable sources (2019: 33.6%). Austria ranks 5th in the European Commission's Eco-innovation Scoreboard. At the same time, GHG emissions per capita amounted to a rather mediocre 9.2 tons p.c. (EU-27 average: 8.7).

## Fiscal Sustainability

*The corona crisis put an end to the favorable debt trend seen before the outbreak of the pandemic. Austria's debt-to-GDP ratio will presumably continue to rise this year before resuming a downward trend from next year, but we expect that it will take several years until pre-pandemic levels are reached. We believe that elevated public debt and medium- to long-term fiscal sustainability risks stemming from increased public guarantees and demographics are tempered by high debt affordability and sound debt management. Based on past experience, we are confident that that fiscal space will be rebuilt, as the government has demonstrated its ability to consolidate public finances multiple times over the last two decades.*

Prior to the outbreak of the Covid-19 pandemic, Austria had exhibited a remarkable and persistent improvement in its public finances, most visibly in the reduction of its elevated public debt ratio from 84.9% of GDP to 70.5% in 2015-19, the lowest level since the Global Financial Crisis (2008). What is more, the sovereign could well have achieved a third headline surplus in a row, after 0.2% and 0.6% of GDP in 2018 and 2019 respectively.

The indispensable government response to the grave health and economic crisis mitigated a more protracted and severe downturn, preventing hefty job losses and a higher number of lives lost. At the same time, the fiscal actions resulted in tremendous costs which translated into a sharp and rapid deterioration in Austria's public finances. Drawing on preliminary Statistik Austria data, last year's headline general government deficit came in at 8.9% of GDP, the largest deficit on record.

General government revenues decreased by 5.8% in 2020, mainly due to a sharp slump in taxes on income and wealth (-11.3%) and taxes on production and imports (-6.4%). On the other hand, total expenditure jumped by 12.6% to a whopping 57.9% of GDP last year (2019: 48.6% of GDP), largely driven by brisk increases in social payments (+7.5%) and subsidies (+240.7%). While collapsing economic activity had severe repercussions on its revenue intake, the exceptionally large fiscal support raised the government deficit materially.

The adopted fiscal envelope intended for Covid-19 measures and that has been amended several times since March 2020 sums up to a total volume of EUR 49.6bn or 13.2% of GDP. Main items are inter alia the short-time work scheme (3.6% of GDP), fixed cost grants for corporates (3.2% of GDP) and tax relief measures (2.7% of GDP). Also, the government implemented a raft of measures geared towards the health sector, social security, self-employed and micro entities, non-profit organizations, as well as providing aid at the municipal level (Kommunalinvestitionsgesetz 2020). In addition, the package foresees a maximum budgeted volume of public guarantees of roughly 2.9% of GDP (COFAG, OeKB).

Whilst the take-up of the funds was well below the budgeted framework for 2020, the utilization of the measures varied considerably. The drawdown on bigger tickets such as the furlough

scheme appears comparatively low, with outlays for short-term work amounting to roughly EUR 5.49bn (cash based). Drawing on Ministry of Finance data, the direct budgetary impact of Covid-19 measures in 2020 totaled 20.8bn or 5.5% of GDP. Furthermore, authorities had enacted tax measures aiming at stimulating economic activity, which weighed on the revenue side (roughly 1.1% of GDP). In this context, we note that the government implemented an income tax reform that entailed a PIT cut in the lowest tax bracket.

Looking ahead, we expect a gradual improvement of public finances. With a view to 2021, however, we expect the headline deficit to decrease only moderately as the pandemic casts a grim shadow on economic activity and fiscal support continues. Many supporting measures have been extended, in particular the short-time work scheme (until at least 30 June 2021), meaning that the EUR 9.2bn for the crisis management fund as foreseen in the budget 2021 may prove too optimistic. Moreover, authorities envisaged a continuation of its measures implemented as part of the economic stimulus package, including tax measures such as the permanent PIT cut, the loss carryback, and the VAT reduction – coming at a prospective cost of around EUR 5.94bn. What is more, additional stimulus measures have been decided in order to aid the economic recovery, e.g. the above mentioned Corona Labor Foundation as well as sizable investments (approx. EUR 1.32bn) in environmental issues (1-2-3 Klimaticket, Forstpaket, development of renewable energies), public infrastructure, digitalization, and defense. While forecasting remains a challenging exercise, as the epidemiological development undoubtedly requires an agile and flexible fiscal approach, we forecast a headline deficit of 7.0% of GDP in 2021, which should narrow to just short of 4% of GDP in 2022.

As a corollary of the substantial deficit and the steep slump in real GDP, Austria's general government debt rose sharply by 13.4 p.p. to 83.9% of GDP in 2019-20, bringing the ratio back to the level seen in 2015/16. This highlights the importance of the previous years' fiscal consolidation efforts, which had been aided by the favorable economic and interest rate environment as well as by progress in winding down the Austrian defeasance vehicles. The debt reduction eventually catered for fiscal buffers that enabled authorities to draw on resources for its response to the pandemic without lifting the public debt ratio above prudential or even unsustainable levels.

In light of the only partial economic recovery and the decreasing, albeit still high headline deficit, reflecting extended fiscal support measures amidst ongoing corona crisis management and additional economic stimulus measures, we expect a further increase in the debt ratio this year. Although subject to very high uncertainty, we pencil in an increase to close to 88% of GDP in 2021, before we see debt-to-GDP stabilizing and resuming a gradual downward trend in line with the accelerating economic recovery.

The fiscal consolidation path proposed by the government in its budget, projecting a deficit of 1.5% of GDP by 2024, may turn out to be somewhat ambitious if policy-makers hold on to their tax reform plans aiming at lowering the tax rate, and in view of the need to step up investments in digitalization, infrastructure, and a greener economy alongside mounting demographic pressure.

With all that said, we view fiscal sustainability risks as contained. First and foremost, debt affordability remains high, in a context of historically low interest rates. Despite opposing denominator-effects, interest expenditure continued to decrease as measured by both GDP (1.41% to 1.36% in 2019-20) and revenues (2.9% to 2.8% in 2019-20). The average effective interest rate of the federal debt portfolio declined from 1.99% in 2019 to a new historical low of 1.47% in 2020.

After being negative for the first time in 2019 (-0.12%), the average yield (annual) continued to fall in 2020 and reached an all-time low at -0.32% in 2020. Long-term government bond yields should stay at historical low levels, enabling the sovereign to replace higher-yielding bonds by lower-yielding ones. 10-year bond yields have been continuously in negative territory since April 2020, posting at a low –0.06% as of 9 April (weekly quote), and continue to display a narrow Bund spread (24 bp).

Against this backdrop, we expect Austria to continue to benefit from the ECB's very accommodative monetary policy. Over the twelve months up to March 2021, net purchases of Austrian government bonds under PSPP amounted to EUR 8.0bn under PSPP, corresponding to an increase of 13.0% y-o-y. Concurrently, the PEPP envelope was increased by EUR 500bn to a total of EUR 1,850bn, while the horizon for net purchases under PEPP was extended to at least the end of March 2022, along with extended and enhanced refinancing operations (TLTRO, PELTRO). At the end of March 2021, net purchases of Austrian government bonds under PEPP totaled approx. EUR 24.2bn.

Secondly, we see fiscal risks to be mitigated by sound debt management, as reflected by the Austrian public debt portfolio, which carries no foreign exchange risk. The debt portfolio is well-laddered, featuring an average weighted maturity of 10.87y in Feb-21, up from 10.5y a year before (ECB data), pointing to very low interest rate and rollover risks. The investor base is wide and varied. Thanks to Austria's safe haven status and continued prudent debt management, debt servicing costs should dwindle further (OeBFA forecast 2021: 0.9%).

Thirdly, we have confidence in the sovereign's ability to create fiscal space after the dust engendered by the pandemic has settled, based on past experience. In the aftermath of the Global Financial Crisis, the sovereign reduced its headline deficit from 5.3% of GDP in 2009 to 2.0% of GDP in 2013, thereby stabilizing government debt. Again, between 2014 and 2019, the government turned a deficit of 2.7% of GDP into a surplus (2019: 0.6% of GDP), and lowered debt-to-GDP by 14.4 p.p. – freeing the resources to handle the fallout from the pandemic.

From a medium- and long-term perspective, we continue to identify two main risks factors to fiscal sustainability. Austria still features a high level of public guarantees, although these followed a declining trend before the outbreak of the corona crisis, having diminished to 16.1% of GDP in 2019 (2012: 38.2%). Risks are limited to some degree, as large parts of these guarantees are related to the provision of export finance, which is characterized by historically low default rates. As regards the risks related to guarantees adopted in response to the corona crisis, we see relatively low additional risks, as the amount of guarantees is capped and the take-up stood at 1.6% of GDP at year-end 2020. Secondly, we reiterate our concern about age-related costs in conjunction with demographic prospects. While awaiting the 2021 Ageing Report with updated figures, Austria's ageing costs are among the highest in the EU (2016) and are projected to edge up further by 2030.

Risks stemming from the banking sector have increased since our last review, owing to the challenging environment which will put banking sector stability to the test. Large-scale insolvencies could entail significantly rising unemployment and a severe scarring effect, derail banking stability, and let contingent liability risks materialize. So far, Austrian banks have remained resilient, also thanks to an exceptional and swift government response which helped to contain financial stability risks. Financial institutions entered the corona crisis in significantly better shape than the Global Financial Crisis, and banking stability metrics remain at prudent levels.

Capital buffers are still comfortable, posting a CET1 of 16.5% in Q4-20 (Q3-19: 15.6%), broadly in line with the EU average (17.2%, EBA data). The NPL ratio was still declining from 2.3% in Q4-19 to 2.1% in Q4-20 (EU: 2.6%). OeNB stress-tests signal that the banking sector is in a good position to cope with the damage caused by the pandemic. At the same time, credit quality seems to have deteriorated significantly since the outbreak of Covid-19. The share of so-called stage 2 loans amounted to a high 18.1% in Q4-20 (Q4-19: 10.3%), twice as high as the EU average (9.1%).

We vigilantly monitor the Austrian residential property market, as housing prices have increased unabatedly during the crisis. OECD data shows that the three-year growth rate increased to 15.3% in Q3-20 (Q3-19: 10.6%) and that real house prices stood 44% above their long-term average (2000-19). Affordability indicators hint at some misalignments, with the price-to-income ratio posting 41% its long-term average. The OeNB fundamentals indicators also rose further (Q4-20: 18.6%), flagging increasing signs of overheating.

Foreign Exposure

*Irrespective of the exceptional Covid-19-related shock to external trade, we continue to view risks related to Austria´s external position as a minor source of vulnerability weighing on our credit assessment. Its net international investment position (NIIP) remains positive, buttressed by a sustained current account surplus which benefits from strong competitiveness and diversified exports (see above).*

Austria was able to retain its significant long-standing current account surplus, even in the year of the corona crisis. Its current account surplus narrowed only slightly from 2.8% of GDP in 2019 to 2.5% of GDP last year, which we deem quite remarkable considering the gravity of the shock. Thanks to a strong manufacturing base, the goods surplus widened by 0.7 p.p. to 1.4% of GDP, as the decline in exports was less pronounced than that of imports. This increase cushioned the effects of the narrowing services surplus (2.5% of GDP to 2.1%) and the primary income balance's shift into a modest deficit of 0.1% of GDP (2019: +0.5% of GDP).

In line with reinvigorated economic activity in its main trading partners and assuming a gradual recovery of its tourism industry as vaccination progresses and confidence is regained, we expect the current account surplus to widen moderately this and next year. The rather benign development of the current account resulted in a modest decline of Austria's NIIP, falling from 12.1% of GDP to 11.0% in 2019-20. Persistent current account surpluses should allow Austria to sustain its net creditor status, which it has held since the NIIP has turned positive in 2013. Limited external risks are underscored by Austria's NIIP excluding non-defaultable investment (NENDI), which has trended upwards since its trough in 2012, standing at -4.5% of GDP in 2020 (Eurostat data).

## Rating Outlook and Sensitivity

Our rating outlook on the Republic of Austria's long-term credit ratings is stable, as we deem significant downside risks regarding the economic and fiscal outlook to be balanced by strong economic fundamentals and very high institutional quality, as well as by the above-mentioned factors mitigating fiscal risks. We still have to emphasize the abnormal uncertainty related to economic prospects and the very dynamic development of the pandemic, which impedes the assessment and interpretation of economic developments, as is the case for other indicators, e.g. from the fiscal realm.

We could raise the sovereign's credit ratings or the outlook if the Austrian economy experiences a stronger-than-expected recovery, possibly on the back of a more rapid vaccine coverage translating into higher medium-term growth and less severe scarring effects. This could also permit a faster scaling back of costly fiscal support measures, which is key for eschewing derailing public finances. More generally, upward pressure could result from debt-to-GDP resuming a firm downward trajectory. Moreover, we could also consider a positive action if the government embraces stringent reforms to tackle structural shortcomings, in particular with regard to fiscal issues such as reining in fiscal pressure entailed by demographics.

Conversely, we could lower the rating or the outlook if medium-term economic growth remains below our expectation, which may materialize in a scenario of delayed immunization against Covid-19, inhibiting a timely easing of restrictions to economic activity. Failure to bring the public debt ratio onto a downward trend, resulting in debt rising above prudential levels, could trigger a negative rating action.

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## Ratings*

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

*) Unsolicited

## ESG Factors

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

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

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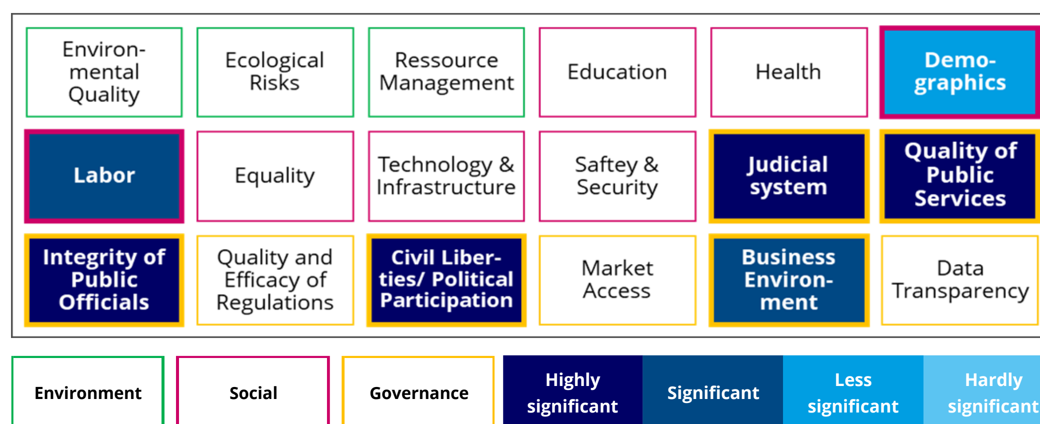
**ESG Factor Box**




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

Since indicators relating to the competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

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

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

## Economic Data

| [in %, otherwise noted] | 2015 | 2016 | 2017 | 2018 | 2019 | 2020e | 2021e |
|---|---|---|---|---|---|---|---|
| ***Macroeconomic Performance*** | | | | | | | |
| Real GDP growth | 1.0 | 2.0 | 2.4 | 2.6 | 1.4 | -6.6 | 2.2 |
| GDP per capita (PPP, USD) | 49,955 | 52,660 | 54,391 | 56,684 | 58,685 | 55,218 | 57,891 |
| Credit to the private sector/GDP | 90.6 | 87.8 | 87.1 | 87.3 | 88.6 | 97.1 | n/a |
| Unemployment rate | 5.7 | 6.0 | 5.5 | 4.9 | 4.5 | 5.4 | n/a |
| Real unit labor costs (index 2015=100) | 100.0 | 99.8 | 99.9 | 100.2 | 101.0 | n/a | n/a |
| Ease of doing business (score) | 78.8 | 78.9 | 78.7 | 78.7 | 78.7 | n/a | n/a |
| Life expectancy at birth (years) | 81.3 | 81.8 | 81.7 | 81.8 | 82.0 | 81.3 | n/a |
| ***Institutional Structure*** | | | | | | | |
| WGI Rule of Law (score) | 1.9 | 1.8 | 1.8 | 1.9 | 1.9 | n/a | n/a |
| WGI Control of Corruption (score) | 1.5 | 1.5 | 1.5 | 1.6 | 1.5 | n/a | n/a |
| WGI Voice and Accountability (score) | 1.4 | 1.3 | 1.3 | 1.4 | 1.3 | n/a | n/a |
| WGI Government Effectiveness (score) | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | n/a | n/a |
| HICP inflation rate, y-o-y change | 0.8 | 1.0 | 2.2 | 2.1 | 1.5 | 1.4 | 1.8 |
| GHG emissions (tons of CO2 equivalent p.c.) | 9.3 | 9.4 | 9.6 | 9.2 | n/a | n/a | n/a |
| Default history (years since default) | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| ***Fiscal Sustainability*** | | | | | | | |
| Fiscal balance/GDP | -1.0 | -1.5 | -0.8 | 0.2 | 0.6 | -8.9 | -7.0 |
| General government gross debt/GDP | 84.9 | 82.8 | 78.5 | 74.0 | 70.5 | 83.9 | 87.6 |
| Interest/revenue | 4.7 | 4.3 | 3.8 | 3.3 | 2.9 | 2.8 | n/a |
| Debt/revenue | 169.4 | 170.7 | 161.9 | 151.4 | 143.4 | 171.1 | n/a |
| Weighted average maturity of debt (years) | 8.1 | 8.1 | 8.9 | 9.9 | 10.2 | 10.7 | n/a |
| ***Foreign exposure*** | | | | | | | |
| Current account balance/GDP | 1.7 | 2.7 | 1.4 | 1.3 | 2.8 | 2.5 | n/a |
| International reserves/imports | 14.2 | 14.8 | 12.3 | 12.0 | 12.8 | 18.0 | n/a |
| NIIP/GDP | 2.2 | 4.1 | 4.3 | 5.3 | 12.1 | 11.0 | n/a |
| External debt/GDP | 171.9 | 164.6 | 155.0 | 149.8 | 153.7 | 164.8 | n/a |

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

## Appendix

### Rating History

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

## Regulatory Requirements

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

This sovereign rating is an unsolicited credit rating. The Ministry of Finance (BMF) participated in the credit rating process as it commented on a draft version of the rating report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of BMF during their review. However, the rating outcome as well as the related outlook remained unchanged.

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

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

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

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

arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

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

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

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

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

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