Research Update:

Austrian State of Styria 'AA/A-1+' Ratings Affirmed; Outlook Remains Stable

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Overview

- COVID-19-related tax revenue losses, stemming from reduced economic activity and the new Austrian federal stimulus package, imply a significantly elevated deficit for Styria in 2020 and 2021.
- We expect the state to cover the predicted deficits through higher borrowings from the Austrian federal debt management agency.
- From 2022, we anticipate a normalization of budgetary performance, reduced deficits, and a stabilization of Styria's debt ratio, albeit 10-15 percentage points higher than today.
- We are affirming our 'AA/A-1+' ratings on Styria with a stable outlook.

Rating Action

On July 31, 2020, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on the Austrian state of Styria. The outlook is stable.

Outlook

The stable outlook reflects our view that an eventual recovery from the current economic slump will allow Styria to return to much more sustainable budgetary performance from 2022. We anticipate that the state's currently elevated deficits will then recede, and its ratio of debt to operating revenue will stabilize below 100%. Furthermore, we assume that access to Austrian federal debt management agency Österreichische Bundesfinanzierungsagentur (OeBFA) will ensure the state's liquidity at all times.

Downside scenario

We could lower our ratings if Styria failed to return its deficits after capital accounts to below 5% of total revenue by 2022, for example, due to continued adverse macroeconomic conditions, negative changes to the institutional framework occurring, or the state's financial management losing sight of consolidation requirements. Such developments would likely prevent the debt ratio from stabilizing. In addition, given current borrowing needs, any doubt about unfettered access to liquidity and funding from OeBFA could also result in a downgrade.

Upside scenario

Any upside scenario would require an extreme improvement in Styria's budgetary performance and debt dynamics, which we currently consider highly unlikely.

Rationale

Before the onset of COVID-19, Styria was on a consolidation path. The pandemic has thrown this into disarray, and we believe that there is little that the state can do to avoid significant deficits of almost 10% of total revenue in 2020 and, due to tax collection mechanics, 2021. Accordingly, Styria's debt to operating revenue will rise until the recovery feeds through into better tax collections and lifts budgetary performance, leading to much more moderate deficits after capital accounts. We anticipate this will happen in 2022, and hence believe that the state's relative debt load will remain average when compared internationally.

Our ratings on Styria are supported by the general strength of the Austrian national economy, despite the effects of the COVID-19 pandemic, and our view that financial management maintains a certain degree of cost control--even in its various spending decisions during the current slump. Styria further benefits from low contingent liabilities--after the state sold its remaining stake in a local bank in 2019--and exceptional access to liquidity via OeBFA and commercial banks.

The pandemic-induced recession and federal stimulus package will cause a significant decline in tax revenue

The current global recession caused by the COVID-19 pandemic and the Austrian federal government's attempt to re-start the economy with its July stimulus package will produce significant fiscal damage for Styria through the tax-sharing system. We currently anticipate Austria's national GDP will decline by 6.7% in 2020, followed by a strong, but not full, rebound in 2021. Because the Austrian fiscal system collects taxes nationally and distributes revenue to the states according to their relative population, Styria will be directly affected. In our view, tax revenue losses on the back of the economic contraction, the central government's payment holiday for taxpayers, and a reduced rate for the lower income tax bracket introduced by the newly-passed Austrian stimulus package could total €300 million-€400 million of revenue losses per year for Styria in 2020 and 2021. Although we expect recovery to be well underway in 2021, collection and distribution mechanics imply that next year's tax revenue will be similarly affected as in 2020.

We expect Austria's national GDP per capita to nevertheless remain at €42,300 (equivalent to $47,400) in 2020. Despite a COVID-19-induced drop, this still signals a very strong economy and clearly supports our ratings on Styria, given the described link between state revenue and the national fiscal intake.

We continue to regard the institutional framework under which Styria operates as very predictable and supportive, but we anticipate that a pending update to the national tax sharing formula will likely be delayed. The national fiscal equalization mechanism (Finanzausgleich), which determines the allocation of shared taxes between the federal, state, and local levels, was originally scheduled to be renegotiated by 2022. However, we understand that, given uncertainty about fiscal developments and limited resources for renegotiations, the existing formula might continue for two additional years. Important aspects of the second, long-discussed, reform project--namely a far-reaching tax reform--were built into the federal stimulus package passed by the national parliament on July 7 and 15. We are therefore not sure if, as originally planned, the Austrian federal legislators will enact further meaningful changes to the tax code, with implications for states' finances, in the near future.

In our view, Styria's financial management has so far demonstrated relative restraint in various spending decisions taken to mitigate the effects of COVID-19. Bundled into three packages (Massnahmenpakete I, II, and III), a number of assistance measures have been or are being put in place. These comprise, for example, the acquisition of protective medical equipment, support to individuals and enterprises not sufficiently covered by federal programs, and payments to facilitate capital expenditure by Styrian municipalities. However, with expected annual costs in 2020 and 2021 of about €50 million and €90 million, respectively, these measures appear much more parsimonious, but also realistic, than those of many other German-speaking regional governments. We interpret this as a sign that cost control still remains an important target for Styria's financial management.

Elevated deficits in 2020 and 2021 will push up Styria's debt ratio

Due to COVID-19, we forecast Styria will post deficits after capital accounts of close to 10% of total revenue in 2020 and 2021. This follows a healthy operating margin of 7.4% in 2019 and, thanks to a significant premium collected from a debt refinancing exercise, an exceptional surplus after capital accounts of 3.5%, according to our cash-focused calculation approach. The currently accruing tax revenue losses will, however, totally reverse recent developments and, in our view, produce only marginally positive operating margins and a deficit after capital accounts of 9.5% and 8.2% in 2020 and 2021, respectively. We further anticipate that an eventual recovery will start to show in budgetary results from 2022. Although this should reduce deficits to a much more manageable 3.0%-4.5%, we believe that a negative base effect and the impact from the national stimulus package's tax rate reduction will prevent Styria from fully balancing its accounts until at least 2023. Our assessment of budgetary performance reflects ongoing payments for unfunded, pay-as-you-go pension liabilities that, although not excessively large, will also weigh on results for the foreseeable future.

Despite a predicted rise of Styria's debt ratio by about 10 percentage points due to COVID-19, we anticipate its debt burden will remain average in an international context. Styria predominantly borrows from the Austrian federal debt management agency OeBFA, which allows for low-cost funding and offers long tenors. In fact, Styria successfully restructured €736 million of near-term debt maturities into fixed-rate, ultra-long-term funding provided by OeBFA in 2019. As a result, the state's long-term annual debt maturities now generally remain below €300 million. Funding the deficits of 2020 and 2021 will, in our view, push up Styria's outstanding direct debt to about 95% of operating revenue. However, we believe that the predicted normalization of performance thereafter will enable Styria to stabilize its debt burden at this level.

After the sale of Styria's residual stake in Landes-Hypothekenbank Steiermark in 2019, we see no need to adjust the state's debt burden for its exposure to contingent liability risk. The remaining below €600 million of Landes-Hypothekenbank Steiermark grandfathered guaranteed debt and slightly more than €600 million of sold housing loan receivables that Styria also guarantees nominally constitute its largest exposures. However, we consider the actual economic risk from these two items, and from the state's various participations, including a 75% stake in local utility

ESTAG, rather limited.

Similar to most other Austrian states, we believe Styria's liquidity position is predominantly determined by its exceptional access to external liquidity via OeBFA and, with decreasing importance, the capital market. The state is entitled to borrow from OeBFA for planned drawings of funds and maintains a sizable credit facility with the agency for liquidity management purposes. We assume that OeBFA stands ready to do what is required to support Styria's and its peers' liquidity during the current slump. Styria also maintains €300 million of committed credit lines with commercial banks. Relative to the elevated deficits after capital accounts that we predict for 2020 and 2021, existing liquidity and these commercial credit lines alone are, however, insufficient to keep our calculated debt service coverage ratio above the relevant threshold of 40% during this period. But, since we anticipate performance will normalize from 2022, we continue to assess Styria's liquidity position as exceptional.

Key Statistics

Table 1

State of Styria Selected Indicators

	2018	2019	2020bc	2021bc	2022bc	2023bc
Operating revenues	5,358	5,545	5,259	5,436	5,755	5,973
Operating expenditures	5,018	5,137	5,214	5,274	5,419	5,557
Operating balance	340	407	45	163	336	416
Operating balance (% of operating revenues)	6.3	7.3	0.8	3.0	5.8	7.0
Capital revenues	255	567	231	231	231	231
Capital expenditures	836	764	798	860	823	845
Balance after capital accounts	(241)	211	(523)	(467)	(257)	(198)
Balance after capital accounts (% of total revenues)	(4.3)	3.5	(9.5)	(8.2)	(4.3)	(3.2)
Debt repaid	468	1,220	450	455	440	518
Gross borrowings	770	1,083	872	922	697	716
Balance after borrowings	31	67	(101)	0	0	0
Direct debt (outstanding at year-end)	4,547	4,398	4,808	5,263	5,509	5,696
Direct debt (% of operating revenues)	84.9	79.3	91.4	96.8	95.7	95.4
Tax-supported debt (outstanding at year-end)	4,742	4,562	4,972	5,427	5,673	5,860
Tax-supported debt (% of consolidated operating revenues)	88.4	82.2	94.5	99.7	98.5	98.0
Interest (% of operating revenues)	1.9	1.9	2.1	2.1	2.0	2.0
Local GDP per capita (single units)	40,000	41,152	39,004	41,044	42,131	43,290
National GDP per capita (single units)	43,720	45,004	42,344	44,629	45,817	47,083

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

State of Styria Ratings Score Snapshot

Table 2

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	4
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, July 14, 2020. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Economic Research: Eurozone Economy: The Balancing Act To Recovery, June 25, 2020
- COVID-19 Will Test The Financial Flexibility Of LRGs In Germany, Switzerland, And Austria, April 27, 2020
- Austria, March 13, 2020
- Local Government Debt In Germany, Switzerland, And Austria For 2020, March 2, 2020
- Styria (State of), Jan. 31, 2020
- Energie Steiermark AG, Dec. 3, 2019

- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Public Finance System Overview: Austrian States, Sept. 6, 2018

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Styria (State of)	
Issuer Credit Rating	AA/Stable/A-1+