S&P Global
Ratings

RatingsDirect®

# Upper Austria (State of)

**May 22, 2023**

This report does not constitute a rating action.


Primary contact

**Marius Schulte**
Frankfurt
49-6933999240
marius.schulte
@spglobal.com

Secondary contact

**Sabine Daehn**
Frankfurt
49-693-399-9106
sabine.daehn
@spglobal.com

Analytical group contact

SovereignIPF
@spglobal.com


## Credit Highlights

### Overview

| Credit context and assumptions | Base-case expectations |
|---|---|
| Upper Austria's wealthy, industry-heavy economy has been resilient in the current challenging environment with higher energy prices and slowing global demand. | Upper Austria will post moderate deficits after capital accounts given its rising cost pressures and large investment needs. |
| Federal support and strong tax collection are supporting the state's performance. | The state's debt burden will increase but remain low since interest costs are negligible and deficits are expected to widen only marginally over the coming years. |
| We do not anticipate that the 2024 amendments to the national fiscal equalization system will materially affect the state's budget. | Upper Austria has a strong liquidity position due to its well-established access to short-term financing at the national state-financing agency. |

**The strength of Upper Austria's manufacturing-focused economy and a generally very supportive institutional framework for Austrian states support the ratings.** S&P Global Ratings does not expect material changes to the Austrian fiscal equalization system, which is currently under renegotiation with the results anticipated to be effective from 2024. The system provides a reliable revenue base, shielding the state's finances during economic slowdowns. In addition, Upper Austria's easy access to funding via the Austrian federal state-financing agency has maintained its outstanding liquidity position.

**We believe the state's prudent fiscal policies amid increasing cost pressures will lead to moderate budget deficits.** Although the state's financial management is keen to consolidate its budgets, we expect that cost pressures and large investment requirements amid subdued economic growth prospects will lead to moderate budget deficits in the medium term. The strong performance in 2022 was driven by exceptionally strong tax revenue growth on the back of high inflation, and therefore might be difficult to maintain, in our view. That said, the state's debt burden is set to remain low in an international comparison.

# Outlook

The stable outlook reflects our expectation that Upper Austria's operating revenue growth will allow it to maintain deficits after capital accounts at moderate levels in the next few years. At the same time, we forecast that Upper Austria's debt to operating revenue, while slightly increasing to cover deficits, will remain low in an international comparison.

## Downside scenario

We could consider a negative rating action on Upper Austria if its budgetary performance materially deteriorates compared to our current base-case scenario. This could happen due to an adverse impact from macroeconomic developments on tax revenue or higher-than-anticipated expenditure, for example, stemming from more pronounced operating cost pressures due to inflation and a higher execution of the state's stimulus and investment plan. Elevated spending amid weaker revenue could also signal a departure by financial management from the state's historically strong focus on budgetary consolidation.

## Upside scenario

A positive rating action would depend on Upper Austria's budgetary performance trajectory exceeding our current projections, while decreasing the state's debt burden and maintaining a strong liquidity position. In addition, any upgrade would be contingent on positive developments in the credit quality of Austria (AA+/Stable/A-1+), which we currently rate at the same level as Upper Austria. In our view, Upper Austria does not meet the conditions that would allow us to rate it higher than the related sovereign.

# Rationale

### Upper Austria's wealthy economy and the federal government's extensive support measures are favorable for budgetary performance.

We expect robust performance from Upper Austria's export-oriented economy, in-line with national economic developments, despite the current challenges of inflation remaining higher for longer, tighter financing conditions, and weaker international demand. We forecast overall Austrian national economic growth will stagnate this year to 0.3% before expanding moderately in 2024 (1.8%) and beyond.

Upper Austria's economy is more strongly focused on manufacturing sectors and less on tourism compared to national peers. It has proven resilient despite the relatively large exposure of its industry to the rise in energy prices, benefiting from extensive economic support and inflation-containing measures introduced by the central government, like electricity price-breaks and subsidies for alternative energy supply sources. The state's economic wealth levels--GDP per capita is estimated at about €53,500 (or $57,400) for 2023--remain marginally above those nationally and high in an international comparison. Upper Austria's local unemployment rate--3.6% in the state versus a 6.2% national average in April 2023--remains exceptionally low amid a reported shortage of skilled workers, therefore keeping the state's required spending on social support measures also relatively low.

We expect tax revenue growth will remain ample, with inflation and nominal growth set to remain high. Tax collection was still strong in early 2023 after an exceptional 2022 on the back of high inflation and economic growth, despite the introduction of tax rate cuts at the federal level. The Austrian fiscal system collects taxes nationally and then distributes revenue to the regional states according to their relative population. Therefore, Upper Austria will always participate directly in national developments, potentially shielding the state's finances in times of local economic distress but also limiting its budgetary flexibility.

The Austrian fiscal equalization mechanism--a key building block of the institutional framework under which Upper Austria operates (see "Institutional Framework Assessment: Austrian States," published Dec. 30, 2022, on RatingsDirect)--is currently under re-negotiation between the Austrian federal, state, and municipal levels, with a new agreement anticipated to be effective from 2024. Overall, we expect only minor changes in the tax-sharing formula and possibly small adjustments in the allocation of funds for the states' health and long-term care sectors. Consequently, since we believe there will be no significant additional allocation from the federal level, higher spending pressures--particularly for health and long-term care due to the country's aging population--amid stable revenue streams from the equalization system might require states to slow planned investment expenditure. This is especially given national fiscal rules are expected to be reimposed from 2024.

## Strong cost pressure and a large appetite for investment are challenging Upper Austria's prudent budgetary policies.

We expect that Upper Austria's budgetary performance will slightly weaken over the medium term because cost pressures are rising, for example, for health and long-term care, affordable housing, and the state's wage bill. At the same time, investment expenditure for mobility infrastructure, digitalization and green energy is likely to remain elevated, also because of a state-specific economic stimulus and investment program introduced in 2021 with an additional €200 million planned each year until 2026. Still, we assume less than full implementation of the plan based on the actual execution so far, which we partially attribute to financial management's commitment to prudent fiscal policies. Overall, we believe moderate tax revenue growth, due to inflation remaining higher, and efforts by management to contain expenditure to comply with national debt-brake rules, will allow the state to maintain operating margins above 5% and moderate deficits after capital accounts of below 5% in the next few years. Although strong 2022 results indicate already much improved performance compared to previous years during the pandemic, this is largely owed to the exceptionally strong tax revenue growth driven by record-high inflation last year, which we believe will be very difficult to maintain with tax revenue growth slowing. We note that much higher execution of projects under the stimulus and investment plan and adverse macroeconomic developments present the biggest risks to our forecast. Our overall assessment of budgetary performance reflects ongoing payments for unfunded, pay-as-you-go, pension liabilities that--while currently amounting to about 9% of operating revenue each year--we expect could increase up to one-third over the next decade, therefore presumably weighing on results.

We expect that Upper Austria will borrow the required funds to cover its moderate deficits from the national state-financing agency, while last year no new borrowings were required due to strong tax revenue. In our view, the state's consolidated debt will rise to about 34% of consolidated operating revenue by 2025 from 26% today, therefore remaining low by international standards. The major part of this debt increase will be recorded in the state's core budget, while we anticipate that guarantees, leasing contracts, and loans incurred by state-owned enterprises will rise only moderately. All Upper Austria's outstanding direct debt has been sourced from the Austrian federal state-financing agency at comparatively low fixed interest rates and is denominated in euros. In our overall debt assessment, we also consider the risk from contingent liabilities, partially because Upper Austria is the majority owner of Oberoesterreichische Landesbank AG--a local credit institution--and Energie AG Oberoesterreich--a local energy producer and utility provider--although they have not required any substantial support from the state in the recent past. In addition, we consider a large notional amount of outstanding guarantees for housing loans relative to the state's revenue, although we view the likelihood of materialization as very low.

We continue to assess Upper Austria's overall liquidity as exceptional, primarily based on its legally defined and continued sufficient access to a facility with the state-financing agency to cover short-term liquidity needs. We believe Upper Austria could also, in principle, utilize access to commercial bank lending on short notice, for instance via Oberoesterreichische Landesbank, or borrow directly in the capital market. Overall, we estimate the state's debt service coverage ratio will remain well above 100% throughout the forecast horizon.

### State of Upper Austria Selected Indicators

| Mil. EUR | 2020 | 2021 | 2022e | 2023bc | 2024bc | 2025bc |
|---|---|---|---|---|---|---|
| Operating revenue | 5,432 | 5,911 | 7,084 | 7,164 | 7,257 | 7,471 |
| Operating expenditure | 5,222 | 5,858 | 6,021 | 6,476 | 6,688 | 6,907 |
| Operating balance | 209 | 53 | 1,063 | 688 | 569 | 564 |
| Operating balance (% of operating revenue) | 3.9 | 0.9 | 15.0 | 9.6 | 7.8 | 7.6 |
| Capital revenue | 33 | 33 | 33 | 29 | 35 | 41 |
| Capital expenditure | 581 | 523 | 867 | 869 | 878 | 881 |
| Balance after capital accounts | (339) | (437) | 229 | (151) | (274) | (276) |
| Balance after capital accounts (% of total revenue) | (6.2) | (7.4) | 3.2 | (2.1) | (3.8) | (3.7) |
| Debt repaid | 83 | 8 | 5 | 134 | 70 | 47 |
| Gross borrowings | 191 | 626 | 0 | 200 | 300 | 300 |
| Balance after borrowings | (228) | 188 | 224 | (85) | (44) | (23) |
| Direct debt (outstanding at year-end) | 748 | 1,363 | 1,325 | 1,395 | 1,638 | 1,901 |
| Direct debt (% of operating revenue) | 13.8 | 23.1 | 18.7 | 19.5 | 22.6 | 25.4 |
| Tax-supported debt (outstanding at year-end) | 1,646 | 2,063 | 1,815 | 1,934 | 2,231 | 2,553 |
| Tax-supported debt (% of consolidated operating revenue) | 30.3 | 34.9 | 25.6 | 27.0 | 30.7 | 34.2 |
| Interest (% of operating revenue) | 0.1 | 0.2 | 0.1 | 0.2 | 0.2 | 0.2 |
| Local GDP per capita ($) | 50,371.0 | 55,232.1 | 54,220.5 | 57,409.5 | 62,630.4 | 66,968.3 |
| National GDP per capita ($) | 48,896.0 | 53,774.8 | 52,498.3 | 56,003.0 | 61,120.6 | 65,366.0 |

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. EUR--euro. $--U.S. dollar.

### Ratings Score Snapshot

| Key rating factors | Scores |
|---|---|
| Institutional framework | 2 |
| Economy | 1 |

| | |
|---|---|
| Financial management | 1 |
| Budgetary performance | 3 |
| Liquidity | 1 |
| Debt burden | 3 |
| Stand-alone credit profile | aa+ |
| Issuer credit rating | AA+ |

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "**Methodology For Rating Local And Regional Governments Outside Of The U.S.**," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

# Key Sovereign Statistics

- Sovereign Risk Indicators, April 10, 2023. An interactive version is available at http://www.spratings.com/sri

# Related Criteria

- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

# Related Research

- Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., March 22, 2023
- Energie AG Oberoesterreich 'A' Rating Affirmed On Predictable Financial Policy; Outlook Stable, March 20, 2023

- Oberoesterreichische Landesbank AG, March 14, 2023
- Subnational Debt 2023: An Easing Burden In Germany, Austria, And Switzerland, March 2, 2023
- Subnational Debt 2023: Fiscal Sustainability Rules Are Put To The Test, March 2, 2023
- Austria, Feb. 27, 2023
- Institutional Framework Assessment: Austrian States, Dec. 30, 2022
- Local And Regional Governments Outlook 2023: Rougher Seas Ahead, Nov. 29, 2022
- State Of Upper Austria Outlook Revised To Stable; 'AA+/A-1+' Ratings Affirmed, May 20, 2022

## Ratings Detail (as of May 19, 2023)*

| | |
|---|---|
| **Upper Austria (State of)** | |
| Issuer Credit Rating | AA+/Stable/A-1+ |
| **Issuer Credit Ratings History** | |
| 20-May-2022 | AA+/Stable/A-1+ |
| 20-Nov-2020 | AA+/Negative/A-1+ |
| 08-Jun-2018 | AA+/Stable/A-1+ |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.