Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF AUSTRIA	Assigned Ratings/Outlook: **AA+ /stable**	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	29-07-2016 08-04-2022 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 08 April 2022

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. Austria's very wealthy, well-diversified, and competitive economy was hit hard by the pandemic, but recovered strongly last year; we expect solid growth for 2022 which will be dragged down by adverse effects from the war in Ukraine; while intensifying supply-side shortages and inflationary pressure will weigh on domestic demand, the recovery in tourism will likely buttress output growth, reflecting our assumption of a modest impact of renewed Covid waves
2. Over the medium term, growth should be supported by the eco-social tax reform, and investment and reforms coming on the back of the Recovery and Resilience Plan (RRP) will likely lift the economy's underlying trend growth; we continue to see Austria's strong labor market performance and comparatively low private sector debt as supportive factors, whereas a dwindling labor force is set to increasingly drag on the economy's potential growth further out
3. Sovereign continues to feature very strong institutional conditions, including significant benefits stemming from membership in EU and EMU; while political volatility has increased substantially as reflected by three chancellors in twelve months, we assume policy continuity and a thorough reform implementation as warranted; we will follow high-level corruption allegations
4. We view fiscal sustainability risks as very limited, expecting the ongoing economic recovery and ceasing Covid support measures to result in a gradually declining public debt ratio over the medium term; debt remains highly affordable alongside very sound debt management, being a key mitigating factor with a view to fiscal risks; contingent liabilities and demographics will have to be monitored, while the healthy banking sector sees itself confronted with high and rising prices in the residential property market

5. Despite the pandemic's devastating effects on Austria's tourism industry, we see external vulnerabilities as contained, also reflected by its still positive net international investment position (NIIP)

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Despite the adverse consequences from the corona crisis for the Austrian economy, we continue to view the sovereign's overall strong macroeconomic performance as supportive for its very high creditworthiness. Very high per capita income levels and a high degree of diversification in its economic structure and export structure continue to buttress Austria's macro profile. A high degree of competitiveness and strong labor market conditions, including good performance in the European Commission's (EC) Social Scoreboard, are further key traits of the sovereign. While Russia's importance to the Austrian economy has waned over the last decade, the consequences of the war against Ukraine is set to weigh on Austria's economic performance. However, sound economic fundamentals and gradually recovering tourism will likely cushion the fallout from the Ukraine war to some extent. The implementation of the RRP is set to lead to higher investment and help to tackle structural challenges in the Austrian economy, improving prospects for potential growth. Moreover, the eco-social tax reform should facilitate medium-term growth by providing significant relief to households and companies alike.

The Austrian economy was heavily hit by the pandemic, resulting in a significant output loss of 6.7% in 2020, but bounced back strongly in 2021, mirroring eased pandemic-related refinement measures during summer and progressing vaccination of the Austrian population. According to latest Eurostat data, Austrian real GDP rose by 4.5% last year, entirely driven by domestic demand, close to the outturn in the euro area (EA) as a whole (5.3%). In the same vein, medium-term growth for 2017-21, including the deepest recession since WW2 as well as the strong rebound, was broadly on par with the euro area overall (0.8% p.a. vs. 1.0%).

GDP per capita, in turn, increased to an estimated USD 59,406 in 2021 (IMF Oct-21 data, in PPP terms), and thus continues to represent a key credit support. We have to reiterate that the Austrian income level (5th in the EU27) appears more aligned with our AAA universe, even exceeding that of Germany (USD 58,150), whereas Austria surpasses the GDP p.c. observed in other 'AA' peers in our rated universe by far, e.g. Finland (USD 53,084) and France (USD 50,876).

Although failing to recoup its pre-crisis level, as virus dynamics and restrictions posed a drag in early and late 2021, household spending was the main driver of last year's growth, increasing by 3.3% and contributing 1.7 p.p. to total output growth. Whilst gross fixed capital formation grew by 4.0%, buttressed by both construction investment and investment in machinery and equipment, public consumption also contributed markedly to GDP growth (+1.4 p.p.). On the other hand, net external trade weighed on last year's growth performance (-0.5 p.p.), as import growth outpaced that of exports.

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[1] This rating update takes into account information available until 01 April 2022.

That said, Austria's economy continued to suffer from adverse repercussions of epidemiological developments. Thus, last year's recovery was relatively uneven, with the quarterly growth profile shaped by resurging Covid-19 infections. Very robust real GDP growth rates of 4.1% and 3.4% q-o-q in Q2 and Q3, respectively, came on the heels of a decline of 0.4% in the first quarter of 2021. However, a further infection wave and concomitant containment measures resulted in another drop in total output by 1.5% in Q4-21.

The fourth lockdown proved rather short-lived, lasting from 22-Nov-21 to 12-Dec-21. The Omicron strain is spreading swiftly, but, as it appears to be less severe than previous strains, authorities have been re-opening the Austrian economy cautiously, with restrictive measures gradually eased from February 2022. Containment measures as well as travel bans have been largely lifted. The mandatory Covid-19 vaccination was suspended more recently.

In our view, this creates a generally constructive backdrop as regards the ongoing recovery of the pivotal tourism industry, which accounted for over 7% of Austrian GDP prior to the pandemic (2019: 7.5%, Statistik Austria) and should have gained ground over Q1. While last year's overnight stays plummeted by 18.7% as compared to 2020 and 47.9% with a view to 2019 (Statistik Austria), available data for the current winter season 2021/22 offers a glimpse of hope, as overnight stays in Nov/Dec-21 jumped by approx. 415% y-o-y.

We expect the recovery of the Austrian tourism sector to continue gradually, stepping in as a key supporting factor for the Austrian economy. Further Covid-19 infection waves may generally cloud tourism prospects, with the risk of renewed headwinds in the next winter season. The Russian invasion of Ukraine may also obstruct the recovery to some degree, possibly making long-distance travel to Austria less attractive from a cost perspective, whereas the share of Russia in total travel receipts is relatively small (2019: 1.5%, OeNB).

Arguably more importantly, the Ukraine war will very likely have adverse effects on goods trade. While we assume overall positive export growth, re-intensifying supply chain disruptions, shortages in materials (essentially in the important automotive industry), and rising prices are set to hamper Austrian goods exports. To be sure, direct ties with Russia have loosened over the last decade, with the share of exports to Russia having dropped from 3.3% in 2013 to 1.2% in 2021 (Jan-Oct, OeNB data). Still, second-round effects via its main trading partners should entail further curtailing effects as Austria is closely intertwined in European supply chains (EU27: 68% of total exports).

While leading indicators may not fully capture recent geopolitical events, these continue to point to robust export performance. Judging by the European Commission's (EC) survey data, export expectations in the industrial sector remain comparatively optimistic, having increased markedly in Q1-22, and order books from abroad still seem well-filled. Overall, we expect to see a positive growth contribution by net external trade in this year and next.

As in 2021, we project household spending to be the key driver of economic expansion. Briskly rising consumer prices, which will be significantly boosted by soaring energy prices amid the Russian attack on Ukraine, are set to dampen private consumption in this year, and also likely in 2023. Nevertheless, consumption will rise significantly as households resume their pre-pandemic spending patterns and tap huge amounts of excess savings, although consumer spending may be somewhat more hesitant than before the Ukraine war as signaled by consumer confidence data, which still posts at high levels. OeNB estimates that households accumulated roughly EUR 10.8bn in excess savings, equivalent to 2.7% of GDP.

Moreover, disposable income should be fostered by wage growth coming on the back of a tightening labor market including pronounced skills shortages and high collective wage agreements. The short-time working scheme will continue shielding employees until the end of June 2022 (phase V). An additional stimulus will be provided by the eco-social tax reform which will enter into force from July 2022 and provide significant relief to households' budget (see below). According to WIFO estimates, the reduction in the tax burden for households as well as social security contributions will translate into an increase in disposable income of EUR 3.3bn and EUR 1.7bn in 2022 and 2023, respectively.

Labor market conditions remain largely favorable, supporting growth and constituting a rating strength. The labor market has proved relatively resilient to the deep health and economic crisis, mainly thanks to the government's swift and forceful policy response including the short-time work scheme. This is also reflected by monthly unemployment data (LFS-adj.), according to which the Austrian unemployment ratio declined rapidly from a transitory peak of 7.6% in Jan-21 to a mere 4.8% this February (Feb-20: 4.6%), well below euro area levels (EA: 6.8%) and other sovereign from our AA-universe (Belgium 5.6%, Finland: 6.5%).

Adding to that, Austria continues to post a labor participation rate well above the euro area average (Q3-21: 77.3% vs. 74.1%), even surpassing its pre-pandemic level (Q4-19: 77.2%). Employment growth has been in synch with the economic recovery, amounting to 2.7% and 3.2% y-o-y in Q3 and Q4 respectively. What is more, Austria performs well on the Social Scoreboard, in particular regarding social protection and inclusion.

Despite the detrimental effects of the Ukraine war, we believe that gross fixed capital formation will continue to increase. That said, material shortages and supply-chain disruptions stemming from the Russian invasion will also dampen investment activity, as investment projects may be pushed back into subsequent years. Investment premiums' will balance this effect to some degree, but its support should gradually fade beyond 2022.

We project investment growth to be facilitated by the RRP and low funding costs, whilst corporate balance sheets will be relieved via the eco-social tax reform as well. Survey-based indicators related to the industrial sector hint at a fundamentally constructive environment for higher investment activity, as new orders stood at high levels and capacity utilization is well above its long-term average (88.2% in Q1-22 vs. 84.2%).

In any case, gross fixed capital formation is set to be supported by construction investment, which should continue at a strong pace as favorable financing conditions remain in place, translating into vivid demand for residential property (see below). Although material and labor shortages could also hamper construction activity to some degree, we expect housing investment to buttress total output expansion.

Overall, we expect real GDP growth to increase by 3.0% this year. With some momentum pushed back into next year, we currently pencil in GDP growth of 3.5% for 2023. However, we have to flag that forecast uncertainty is extremely high at this stage, reflecting the geopolitical situation and still substantial uncertainty over epidemiological developments.

Medium-term prospects generally appear solid, as Austria remains a highly productive and competitive economy. Austria's nominal labor productivity per hour worked posted 14.7% above the EU27-level in 2021. Despite a slight decline from 2019 levels (15.9%), this still corresponds to one of the highest readings from a European perspective. Real unit labor costs improved somewhat after the pandemic-induced spike in 2020, decreasing by 2.3% in 2021, but standing 2.5%

above the pre-pandemic 2019-levels as compared to +0.3% in the euro area overall (AMECO data). We will monitor Austria's cost competitiveness going forward, but do not see Austria's international competitiveness at risk, as the Covid-shock somewhat blurs the big picture at the current juncture. As a case in point, Austria's global export market share trended slightly upward over the last years, equaling 1.01% in 2020 (2019: 1.00%).

Structural reforms and investment coming on the back of the RRP are set to aid Austria's medium-term growth. The financial envelope of the plan totals EUR 4.5bn or 1.1% of (2021) GDP, of which roughly EUR 3.5bn will come from EU financing in the form of Recovery and Resilience Facility (RRF) grants. The RRP aims to foster inclusive growth and helps in tackling structural challenges concerning the labor market, inter alia related to pervasive (vertical and horizontal) skills mismatches, a high labor tax wedge and labor participation of women. Investment will be significantly ramped up going forward, essentially contributing to the twin transformation (i.e. green/digital). Furthermore, Austria's welcoming business environment will be enhanced by easing the administrative burden for companies. On the whole, the EC estimates that an effective implementation of the RRP should raise GDP by 0.4% to 0.7% by 2026.

The eco-social tax reform is an essential part of the RRP, geared towards providing a substantial relief to households and corporates whilst enabling a green transformation of the Austrian economy. Coming into force this year, authorities thus introduced progressively increasing CO2 pricing that is to be compensated by a raft of measures to cushion the effects on private sector balance sheets. Compensatory measures for households include a regional climate bonus, lower health insurance contributions, personal income tax cuts via reductions in the second and third tax bracket, higher Family Bonus Plus payments and additional child allowance. In addition, the corporate income tax rate will be reduced from 25% to 23% by 2024. The Ministry of Finance (MoF) estimates that the cumulative net relief to households and businesses adds up to approx. EUR 18.6bn in 2022-25.

We continue to deem private sector balance sheets as relatively healthy, catering for sufficient risk-bearing capacities. Non-financial corporations' debt peaked at 84.8% of GDP in Q1-21 (ECB data), exceeding highs experienced in the wake of the global financial crisis before falling back to 81.5% of GDP in last year's third quarter. While this represents a comparatively moderate level from a European perspective, debt servicing costs generally remain modest and the ramp-up in debt was accompanied by a considerable increase in liquid assets. Thanks to public support measures, corporate insolvencies rose by a moderate 2.4% in 2021. Household debt remained virtually unchanged in the year to Q3-21, with 86.8% of disposable income (Q3-20: 86.5%) posting at a slightly higher level than before the outbreak of the pandemic (Q4-19: 83.3%).

Institutional Structure

The sovereign's creditworthiness remains decisively supported by its very high institutional quality, including high policy responsiveness. It is also corroborated by substantial advantages entailed by being part of the EU/EMU. Thus, Austria benefits considerably from the euro's reserve currency status and the ECB's highly credible monetary policy. Austrian HICP inflation, wages, and MFI interest rates have been closely aligned with the euro area over the last decade. Political volatility has increased significantly since our last review, but the coalition between the ÖVP and the Green party appears to be intact. We broadly assume policy continuity and a focus on implementing the climate change, digitalization, and tax reforms going forward.

We note that repeated high-level corruption allegations have led to a significant deterioration in political stability over recent years and in particular since our last review (Apr-21). Whilst the former, center-right government (comprising ÖVP and FPÖ) had already collapsed due to corruption allegations against former FPÖ-leader and vice-chancellor Strache, the governing coalition between ÖVP and the Greens was taken to the brink of a collapse again last year. Then chancellor Kurz eventually resigned amidst corruption allegations in October 2021. On 6 December 2021, Karl Nehammer was sworn in as chancellor, replacing Alexander Schallenberg who had resigned after less than two months. We will closely follow any investigations around high-level corruption. To be sure, the implementation of the National Anti-Corruption Strategy is progressing.

Weaker political stability is equally mirrored by the respective World Bank's Worldwide Governance Indicator (WGI), seeing the sovereign fall from relative rank 44 to 55 (out of 213 economies, euro area median rank: 65) in 2019-20. Generally, WGIs for Austria persistently outperform the majority of its fellow AA-rated peers as, well as the euro area median, by a considerable margin. Tying in with the observations elaborated above, the perception of corruption among public sector officials ultimately remains low as indicated by the WGI control of corruption, according to which Austria achieves a high score, placing it at relative rank 20 out of 209 economies (euro area median rank 20).

Regarding the WGI government effectiveness, which captures the quality of policy formulation and implementation, Austria was placed at a remarkable 12th rank, well above the euro area average (rank 35). Equally important, the quality of public services appears to have improved more recently, as the sovereign climbed five places, up from relative rank 17 a year before, achieving its best outcome since 2010. Institutional quality continues to be very high with regard to freedom of association, media, and speech, as suggested by rank 10 out of 208 economies on the WGI voice and accountability, up from rank 11 in the preceding year. Although having dropped from rank 4 to 7 (out of 209 economies) in 2019-20, the sovereign remains the country with the highest perceived quality of property rights, courts, and justice system.

Austria's authorities appear to continuously pursue improvements to its high-quality justice system. Thus, the government plans to set up a Federal Prosecution Office under an independent prosecutor general. Also, human resources for the courts and prosecution service have been increased, and the digitalization of justice continues to be enhanced. In this vein, the EC's recent Justice Scoreboard pays testament to the persistently high quality and efficiency of the Austrian judicial system.

Sound policy-making and responsiveness to structural challenges is underlined by the government's reform package to facilitate environmental sustainability included in the RRP and in particular by the eco-social reform which enters into force this year. Besides making growth more inclusive, the landmark reform aims to reduce annual CO2 emissions by more than 2.5m tons by 2030. We note that the EC stated in its RRP assessment that the target to reach net carbon neutrality by 2040, as set by Austrian authorities in their National Energy and Climate Plan (NEPC), may be too ambitious and rather difficult to achieve without further measures.

Indeed, greenhouse gas emissions per capita have remained unchanged in 2015-19, at 9.3 tons p.c. in 2019 as compared to the EU27 average of 8.4 tons. Having said this, we have to reiterate that Austria remains a European leader with regard to responsible, i.e. sustainable use of energy resources. Austria displays the highest share of renewable energy sources used for electricity in the EU, namely an exceptional 78.2% (2020, Eurostat), and the fourth-highest share of energy

from renewable sources overall, amounting to 36.5% in 2020, materially above the EU27 average of 22.1%.

Fiscal Sustainability

Although the pandemic resulted in a severe deterioration of the sovereign's fiscal metrics, we view the risks to its medium-term fiscal sustainability as contained. Fiscal risks remain decisively mitigated by the sovereign's conservative and very sound debt management, which is reflected by a very high share of fixed rate debt, no foreign currency risks, and a well-balanced maturity profile entailing low rollover risks. Furthermore, debt continues to be highly affordable. Whilst the pandemic caused Austria's public debt to balloon, we note that its debt-to-GDP ratio remained below levels seen five years ago. We expect debt to decline gradually over the medium term, driven by expiring Covid-19 measures and the ongoing economic recovery, which will likely be obstructed by current geopolitical events. More generally, the authorities' reputation for fiscal soundness leaves us confident that the public debt ratio will resume a sustainable downward path. That said, risks associated with public guarantees and prospectively adverse demographic developments remain in place.

The pandemic left a significant mark on the sovereign's public finances in 2021, with the fiscal outturn mainly a result of the authorities' crisis management and concomitant substantial measures to cushion the social and economic fallout from the pandemic and safeguard public health. These measures had a substantial impact on the revenue and expenditure side of the budget. However, the economic recovery and favorable labor market developments led to a marked increase in tax receipts.

According to latest Statistik Austria data, the general government budget deficit posted at 5.9% of GDP. Although still very high, this represents a significant improvement as compared to 2020, when the headline deficits amounted to a record-high 8.0% of GDP, which was revised downwards from 8.3% of GDP. General government expenditure edged up by 4.4%, with the expenditure ratio remaining high at 56.0% of GDP. The better outturn was driven by substantially higher receipts from income and wealth taxes, which leapt by 14.8%, resulting in an increase in general government revenue by 8.7%.

Budget execution was largely determined by Covid-19 measures. Expenditure and revenue measures with a budgetary impact should have totaled approx. 17.9bn or 4.5% of GDP based on the MoF's monthly Covid-19 reporting. As in the year before, the short-time working scheme accounted for the largest impact, totaling roughly EUR 3.7bn (0.9% of GDP), down from EUR 6.2bn in 2020. The impact of the Hardship Fund, Austria's relief fund for smaller firms, came in at about EUR 1.15bn or 0.3% of GDP.

Looking forward, we expect a further improvement in the sovereign's public finances, mainly due to the ongoing economic recovery and Covid-19 support measures largely coming to an end. To be sure, negative reverberations on economic development stemming from the Ukraine war could create a less favorable economic backdrop for fiscal consolidation in 2022/23, with the higher energy price bill prompting the government to introduce a second relief package for the private sector, on top of preceding measures meant to ease the burden of higher energy prices in January 2022. The two packages combined amount to about 0.9% of our estimated 2022 GDP (approx. EUR 3.7bn). Irrespective of the recent flare-up of uncertainty, we would expect the general government deficit to improve further, falling to about 3.0% of GDP in 2022 before narrowing to 1.5% of GDP next year.

Solid economic growth and ongoing favorable labor market developments driving continued employment and wage growth should both provide for robust tax revenues. Deficit-increasing measures related to the pandemic will decline sharply, as support measures will largely cease. Phase IV of the Hardship Fund ran until March 22, whilst the short-time work scheme is to expire in June 2022. The government budgeted discretionary Covid-19 measures of roughly EUR 3.875bn for 2022.

We assess as positive that authorities have committed to return to sustainable public finances, with sound budgetary policies geared towards lowering the sovereign's public debt ratio again. In a bid to shift budget execution from crisis to recovery mode, the government's medium-term budget plans pave the way, in our view, for a sustainable and more inclusive recovery which places a strong focus on climate, digitalization and innovation, whilst aiming for a gradual reduction in annual net financing requirements.

The pivotal eco-social reform comes into effect in July this year. The measures elaborated above will have a net effect of EUR 18.6bn in 2022-25, with EUR 2.6bn and 4.3bn effective in 2022 and 2023 respectively. Furthermore, the government plans significant investments to make the Austrian economy more attractive, foreseeing outlays of EUR 3.0bn for climate protection, EUR 2.9bn for mobility, EUR 1.6bn for digitalization, and EUR 1.5bn for R&D (spread out over 2022-25 respectively). Furthermore, policy-makers shell out approx. EUR 4.6bn for offsetting longer-term consequences of the pandemic, mainly via the investment premium. We note that medium-term measures will be partly financed via the EU's RRF.

At this stage, we project Austria's debt-to-GDP ratio to decline over the medium term and remain well below euro area average levels, driven by continued economic growth and resuming primary surpluses coming on the back of the ongoing fiscal consolidation, as well as low and falling interest expenditure. General government debt stabilized at 82.8% of GDP in 2021 after posting at 83.3% of GDP in 2020. We expect the debt ratio to fall to 80.9% and 78.1% of GDP in 2022 and 2023 respectively.

We note that the sovereign's public debt ratio remains at manageable levels. In contrast to other euro area peers, the transitory peak in 2020 does not represent a new all-time high. Instead, the 2020 outturn stands below the levels observed in 2014/15. We reiterate our belief that the sovereign will be able to rebuild fiscal buffers depleted over the course of the pandemic, based on its past consolidation track record and, more generally, the authorities' reputation for fiscal soundness.

In any case, Austria continues to display high debt affordability, representing a key strength of the sovereign, mitigating fiscal sustainability risks over the medium term. Interest expenditure is low, amounting to 1.1% of GDP in 2021, and is likely to continue to follow its long-term downward trajectory in 2022. According to OeBFA estimates, debt servicing costs should decrease to 0.72% of GDP this year.

The Austrian Treasury has continued to take advantage of the current interest rate environment, as average maturity of the federal debt portfolio was extended to 10.6 years in 2021, up from 10.1 years in 2020. The average effective interest rate of the federal debt portfolio dropped to a new historical low of 1.17% in 2021 (2020: 1.47%). The average annual yield was negative for the third year in a row, posting at -0.34% (2020: -0.32%, 2019: -0.12%). Additionally, Austria has a diversified holding structure from a geographical and investor base point of view, and features no foreign currency denominated debt.

While the ECB will likely pursue a less accommodative monetary policy path over the coming months, the interest rate environment should remain favorable for the time being. Long-term government bond yields thus remain at historically low levels, standing at only 0.91% at the end of March 2022 (25-3-22, weekly quote). That said, the yield on 10-year government bonds left negative territory in December 2021, posting at its highest level since December 2015.

Against the heightened uncertainty, the ECB may only gradually start to tighten monetary policy, maintaining a high degree of flexibility at this stage. As envisaged, the ECB terminated the PEPP at the end of March. While the tapering of the monthly net asset purchases (APP) is envisaged to occur faster than anticipated in Feb-22 and might be concluded as soon as Q3-22, if the medium-term inflation outlook does not weaken even after the end of the net asset purchases, the Governing Council also signaled readiness to delay such a decision if deemed necessary. We consider a first rate hike towards the end of the current year the most likely outcome, but acknowledge that the probability of this happening may also depend on the events around the war in Ukraine.

Contingent liability risks remain elevated, as public guarantees amount to 17.3% of GDP in 2021 (MoF, DBP22). In this context, however, we have to emphasize that guarantees had been trending downwards before the pandemic hit. Public guarantees appear to have resumed this downward trajectory, having dropped from 19.1% of GDP in 2020 and being projected to fall further to 16.4% of GDP this year. Risks continue to be contained to some extent, as large parts of these guarantees are related to the provision of export finance, which is characterized by historically low default rates.

We continue to monitor the Austrian banking sector vigilantly, as risks related to financial stability have risen persistently over recent years. Vulnerabilities in the residential property market are increasing, as housing prices have continued to rise rapidly since our last review, and are coupled with dynamic mortgage loan growth (outstanding volume: +6.9% y-o-y in Jan-22), although from a low level. Mortgage lending accounts for 34% of domestic credit according to OeNB data. This is the forth-lowest ratio in the euro area (EA: 42%).

More importantly, residential property prices are increasingly less aligned with fundamentals as repeatedly highlighted by OeNB. The central bank's fundamentals indicator jumped by 7.6 p.p. to 29.8% nationwide in Q4-21, and for Vienna it surged by 5.1 p.p. to 35.6%. In addition, affordability has continued to deteriorate judging by OECD data on the price-to-income ratio, which stood more than 50% above its long-term average (2000-2020) in Q3-21. The Austrian Financial Stability Board (FMSG) has flagged rising systemic risks entailed by developments on the housing market.

Moreover, banking sector risks have jolted in the face of the Russian invasion of Ukraine, as Austrian banks carry a significant exposure to Russia. Drawing on BIS data, international banks had claims on an immediate counterparty basis in the amount of roughly USD 121.5bn on Russia as of Sep-21. Among these, euro area banks were owed USD 83.8bn, an increase of almost 11% in five years (Sep-16). In fact, Austrian banks face the largest exposure as measured by GDP, posting at 3.8%.

Financial stability risks are limited by still relatively low household debt and by healthy levels of capitalization and improving asset quality in the banking sector, as suggested by respective metrics provided by EBA. The NPL ratio of EBA-supervised banks fell slightly from 2.1% in Q4-20 to 1.9% in last year's fourth quarter (EU: 2.0 in Q4-21), while the CET1 ratio remains slightly sub-

par as compared to the EU average (Q4-21: 15.7%), but broadly stable at 15.0% in Q4-21 (Q4-20: 14.3%).

Demographics continue to pose a significant fiscal risk from a medium- to long-term perspective. Risks stemming from Austria's age-related costs coupled with its demographic trajectory are underscored by the EC's Aging Report 2021. Hence, Austria displays the second-highest aging costs in the EU27 (26.7% of GDP in 2019), expected to increase to 29.1% of GDP in 2030, mainly driven by the increase in public pensions (+1.8 p.p.). Our concerns are shared by Austria's Fiscal Council, which published a sustainability report in September 2021, showing that the long-term sustainability of public finances is not ensured due to the increase in age-related spending.

Foreign Exposure

The adverse repercussions of the pandemic on Austria's tourism industry are gradually becoming visible in its balance of payments, as its current account balance has shifted from a surplus to a slight deficit last year. However, we consider external vulnerabilities to be contained, as the sovereign retained its net creditor status, with its NIIP remaining comfortably in positive territory.

Risks arising from the external sector appear limited at this point in time. Austria's current account balance remained broadly stable in the year the pandemic broke out (2020: 1.9% of GDP, 2010-19 average: 1.9% of GDP), but shifted into negative territory in 2021 overall, dropping to -0.5% of GDP (OeNB provisional data). The shift was mainly due to the trade in the services balance, which slipped from a surplus of 2.1% of GDP in 2020 to 0.7% of GDP in 2021. To be sure, the trade in goods surplus turned into a deficit of 0.4% of GDP.

Looking forward, we expect a gradually improving external position. While the current account should be broadly balanced this year, it should record a moderate surplus in 2023 before gradually widening further out, largely driven by slowly falling energy and commodity prices as well as by Austria's gradually recovering tourism industry. Austria's NIIP remained robust last year, having improved to 14.7% of GDP in 2021 as compared to 9.3% a year before.

Rating Outlook and Sensitivity

Our rating outlook for Austria's long-term credit ratings is stable. We view risks to the economic outlook and to prospects for fiscal consolidation stemming from the geopolitical situation and still remaining uncertainty pertaining to the Covid-19 pandemic as broadly balanced by robust economic fundamentals, the strong institutional set-up, and the sovereign's track record of prudent budget execution. Still, we emphasize that the assessment and interpretation of economic and fiscal developments remain subject to considerable uncertainty in light of the recent accumulation of crises.

We could consider a positive rating action if the sovereign's public finances improve significantly, setting its debt-to-GDP ratio on a sustained downward path. Robust medium-term growth would be conducive to such a scenario. Higher-than-expected medium-term growth could also exert upward pressure on the rating or the outlook, which could be the case if the Russian invasion of Ukraine resulted in a less detrimental economic outcome and/or if tourism catches up faster than expected at this stage.

On the other hand, a negative rating action could be contemplated if we observe a weaker-than-expected growth outturn over the medium term, or if the public debt ratio fails to resume its

downward path or even continues to rise going forward. Failure to put the public debt ratio on a sustainable downward trend could result from an adverse growth performance and materializing contingent liability risks.

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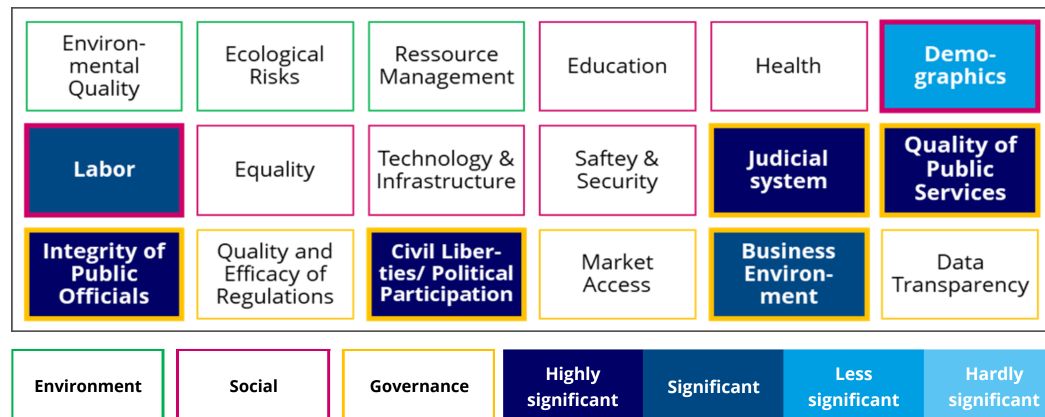
Ratings*

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

ESG Factor Box



Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is

thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

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 what follows, we explain how and to which 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 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.

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]	2016	2017	2018	2019	2020	2021e	2022e
Macroeconomic Performance							
Real GDP growth	2.0	2.3	2.5	1.5	-6.7	4.5	3.0
GDP per capita (PPP, USD)	52,660	54,391	56,677	58,680	55,453	59,406	63,470
Credit to the private sector/GDP	87.8	87.1	87.3	88.6	96.1	96.4	n/a
Unemployment rate	6.5	5.9	5.2	4.8	6.0	n/a	n/a
Real unit labor costs (index 2015=100)	99.8	99.9	100.2	101.0	105.9	n/a	n/a
Life expectancy at birth (years)	81.8	81.7	81.8	82.0	81.3	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.8	1.8	1.9	1.9	1.8	n/a	n/a
WGI Control of Corruption (score)	1.5	1.5	1.6	1.6	1.5	n/a	n/a
WGI Voice and Accountability (score)	1.3	1.4	1.4	1.3	1.4	n/a	n/a
WGI Government Effectiveness (score)	1.5	1.5	1.5	1.5	1.7	n/a	n/a
HICP inflation rate, y-o-y change	1.0	2.2	2.1	1.5	1.4	2.8	5.4
GHG emissions (tons of CO2 equivalent p.c.)	9.4	9.6	9.2	9.3	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	-1.5	-0.8	0.2	0.6	-8.0	-5.9	-3.0
General government gross debt/GDP	82.8	78.5	74.0	70.6	83.3	82.8	80.9
Interest/revenue	4.3	3.8	3.3	2.9	2.7	n/a	n/a
Debt/revenue	170.7	161.9	151.4	143.5	170.7	n/a	n/a
Total residual maturity of debt securities (years)	8.1	8.9	9.9	10.2	10.7	11.1	n/a
Foreign exposure							
Current account balance/GDP	2.7	1.4	0.9	2.1	1.9	-0.5	n/a
International reserves/imports	0.1	0.1	0.1	0.1	0.2	n/a	n/a
NIIP/GDP	4.1	4.3	6.0	13.5	9.3	14.7	n/a
External debt/GDP	164.6	155.0	150.8	154.4	164.9	n/a	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
Monitoring	08.04.2022	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) commented on a draft version of the rating report. Thus, this report represents an updated version, which was augmented in response to BMF's factual remarks 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 Investment Bank, Blavatnik School of Government, ECDC, Österreichische Nationalbank, Statistik Austria, Fiskalrat, Österreichische Bundesfinanzierungsagentur (OeBFA), Republik Österreich – Bundesministerium für Finanzen, Finanzmarktstabilitätsgremium (FMSG).

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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