CREDIT REPORT | AUSTRIA

Credit Report: Republic of Austria

AA+/Aa1/AA+/AAA

Analysts:
Maximilian Möstl
maximilian.moestl@erstegroup.com

Ratings

Agency	LT	ST	Outlook
Fitch	AA+	F1+	stable
Moody's	Aa1	P-1	stable
S&P	AA+	A-1+	positive
DBRS Morningstar	AAA	R-1	stable

Source: OeBFA, Erste Group Research

Key figures

	2022	2023	2024f	2025f
Population (mn)	9.0	9.1	9.2	9.2
Real GDP, y/y (%)	5.3	-1.0	-0.7	0.6
Inflation (%)	8.6	7.7	2.9	1.9
Unemployment rate (%)	4.8	5.1	5.3	5.2
Govt. deficit (% GDP)	-3.3	-2.7	-3.9	-4.1
Govt. Debt (% GDP)	78.4	78.6	79.7	81.6

Source: Eurostat, Fiscal Council, MoF, Erste Group Research

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Economy remains weak, second year of recession

After a recession in 2023, the economy continued to decline in 2024. All components of GDP shrank, except for public consumption. Based on sentiment indicators and preliminary business cycle indices, no upturn is yet in sight. Inflation has recently fallen due to energy prices but remains above the eurozone average due to increased inflationary pressure in the services sector. The labour market remains stable, even though the number of vacancies has fallen, and the unemployment rate has risen slightly.

Increasing deficit in 2024, possible deficit procedure

In 2023, the budget deficit was reduced from -3.3% of GDP to -2.7% of GDP. The public debt-to-GDP ratio rose slightly from 78.4% in 2022 to 78.6% in 2023, partly due to last year's recession. The Maastricht deficit will remain well above the threshold of 3.0% of GDP in 2024. Due to the continued weak economic development and the parliamentary elections in September, the budget situation for 2025 and the following years is unclear.

Risk premium should continue to fall

The European Central Bank (ECB) began to lower its key interest rates at the beginning of June. After four interest rate cuts, we expect further interest rate cuts at the upcoming meetings. The risk premium for 10-year Austrian government bonds compared to 10-year German government bonds narrowed significantly in 2024 and recently stood at just under 40 basis points. We expect risk premiums to continue to fall slightly in the coming quarters, also due to positive rating reports.

High ratings confirmed once again

All four major rating agencies confirmed Austria's high ratings. Standard & Poor's revised Austria's outlook from stable to positive in August 2024 due to the reduced risk of a medium-term energy shortage resulting from Austria's dependence on Russian gas. On the other hand, the rating agencies are concerned about the sharp rise in public debt and the weak growth trend of the Austrian economy compared to other economies.

Major Markets & Credit Research
Rainer Singer (Head)

Maurice Jiszda, CEFA®, CFDS®
(Senior Economist USA, CHF)
Maximilian Möstl (Economist AT)
Gerald Walek, CFA® (Senior Economist EZ)

Economic Outlook

GDP and economic growth

Recession in 2023, followed by a further decline in GDP growth in 2024

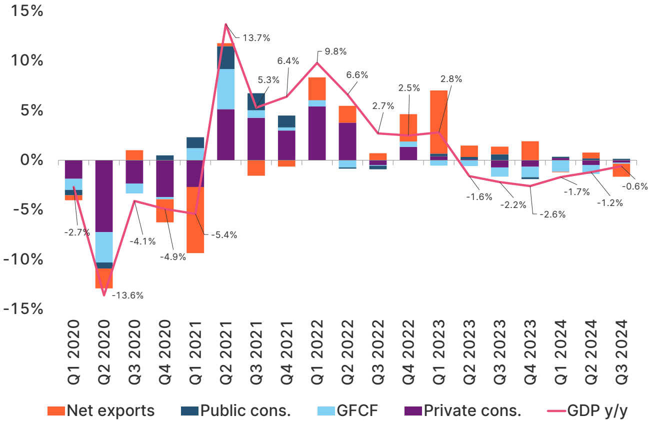
In 2023, the Austrian economy experienced a downturn, with a real GDP decline of -1.0%. While growth in 1Q23 was still clearly positive at 2.8%, its development deteriorated from 2Q23 onwards. From this quarter onwards, GDP shrank in all subsequent quarters. The decline in GDP was broad-based. Almost all components, except public consumption, were affected by the decline. However, the simultaneous sharp decline in both exports and imports meant that the contribution of foreign trade to GDP development remained positive in 2023. At the sector level, it can be seen that industry and construction have been experiencing shrinking value added since 2Q23 and 3Q21, respectively.

Almost all GDP components are declining

In 2024, the downward trend in economic output continued and is becoming more widespread. Investments and exports declined sharply in some cases over the course of the year (1Q24: -5.1% and -3.8%, 2Q24: -5.6% and -4.4%, 3Q24: -0.5% and -3.3%, respectively) and consumption also shrank in the last quarter (2Q24 and 3Q24: -0.8% and -0.5%, respectively). Public consumption was the only GDP component to grow in the previous quarters (1Q24: 0.6%, 2Q24: 0.9%, 3Q24: 0.7%).

Recession since Q2 2023 in all GDP components except the public sector and net exports

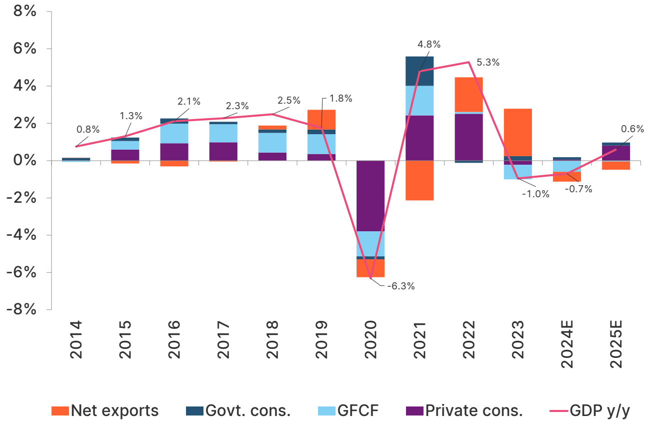
GDP, y/y, contribution of GDP components in %



Source: Eurostat, Erste Group Research

Weak momentum in private consumption and investment dampen GDP growth in 2024

GDP, y/y, contribution of GDP components in %



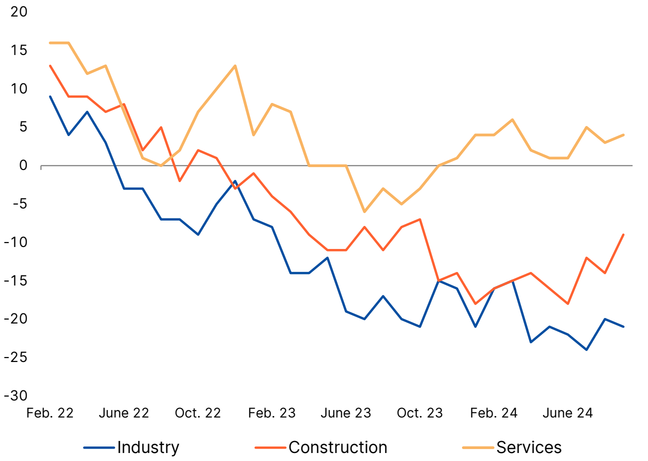
Source: Eurostat, Erste Group Research

Investment activity continues to shrink

The sustained slowdown in investment activity began in mid-2022. Construction investment also slowed, with the number of building permits in 2023 falling to a low not seen since statistics began in 2010. Data from 2024 suggests that this figure will be undercut again this year. The number of construction completions followed this trend and declined in 2023. High interest rates on loans continue to weigh on corporate borrowing and on the willingness of households to take out mortgage loans. Overall, investments in 2024 are likely to shrink sharply compared to the previous year and thus make a negative contribution to GDP growth.

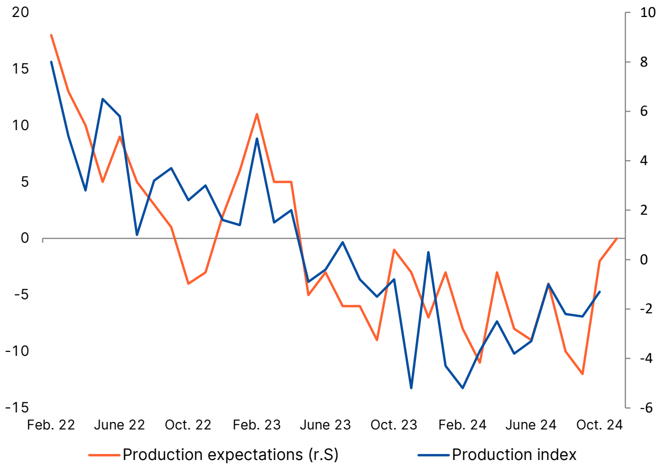
A glance at various sentiment indicators and leading economic indicators shows that economic development in Austria remains subdued. In particular, the industrial and construction sectors are still in strongly negative territory. Only the service sector appears to be unaffected by the ongoing recession. Industrial production is declining, but the trend has been showing a gradual improvement for months. Expectations for the next 12 months are not negative for the first time since May 2023 and suggest that a further recovery can be expected in the coming months.

Negative sentiment persists in industry and construction
EC sentiment indicators



Source: European Commission, OeNB, Erste Group Research

Production has been declining for months
Production index and expectations



Source: Statistics Austria, WIFO, European Commission, Ipsos Austria, Erste Group Research

The recession is widespread in terms of value added, with public administration and state-related areas growing

As for value added, the decline in 2023 extended across almost all sectors of the economy. In industry, value added fell by -2.3% y/y and by -7.5% in construction. Trade was also hit hard, with a decline of -5.7%. By contrast, accommodation and gastronomy grew strongly by +5.4%. It is striking that most of the sectors directly related to public administration, such as energy and water supply and waste disposal, grew by 2.3% and +8.1% respectively in y/y terms.

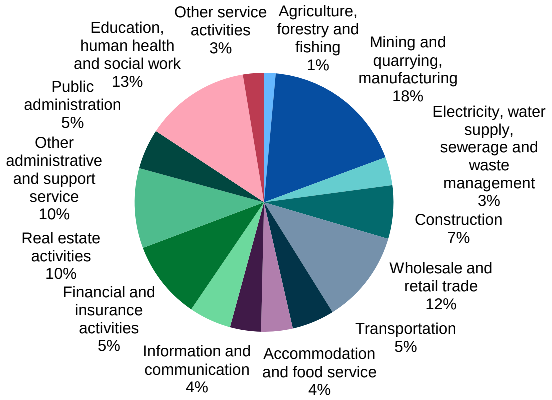
Industry and construction account for almost a quarter of total value added

Industry and construction together account for around 25% of Austrian value added. This makes Austria a rather industry-oriented economy, but other sectors such as trade (12%) and services, accommodation and food services, financial services, insurance and credit, as well as real estate and housing (around 19%), are equally balanced, so that value added is relatively evenly distributed across the various sectors. This time, the economic downturn seems to be affecting almost all sectors, as explained above.

Performance varies greatly from industry to industry

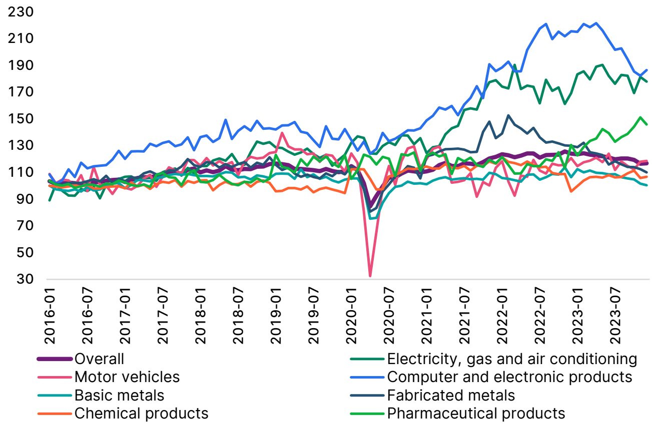
Industry, with its importance for the Austrian economy, is particularly in focus, as it is now suffering from last year's high wage settlements following the energy price shock caused by the Russian invasion of Ukraine. However, looking at the most important sectors does not necessarily paint a completely pessimistic picture. Extremely high growth rates in 2021 during the post-pandemic upswing were followed by a certain correction in 2022. While industries such as processed metals and base metals are still experiencing sharp declines in production, most industries, such as the production of chemical products, appear to be stagnating. In other sectors, such as the production of computers and electronic products as well as motor vehicles, the loss of Austrian competitiveness and weak exports are also evident. Only the pharmaceutical industry has shown above-average growth rates since the beginning of the year. The manufacturing of goods as a whole has shown a slight but stable downward trend since 2H22.

Value creation spread across many industries
Nominal contribution of sectors to GDP, % of total



Source: Statistics Austria, Erste Group Research

Uneven trend in the major industrial sectors
Index 2015=100



Source: Eurostat, Erste Group Research

Insolvencies will increase sharply in 2024

The difficult economic situation in Austria is also currently evident in the corporate sector. According to Statistics Austria, corporate insolvencies rose by an average of 24% in the first three quarters of 2024. The strongest increase in insolvencies was seen in the 'information and communication' sector (an average of 45.2%), followed by 'manufacturing' (an average of 32.3%) and 'financial/other services' (28.9%). The increase in material and energy costs, high wage agreements in connection with rising financing costs and a generally uncertain environment are often cited as reasons for the increase in insolvencies.

The bleaker macroeconomic outlook in Germany and Europe is dampening exports

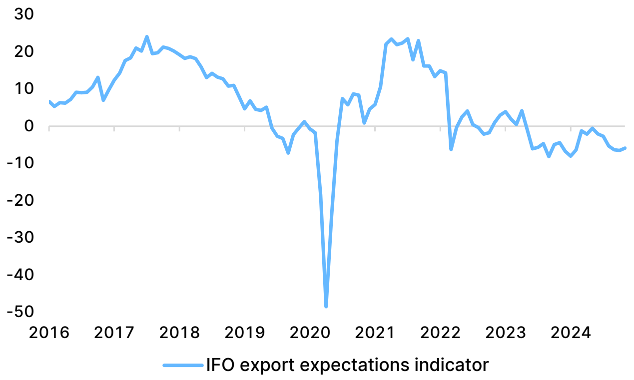
Since 3Q23, export growth has slowed noticeably and has since made a negative contribution to GDP growth, with this trend intensifying in 1Q24. Overall, exports contracted by -5.0% y/y in 1H24, with two of the four largest export destinations recording high negative growth rates: Germany -7.9% y/y and Italy -7.2% y/y. By contrast, exports to the US and Switzerland grew strongly, at +11.2% y/y and +2.3% y/y respectively.

According to preliminary data from Statistics Austria, Austrian exports still rose by +5.9% y/y in July, but then fell in August (-9.2% y/y) and September (-2.9% y/y), so according to the preliminary national accounts, a decline in exports of -3.3% y/y had to be recorded again in 3Q20. This is mainly due to the deteriorating economic situation in Germany, as well as the noticeable decline in demand for machinery and vehicles, the most important product groups in foreign trade.

In the first seven months of 2024, positive impulses still came from the product groups of machinery, vehicles, chemical products and food. Since August 2024, however, exports in the four major product groups – machinery and vehicles, processed goods, chemical products and other manufactured goods – have been declining.

IFO indicator shows no improvement in export expectations

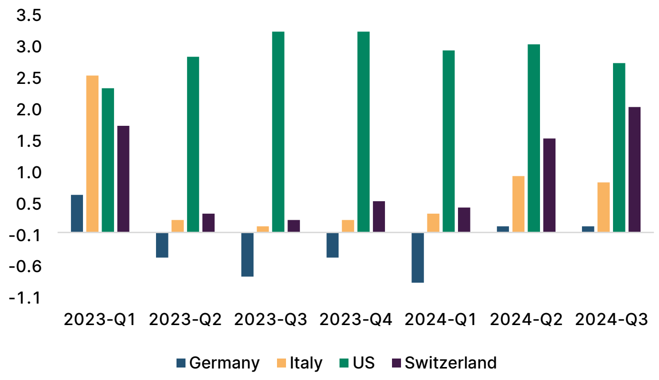
IFO export expectations indicator



Source: IFO Institute, Erste Group Research

Economic situation of Austria's most important trading partners has recently deteriorated

Real GDP growth rates, %, SA



Source: Eurostat, Erste Group Research

No substantial improvement in exports is expected in the coming months

The OeNB's leading indicators do not point to any stabilization in the export sector in the coming months, a view that is also confirmed by the IFO's export expectations indicator. While export order books continue to trend slightly downwards, export new orders have deteriorated again in recent months. We do not expect exports to make a positive contribution to GDP growth this year. We do not expect a slight acceleration in export growth until 2025, due to a moderate economic recovery in Europe and a continued growing economy in the US.

Inflation and housing costs as the main reasons for the perceived loss of household income

Private consumption has been suffering since 3Q23, when persistently high inflation reduced household disposable income and now global uncertainty and still expensive borrowing costs are dampening the propensity to consume. In Austria, 3,000 to 3,600 people aged 18 to 74 are surveyed by Statistics Austria each quarter to measure the development of their disposable income. According to the results of the survey, which was conducted between May and June 2024, around 22% of respondents said they had suffered an income loss in the last 12 months. Compared to a year ago, the number of people with perceived income losses shows a declining trend. Compared to the previous quarter, however, there is a small increase. As in previous quarters, high inflation was cited as the main cause of perceived income losses. For people who said they were getting by on less income, inflation was the main reason, at 31%. In addition, 25% of respondents said that housing costs pose a major financial challenge for them.

A noticeable increase in private consumption is expected from 2025 onwards

However, as inflation is expected to continue to decline in 2025, we predict an improvement in the development of private consumption from 2025 onwards. In particular, an improving economic environment should also lead to the household savings rate no longer increasing. In addition, 2025 should bring a moderate economic recovery in Germany, which should provide some impetus for Austria's exports and thus also for investment. Overall, we forecast a recession of -0.7% in 2024 and a modest recovery of around +0.6% in 2025.

Inflation

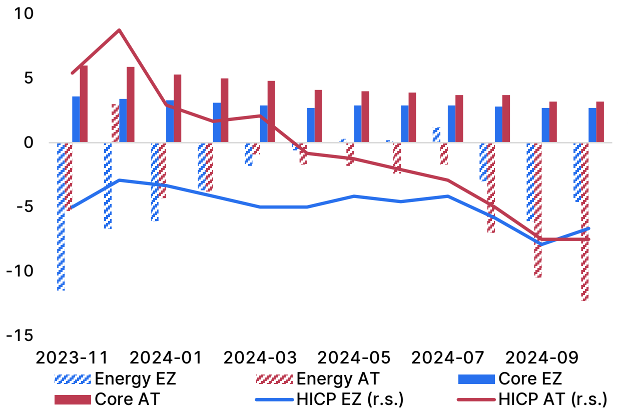
Falling inflation due to falling energy prices and receding core inflation

After headline inflation in 2023, at an average of 7.8%, only slightly receded from its high level in 2022, at 8.6%, it began to fall noticeably from September 2023 onwards. Starting from 11.6% in January, it reached 4.9% in October and November, which at the time was the lowest level since January 2022. In the course of 2024, inflation then continued to decline gradually, reaching 1.8% in September and October, the lowest level since February 2021. Energy inflation, which peaked at 41.5% in October 2022 and had a price-dampening effect on Austrian inflation from mid-2023, was probably the most important factor behind the noticeable slowdown in the decline in overall inflation in 2024, with a continued price-dampening effect in every month. Another noticeable contribution to the slowdown in inflation in 2024 was the decline in core inflation, which more than halved between mid-2023 and October 2024 (April 2023: 8.3%, October 2024: 3.2%). This was largely due to services inflation, particularly in the restaurant and hotel industry, which has now also more than halved from its peak levels in 2023 (April 2023: 13.7%, October 2024: 5.8%).

There are several reasons for the higher inflation in Austria

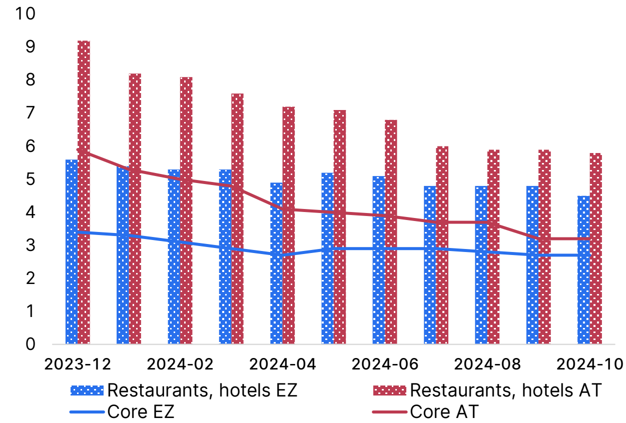
Over the past ten years, Austrian inflation has often been above average inflation in the Eurozone, due in large part to price increases in the ‘restaurants and hotels’ sector, and also to the much higher and more persistent energy price inflation in Austria. Another weighting of various components in overall inflation than in the Eurozone also had a partially reinforcing effect. In recent months, however, we have seen that these effects are now also causing the Austrian inflation rate to fall below the European rate, mainly due to the sharper decline in energy prices in Austria.

Falling prices for services and energy close the gap on eurozone inflation
Inflation rates AT and EZ, %



Source: Statistics Austria, Erste Group Research

Restaurants and hotels keep core inflation in Austria higher than in the eurozone
Inflation rates AT and EZ, %



Source: Eurostat, Erste Group Research

Restaurants and hotels not only given a higher weighting, but also a higher inflation rate than in the retail sector

The different weighting of the components can be illustrated by the above-mentioned category ‘restaurants and hotels’, which in 2024 is weighted at 16.7% in the Austrian basket of goods, while its share in the basket of goods in the Eurozone is only 11.2%. Furthermore, inflation in this sector has accelerated much more in Austria than in the Eurozone in recent quarters. For example, average inflation in the ‘restaurants and hotels’ sector in Austria in 2023 was 11.7% and in the Eurozone 7.5%. From January to October 2024, a similar picture emerges. For example, the inflation rate for these components in these months averaged 6.9% in Austria, while it was 5% in the Eurozone. The situation is similar for core inflation, which accounts for 76.4% of Austrian inflation and 70.6% of Eurozone inflation. If these rates of change are not only more heavily weighted, but also rise more than in the Eurozone, this increases the overall rate compared to the Eurozone, ceteris paribus.

Energy inflation is now falling much more sharply than in the eurozone

The second factor that was also responsible for higher inflation in Austria than in the Eurozone in 2023 was the much higher energy inflation (AT: 8.2%, EZ: -1.44%). The reason for this lies in the nature of contracts with energy suppliers, which are usually binding for one year. This results in significantly delayed price increases or declines. Over the course of 2024, this effect, which had led to high energy price inflation in 2023, was reversed. While energy price inflation in the Eurozone fell by -2.4% in the period January-November, it fell by -5.2% in Austria in the same period. Although the ‘energy’ category has a rather low weight in the basket of goods (EZ: 9.9%, AT: 8%), it can lead to noticeable differences in the two inflation rates if there is a strong divergence between Austrian energy prices and Eurozone energy prices, similar to the ‘restaurants and hotels’ component.

Inflation will fall significantly in 2024 and continue to decline in 2025

Since Austria still had above-average inflation in 1H24, particularly in the service sectors, we forecast an inflation rate of 2.9% for 2024. Since we expect fewer high-profile collective bargaining agreements due to the lower inflation rate, we expect inflation in the service sectors to be noticeably lower next year. According to our forecast, energy prices should not be a price driver next year, but it is possible that due to the phasing out of the electricity price caps and rising grid fees, we may see an increase in electricity prices in 1H25. Overall, we forecast an inflation rate of 1.9% for 2025.

Labor market

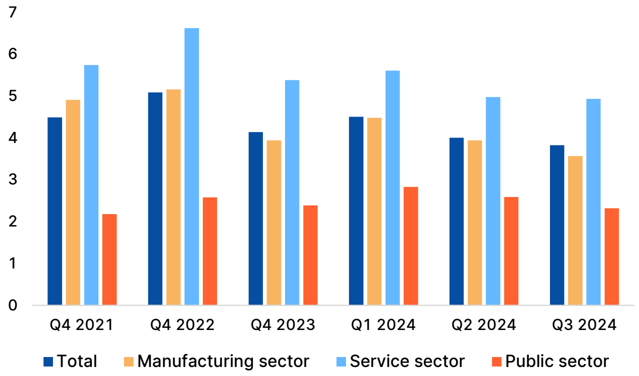
Labour market remains robust despite two years of recession

After the unemployment rate fell to 4.8% in 2022, the year of the post-pandemic economic upturn, it rose to 5.1% in 2023 as a result of the economic downturn. The job vacancy rate fell significantly in 2023, with only the public sector showing no cooling. In 1Q24, there was a slight increase in the job vacancy rate, but this declined again in 2Q24 and 3Q24.

The rise in the unemployment rate is mainly due to the higher labour supply

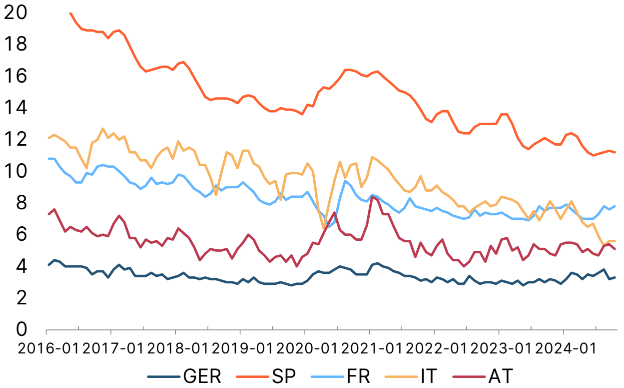
Apart from the decline in vacancies, the economic slowdown has not yet had a widespread impact on the Austrian labor market. Employment growth slowed in 2023, while unemployment rose slightly, mainly due to the higher labor supply. After growing slightly in 1Q24, employment fell slightly for the first time since 4Q22 in 2Q24. One of the reasons for the robust labor market is the decline in hours worked per person since the pandemic. In addition, companies seem to be inclined to retain employees during the downturn to avoid costly new hires during the upturn.

Vacancy rate will be lower in 2024
Number of vacancies*100/(number of vacancies + number of employees)



Source: Statistics Austria, Erste Group Research

Unemployment rate stable at around 5% in 2024
Unemployment rate, % of the working population



Source: Eurostat, Erste Group Research

Cooling of the labour market expected in 2024

However, we expect the current weak economic development to continue to weigh on the labor market in the next few quarters. We expect the labor market to cool, with the unemployment rate rising from 5.1% in 2023 to around 5.3% in 2024 and then falling slightly to 5.2% in 2025.

Public finances

Public deficit and debt in 2023 and 1H24

Smaller deficit, but higher debt ratio in 2023

In 2023, the budget deficit was reduced to -2.6% of GDP from -3.3% of GDP in 2022. However, the government debt-to-GDP ratio rose slightly, from 78.4% in 2022 to 78.6% in 2023. In absolute terms, the debt level at the end of 2023 was EUR 371.1bn, which is EUR 20.4bn more than at the end of the previous year. The largest share of the increase in public debt was accounted for by the federal government sector, and here above all by the core unit of the federal government, which used the newly incurred debt to finance the current deficit, which brought a significantly lower increase in revenues due to tax law measures such as the abolition of the cold progression, but also due to the recessive economic development.

Public debt, deficit in 1H24 rose significantly

Austrian government debt amounted to EUR 394.8bn (83.0% of GDP) in 1H24, an increase of EUR 23.1bn compared to the end of 2023, while the public deficit rose from EUR 7.5bn (1H24) to EUR 11.4bn (4.8% of GDP). In the first half of 2024, government revenues increased by 5.0% compared to the first half of 2023, while tax revenues increased moderately by 3.2% y/y. The increases were significantly lower than in previous years. By contrast, government spending increased by 7.9% in the first half of 2024. In particular, the inflation adjustments for social benefits and wages and salaries in the public sector are significant. The increased financial allocations to federal states and municipalities under the 2024 Fiscal Equalisation Act are already reflected on the expenditure side in the results of the first two quarters in the form of higher current transfers.

Provisional budget 2025

No budget was approved for 2025 due to the parliamentary elections

Pursuant to Article 51 of the Federal Constitutional Act (B-VG), the federal government must submit a draft of the Federal Finance Act (BFG) and the Federal Financial Framework Act (BFRG) for the next financial year to the National Council ten weeks before the end of the calendar year. The National Council then usually adopts the budget in one of its sessions before the end of the year. Due to the National Council election on September 29, 2024, the outgoing federal government did not present the National Council with a Federal Finance Act for 2025 or a Federal Financial Framework Act for 2025–28 in October 2024. Until a resolution on a 2025 budget or a 2025–28 budget framework is passed, an automatic provisional budget will initially come into force for 2025. The National Council can also pass a statutory provisional budget at any time, provided that majorities in the parliament can be found for it.

Budget is updated with caps from last year

Art. 51a paras. 3 and 4 of the B-VG stipulate that in this case, the legally binding upper limits of the BFG of the last financial year continue to apply. For 2025, the upper limits and regulations of the BFG 2024 would thus be relevant for individual subdivisions and global budgets. The administration is thus still authorized to incur expenditure within the limits set by the BFG 2024 in terms of content and amount. The human resources decisions are predetermined by the most recently valid personnel plan.

At the same time, the upper limits set for 2025 by the BFRG 2024-27 must be observed. The estimated amounts may only be utilized up to the level of the binding upper limits of the BFRG. If one compares the estimated amounts of the BFG with the upper limits of the BFRG, one sees that the payment ceiling according to the 2024 estimate is EUR 123.5bn, but that, taking into account the 2025 payment 2025 according to the BFRG, there would be payments of EUR 122.9bn, which would result in a decrease in payments of EUR 600mn for 2025 in the event of a provisional budget.

The law restricts the incurrence of new debt in order to limit the application of the provisional arrangement

A further restriction for the administration is that financial debt may only be incurred up to half of the maximum amounts provided for in the BFG in 2024. Short-term liabilities, on the other hand, can be entered into up to the total amount of the maximum amounts provided for in 2024. This regulation effectively limits the application of an automatic budget provisional arrangement to a certain period of time, the duration of which depends on the extent to which financial liabilities have to be incurred in the financial year in question. The relevant maximum amount for 2025 is derived from the payments received from taking on financial debt, which is estimated at EUR 114.4bn in the 2024 Federal Budget Act. The budget service, which advises the parliament's budget committee on public finance matters, emphasizes that this limit is usually fully utilized before the middle of the year.

Budget planning 2025 and need for consolidation

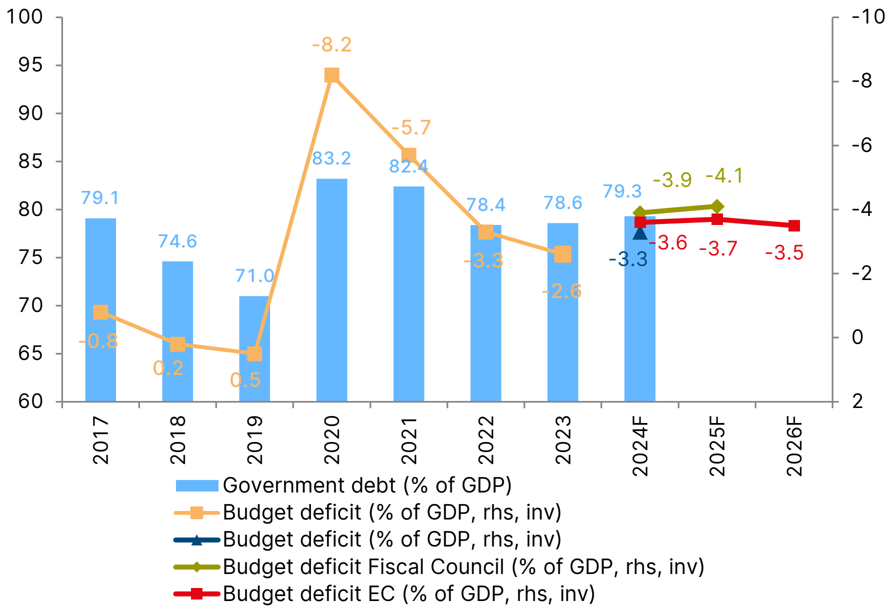
3% criterion will not be met in 2024, nor in the following years without budget consolidation

However, a new federal government will not only have the task of approving a budget for 2025 and a budget framework for 2026-28, but it must also take into account the now more acute debt situation and possible deficit proceedings by the EU Commission. As can be seen in the chart below, Austria will generate a budget deficit of over 3% of GDP in 2024, which means that Austria will violate the European Maastricht criteria. Forecasts by the Fiscal Council, a statutory body that analyses the debt situation and budget planning, and the European Commission, expect that Austria will not be able to meet the 3% criterion in 2025 and 2026 either, based on current legislation.

Risk of an excessive deficit procedure against Austria

New EU fiscal rules have been in force since April 30, 2024, when the package of measures to reorganize the EU's budgetary governance was adopted. This Credit Report does not discuss the elements of the new rules. According to the new EU fiscal rules, the European Commission will only consider initiating an excessive deficit procedure against a state if a state deviates from its predetermined net expenditure path (debt-based procedure) or exceeds the 3% criterion (deficit-based procedure). In the case of Austria, the European Commission is forecasting deficits of 3.6, 3.7 and 3.5 percent of GDP in 2024, 2025 and 2026, respectively (as shown in the chart above). This means that there is a risk that the European Commission will propose to the EU Council that deficit-based proceedings be initiated, as it also stated in writing in a letter dated November 26, 2024. However, this letter also emphasized that it would take into account any decisions of a possible new federal government or other budget-related decisions.

Budget deficit above 3% criterion, budget consolidation necessary
Budget deficit and government debt in % of GDP



Source: European Commission, Fiscal Council, MoF, Statistics Austria, Erste Group Research

Consolidation requirement between EUR 14.9bn and EUR 21.5bn depending on the scenario

The parliament's budget service has calculated the necessary amount of consolidation for the possible scenarios (initiation of an excessive deficit procedure or waiver of an excessive deficit procedure but a mandatory reduction in the debt ratio) and maturities (4 years or 7 years with a reform and investment package). In the event of the initiation of deficit-based proceedings against Austria, the Budget Service calculates that the necessary consolidation amounts to EUR 14.9bn over a period of four years and to EUR 16.9bn over a period of seven years (i.e. with the reform and investment package) EUR 16.9bn, which results in a volume of EUR 4.2bn and EUR 3.8bn of necessary savings in the budget for 2025. If no procedure is initiated against Austria, the debt ratio must fall by 0.5 percentage points per year over the four-year period under review. This, however, results in a necessary consolidation of EUR 21.5bn, which would mean budget savings of EUR 5.7bn in 2025.

Climate bonus and nominally fixed excise taxes as large and fast consolidation options

Since it became known that the European Commission could initiate an excessive deficit procedure against Austria, there have been discussions not only between the parties currently in coalition negotiations about which measures could contribute to a budget consolidation, but also statements and proposals from the major research institutes. At the beginning of December, the Fiscal Council analyzed the consolidation effect of possible measures and also whether these could contribute to budget consolidation as early as 2025. In its summary report, the Fiscal Council concludes that measures in the area of nominally fixed consumption taxes, such as motor-related insurance tax, mineral oil tax and tobacco tax, but also the withdrawal of the climate bonus, could contribute to a significant consolidation. In the medium term, a reform of wealth-related taxes (property tax, inheritance tax and wealth tax) and a pension reform can also relieve the budget. The research institute EcoAustria sees great potential for savings in the area of the climate bonus. According to the institute's calculations, a reform of the climate bonus, including a merger with the commuter allowance, would have savings potential of almost EUR 2bn, which would cover almost half of the consolidation requirement. The IHS, on the other hand, advocates measures in the area of nominally fixed excise duties, as well as the introduction of a sugar tax and a significant increase in tobacco and alcohol taxes, in order to simultaneously reduce health-related spending in the future.

Capital market

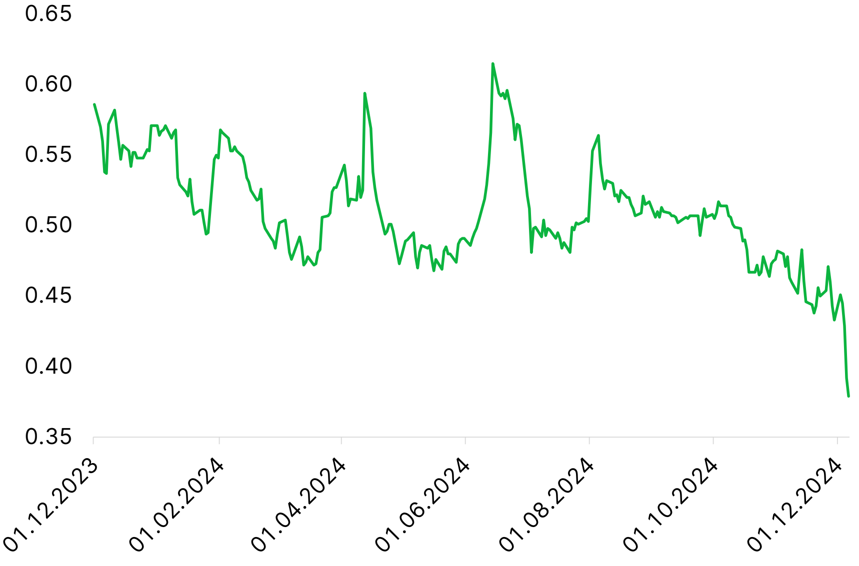
Further interest rate cuts expected

The European Central Bank (ECB) began lowering its key interest rates at the beginning of June. After four interest rate cuts, we expect further interest rate cuts at the upcoming meetings. At its last decision, the ECB emphasized that these will continue to depend on the respective data situation and will take place from meeting to meeting. The interest rate decisions are based primarily on the assessment of the inflation outlook in light of current economic and financial data, the momentum of underlying inflation and the strength of monetary policy transmission. According to the ECB, the latest inflation data show that the disinflationary process is on the right track. Weak economic data are also dampening inflation expectations, giving the ECB further arguments for cutting interest rates in the coming months despite the fact that inflation is currently above target. Given the current trend, we do not expect interest rates to rise.

German Bund yields should remain at their current level

10-year German Bund yields have fallen back to their previous level after rising in October. We expect that the current yield level of medium and longer-term German government bonds should be confirmed in the coming quarters with the onset of an economic recovery in the Eurozone, supported by further interest rate cuts by the ECB.

Risk premium 10Y AT - 10Y DE



Source: Market data provider, Erste Group Research

Risk premium should narrow further

The risk premium of 10-year Austrian government bonds over 10-year German government bonds narrowed significantly in 2024 and most recently stood at just under 40bp. We expect risk premiums to continue to fall slightly in the coming quarters, also due to positive rating reports.

Ratings and sustainability

High ratings confirmed by rating agencies

All four major rating agencies have confirmed Austria's strong ratings, which are supported by the country's well-endowed, diversified, and competitive economy and its strong external profile. The high ratings also reflect the agencies' conviction that the export ban on Russian gas due to diversification efforts, the securing of alternative transport routes and Austria's high inventories now pose only a limited risk to the economy. In addition, they emphasize that medium-term growth prospects are positive, although they expect a sustainable consolidation of public finances in the coming years.

Standard & Poor's revises Austria's outlook from stable to positive

Standard & Poor's revised Austria's outlook from stable to positive in August 2024, citing the reduced risks of a medium-term energy shortage due to Austria's dependence on Russian gas. In addition, the rating agency emphasized that Austria will return to a stable growth path in the medium term, which will also enable the consolidation of public finances.

Unclear budget situation possible point of criticism of future ratings

The latest figures from the Ministry of Finance for 2024 and the development of public finances in 2025-27 published at the end of April differ greatly from the forecasts of the two major research institutes (WIFO and IHS), the forecasts of the fiscal rate and those of the EU Commission. This could be a point of criticism in the upcoming assessments by the rating agencies and possibly lead to a deterioration in the outlook. Especially if fiscal developments do not improve in the coming quarters.

In the medium term, the rating agencies are concerned about the sharp rise in public debt in the wake of the COVID crisis and the energy price crisis following Russia's invasion of Ukraine. Another major concern is the weak growth trend of the Austrian economy compared to other economies, which, according to the rating agencies, is mainly due to an aging population. The aging population and the increasing old-age dependency ratio (ratio of the over-65s to the working-age population, i.e. 15-64) represent an ever-greater burden on social spending in connection with old age. Furthermore, some agencies still see an increased geopolitical risk for Austria.

Triggers for upgrades and downgrades

A deterioration of medium-term growth prospects (possibly due to a larger negative macroeconomic shock resulting from unfavorable energy supply or energy price developments) or a deterioration of public finances due to insufficient progress in consolidation could lead to a downgrade. On the other hand, a faster reduction in the public debt ratio, improved governance standards and the introduction of structural reforms could contribute to an upgrade.

Austria ranks highly in terms of sustainability and institutional strength

Austria also ranks highly in terms of sustainability, which includes country comparisons in areas such as ecological development, living conditions, social development, gender equality, quality of life and the well-being of the population.

Agency	Ranking by the total number of countries
Sustainalytics	11 out of 169
ISS ESG	B (good)
EPI (Yale University)	8 out of 180
SDG Index	5 out of 166

Source: OeBFA, Erste Group Research

Austria has performed well in the SGDs

Austria achieved 6th place out of 166 in the Sustainable Development Goals (SDG) index. This index assesses the achievement of the 17 most important goals for sustainable development, which include, among other things, no poverty, no hunger, good health and well-being, high-quality education, gender equality, peace, justice and strong institutions. One of the 17 goals has been achieved (SDG 1, ‘No poverty’), but Austria is in the ‘red zone’ for two goals, i.e. it faces major challenges. These include climate protection and energy, as well as responsible consumption and production. From a credit perspective, the challenges lie primarily in the area of governance.

Contacts

Group Research

Head of Group Research
Friedrich Mostböck, CEFA®, CESGA® +43 (0)5 0100 11902

CEE Macro/Fixed Income Research
Head: Juraj Kotian (Macro/FI) +43 (0)5 0100 17357
Katarzyna Rzentarzewska (Fixed income) +43 (0)5 0100 17356
Jakub Cery (Fixed income) +43 (0)5 0100 17384

Croatia/Serbia
Alen Kovac (Head) +385 72 37 1383
Mate Jelić +385 72 37 1443
Ivana Rogic +385 72 37 2419

Czech Republic
David Navratil (Head) +420 956 765 439
Jiri Polansky +420 956 765 192
Michal Skorepa +420 956 765 172

Hungary
Orsolya Nyeste +361 268 4428
János Nagy +361 272 5115

Romania
Ciprian Dascalu (Head) +40 3735 10108
Eugen Sinca +40 3735 10435
Dorina Ilasco +40 3735 10436
Vlad Nicolae Ionita +40 7867 15618

Slovakia
Maria Valachyova (Head) +421 2 4862 4185
Matej Hornak +421 902 213 591
Marian Kocis +421 904 677 274

Major Markets & Credit Research
Head: Rainer Singer +43 (0)5 0100 17331
Ralf Burchert, CEFA®, CESGA® (Sub-Sovereigns & Agencies) +43 (0)5 0100 16314
Hans Engel (Global Equities) +43 (0)5 0100 19835
Maurice Jiszda, CEFA®, CFDS® (USA, CHF) +43 (0)5 0100 19630
Peter Kaufmann, CFA® (Corporate Bonds) +43 (0)5 0100 11183
Heiko Langer (Financials & Covered Bonds) +43 (0)5 0100 85509
Stephan Lingnau (Global Equities) +43 (0)5 0100 16574
Maximilian Möstl (Credit Analyst Austria) +43 (0)5 0100 17211
Carmen Riefler-Kowarsch (Financials & Covered Bonds) +43 (0)5 0100 19632
Bernadett Povazsai-Römhild, CEFA®, CESGA® (Corporate Bonds) +43 (0)5 0100 17203
Elena Statelov, CIIA® (Corporate Bonds) +43 (0)5 0100 19641
Gerald Walek, CFA® (Eurozone) +43 (0)5 0100 16360

CEE Equity Research
Head: Henning Eßkuchen, CESGA® +43 (0)5 0100 19634
Daniel Lion, CIIA® (Technology, Ind. Goods&Services) +43 (0)5 0100 17420
Michael Marschallinger, CFA® +43 (0)5 0100 17906
Nora Nagy (Telecom) +43 (0)5 0100 17416
Christoph Schultes, MBA, CIIA® (Real Estate) +43 (0)5 0100 11523
Thomas Unger, CFA® (Banks, Insurance) +43 (0)5 0100 17344
Vladimira Urbankova, MBA (Pharma) +43 (0)5 0100 17343
Martina Valenta, MBA +43 (0)5 0100 11913

Croatia/Serbia
Mladen Dodig (Head) +381 11 22 09178
Boris Pevalek, CFA® +385 99 237 2201
Marko Plastic +385 99 237 5191
Matej Pretkovic +385 99 237 7519
Bruno Barbic +385 99 237 1041
Davor Spoljar, CFA® +385 72 37 2825
Magdalena Basic +385 99 237 1407

Czech Republic
Petr Bartek (Head, Utilities) +420 956 765 227
Jan Bystřický +420 956 765 218

Hungary
József Miró (Head) +361 235 5131
András Nagy +361 235 5132
Tamás Pletser, CFA® (Oil & Gas) +361 235 5135

Poland
Cezary Bernatek (Head) +48 22 257 5751
Piotr Bogusz +48 22 257 5755
Łukasz Jańczak +48 22 257 5754
Krzysztof Kawa, CIIA® +48 22 257 5752
Jakub Szkopek +48 22 257 5753

Romania
Caius Rapanu +40 3735 10441

Group Markets

Head of Group Markets
Oswald Huber +43 (0)5 0100 84901

Group Markets Retail and Agency Business
Head: Christian Reiss +43 (0)5 0100 84012

Markets Retail Sales AT
Head: Markus Kaller +43 (0)5 0100 84239

Group Markets Execution
Head: Kurt Gerhold +43 (0)5 0100 84232

Retail & Sparkassen Sales
Head: Uwe Kolar +43 (0)5 0100 83214

Markets Retail Sales CZ
Head: Roman Choc +420 956 765 374

Markets Retail Sales HUN
Head: Peter Kishazi +36 1 23 55 853

GM Retail Products &Business Development
Head: Martin Langer +43 (0)50100 11313

Corporate Treasury Product Distribution AT
Head: Martina Kranzl-Carvell +43 (0)5 0100 84147

Group Securities Markets
Head: Thomas Einramhof +43 (0)50100 84432

Institutional Distribution Core
Head: Jürgen Niemeier +49 (0)30 8105800 5503

Institutional Distribution DACH+
Head: Marc Friebertshäuser +49 (0)711 810400 5540
Bernd Bollhof +49 (0)30 8105800 5525
Andreas Goll +49 (0)711 810400 5561
Mathias Gindele +49 (0)711 810400 5562
Ulrich Inhofner +43 (0)5 0100 85544
Sven Kienzle +49 (0)711 810400 5541
Rene Klasen +49 (0)30 8105800 5521
Christopher Lampe-Traupe +49 (0)30 8105800 5523
Danijel Popovic +49 1704144713
Michael Schmotz +43 (0)5 0100 85542
Christoph Ungerböck +43 (0)5 0100 85558
Klaus Vosseler +49 (0)711 810400 5560
Slovakia
Šarlota Šipulová +421 2 4862 5619
Monika Směliková +421 2 4862 5629

Institutional Distribution CEE & Insti AM CZ
Head: Antun Burić +385 (0)7237 2439
Jaromir Malak +43 (0)5 0100 84254

Czech Republic
Head: Ondrej Čech +420 2 2499 5577
Milan Bartoš +420 2 2499 5562
Jan Porvich +420 2 2499 5566
Pavel Zdichynec +420 2 2499 5590

Institutional Asset Management Czech Republic
Head: Petr Holeček +420 956 765 453
Petra Maděrová +420 956 765 178
Martin Peřina +420 956 765 106
David Petráček +420 956 765 809
Blanka Weinerová +420 956 765 317
Petr Valenta +420 956 765 140
Croatia
Head: Antun Burić +385 (0)7237 2439
Zvonimir Tukač +385 (0)7237 1787
Ana Tunjić +385 (0)7237 2225
Natalija Zujic +385 (0)7237 1638
Hungary
Head: Peter Csizmadia +36 1 237 8211
Gábor Bálint +36 1 237 8205
Balazs Papay +36 1 237 8213
Gergő Szabo +36 1 237 8209
Romania
Head: Cristian Vasile Pascu +40 373 511 695

Group Institutional Equity Sales
Head: Michal Řízek +420 224 995 537
Werner Fürst +43 (0)50100 83121
Viktoria Kubalcova +43 (0)5 0100 83124
Thomas Schneidhofer +43 (0)5 0100 83120
Oliver Schuster +43 (0)5 0100 83119
Czech Republic
Head: Michal Řízek +420 224 995 537
Jiří Fereš +420 224 995 554
Martin Havlan +420 224 995 551
Pavel Krabička +420 224 995 411
Poland
Head: Jacek Jakub Langer +48 22 257 5711
Tomasz Galanciak +48 22 257 5715
Wojciech Wysocki +48 22 257 5714
Przemyslaw Nowosad +48 22 257 5712
Maciej Senderek +48 22 257 5713
Croatia
Matija Tkalicanac +385 72 37 21 14
Hungary
Nandori Levente + 36 1 23 55 141
Krisztian Kandik + 36 1 23 55 162
Balasz Zankay + 36 1 23 55 156
Romania
Valerian Ionescu +40 3735 16541

Group Fixed Income Securities Markets
Head: Goran Hoblaj +43 (0)50100 84403

Fixed Income Flow Sales
Head: Gorjan Hoblaj +43 (0)5 0100 84403
Margit Hraschek +43 (0)5 0100 84117
Christian Kienesberger +43 (0)5 0100 84323
Ciprian Mitu +43 (0)5 0100 85612
Bernd Thaler +43 (0)5 0100 84119
Zsuzsanna Toth +36 1 237 8209
Poland
Pawel Kielek +48 22 538 6223
Michal Jarmakowicz +43 50100 85611

Fixed Income Flow Trading
Head: Gorjan Hoblaj +43 (0)5 0100 84403

Group Fixed Income Securities Trading
Head: Goran Hoblaj +43 (0)50100 84403

Group Equity Trading & Structuring
Head: Ronald Nemec +43 (0)50100 83011

Business Support
Bettina Mahoric +43 (0)50100 86441

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Group Research
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