S&P Global
Ratings

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Research Update:

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

July 26, 2024

Overview

- Still-weak tax revenue growth, staff cost increases, and transfer expenditure outpacing transfer revenue will likely weigh on the State of Styria's operating margins in 2024.
- From 2025, we expect gradual improvements, anticipating that financial management will implement measures to reduce deficits after capital accounts and limit the intake of direct debt.
- We affirmed our 'AA/A-1+' long-term and short-term ratings on Styria. The outlook is stable.

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Rating Action

On July 26, 2024, S&P Global Ratings affirmed its 'AA/A-1+' long-term and short-term issuer credit ratings on the Austrian State of Styria. The outlook is stable.

Outlook

The stable outlook reflects our view that Styria's financial management will implement consolidation measures to control the dynamic development of expenditure. This, supported by increasing operating revenue, will drive incremental-but-stable improvements in budgetary performance and limit the need for additional debt.

Downside scenario

We could consider a negative rating action on Styria if we were to observe a substantial deviation from expected financial policies, leading to deteriorating budgetary performance with larger deficits than our projected base-case scenario. This could follow the financial management team's inability to control the development of expenditure or significant shortfalls on the revenue side, in a scenario leading to a further increase in debt levels.

Upside scenario

We could raise the long-term rating if we were to observe a more pronounced and sustained revenue improvement through much higher-than-expected transfers from the federal government, while financial management pursues a consolidation path that counteracts the dynamic increase of expenditure and achieves sustained surpluses after capital accounts. This could allow Styria to considerably reduce its debt burden.

Rationale

Our ratings on Styria are underpinned by the very predictable and well-balanced institutional framework the state operates under, and its conservative fiscal policies in a relatively wealthy and dynamic economy. We expect a return to moderate economic growth levels in Austria and the additional revenue from the new national fiscal equalization agreement will support the state in gradually reducing its deficit after capital accounts, given that the purchase of the utilities company ESTAG affected results in 2023.

Styria benefits from an exceptional liquidity position, with access to the federal debt management agency (Oesterreichische Bundesfinanzierungsagentur [OeBFA]), which further support the ratings.

Return to growth and the new financial equalization agreement will boost Styria's revenue in the face of spending pressures

Styria's finances largely benefit from positive developments in Austria's economic performance. The state has a strong manufacturing sector with an export-oriented economic structure representing about 15% of the country's total exports. This underpins our expectation that it will perform broadly in line with the national average. S&P Global Ratings projects GDP growth in Austria to recover gradually in 2024 (0.4%) and 2025 (1.8%) after a technical recession in 2023 (with GDP down 0.7%). This moderate return to growth works in favor of more populous states such as Styria because the Austrian fiscal system collects taxes nationally and distributes revenue to the states based on, among other factors, their relative population.

Styria's revenue is also strengthened by the regular update of Austria's fiscal equalization system, which resulted in additional transfers from the federal government. These give the state about €260 million of additional funds per year from 2024-2028, an 11% increase in total transfers. Although part of this revenue gain is tied to some targets in health care infrastructure, primary education, housing, and climate adaptation, it effectively allows for some flexibility and substitution, supporting Styria's financial management in addressing spending developments in big ticket items such as the social and health care sectors. In addition, all Austrian states often indirectly benefit from diverse nationwide initiatives that result in unbudgeted additional transfers from the federal budget, the most recent example being a federal stimulus program for the construction sector.

On the expenditure side, cost inflation is expected to ease slowly, with CPI inflation falling to 4.1% in 2024 and 3.2% in 2025 from a peak of 7.7% in 2023. Although inflationary pressure over spending remains an issue, Styria has demonstrated its ability to critically examine its balance sheet and implement cost containing measures, offsetting expenditure increases and slightly reducing the burden of high inflation on state finances. More recent examples include the dissolution of Social Welfare Associations (SHV) at the municipal level and the social care sector's integration into the state budget, with the aim of more efficiently managing synergies and allocating funding streams. Management's commitment to controlling costs along the projected resilient tax revenue over our forecast horizon further supports our expectation of steady improvements in budgetary performance over the forecast period through 2026.

We expect that neither the Austrian nor Styrian state elections in fall 2024 will lead to policy changes that might disrupt the current fiscal adjustment path. We think management understands the key challenges the state faces, especially regarding health and social care-related expenditure, and is committed to implementing reforms. While we understand that the political process might produce different paths to consolidation, we do not anticipate consolidation overall to be abandoned. This expectation is also underpinned by the need to comply with the Austrian national debt-brake rules.

The state has comparatively moderate debt, with exceptional access to liquidity via the federal debt agency

Inflation-induced increases in personnel costs and the strong development of transfer payments in a context of slow revenue collection still dampen a more pronounced recovery in 2024 following the strong deficit after capital accounts of about 11% of total revenue in 2023 from the acquisition of the remaining 25% stake in the now 100% state-owned utility Energie Steiermark AG for €530 million. As economic growth slowly picks up, we expect operating revenue to partially offset expenditure rises over the forecast horizon. We expect further consolidation to allow for stable surpluses in operating accounts, which would enable Styria to gradually return to much lower deficits in the capital accounts by 2026.

We think the risk to budgetary performance from the state's unfunded, pay-as-you-go, pension obligations toward retiring civil servants is subsiding. Following changes in hiring practices in the early 2000s, most of Styria's current employees are now covered by the contribution-funded national pension insurance system rather than the state's budget. For the remaining state pension-eligible special-status civil servants (predominantly teachers), the federal government largely reimburses Styria. Deducting these reimbursements, we calculate net pension expenditure for Styria of slightly above 2% of the state's annual operating revenue. While projections show the number of pension-eligible retirees to peak in 2030, this should not increase the burden much, even when allowing for cost-per-capita increases.

In 2024, we expect the debt burden to fall to about 75% of total operating revenue after Styria's direct debt increased to 81% in 2023 due to the ESTAG purchase. However, this decline is largely a technical effect from the integration of the municipalities' social welfare associations into the state budget, which inflates the debt ratio's denominator. We expect the debt burden will stabilize near the current moderate level, in a national and international comparison. Styria predominantly borrows from the OeBFA, which allows for fixed-rate, comparatively low-cost funding and has recently offered ultra-long tenors of up to 100 years.

In our view, Styria's contingent liabilities are low. The largest contingent liability for the state at Dec. 31, 2023, are grandfathered guarantees of €342 million for debt issued by its former state bank many years ago. Besides other smaller amounts, we consider €330 million of housing loan receivables sold and guaranteed to financial institutions, and ESTAG's debt in our contingent liability assessment, but with a very low risk of being called.

We assess Styria's overall liquidity as exceptional, driven by the state's ability to fund via OeBFA. Cash holdings are typically low. However, management can borrow from OeBFA for both short and long-term funding. Styria also maintains €300 million of committed credit lines with four commercial banks and can use funds from its cash pooling with related third parties like the state hospital company or the state real estate company, which represents about 70% of the following year's debt service.

Key Statistics

Table 1

State of Styria--Selected indicators

	--Fiscal year ended Dec. 31--					
Mil. €	**2021**	**2022**	**2023**	**2024bc**	**2025bc**	**2026bc**
Operating revenues	5,847	6,618	7,004	7,859	8,254	8,484
Operating expenditures	5,697	6,115	6,563	7,554	7,841	8,014
Operating balance	150	504	441	305	413	469
Operating balance (% of operating revenues)	2.6	7.6	6.3	3.9	5.0	5.5
Capital revenues	260	233	203	135	136	145
Capital expenditures	681	754	1,442	825	842	855
Balance after capital accounts	(271)	(17)	(798)	(385)	(293)	(241)
Balance after capital accounts (% of total revenues)	(4.4)	(0.3)	(11.1)	(4.8)	(3.5)	(2.8)
Debt repaid	255	240	285	289	283	289
Gross borrowings	619	0	1,176	550	550	550
Balance after borrowings	93	(257)	94	(125)	(26)	20
Direct debt (outstanding at year-end)	4,981	4,723	5,698	5,959	6,241	6,502
Direct debt (% of operating revenues)	85.2	71.4	81.4	75.8	75.6	76.6
Tax-supported debt (outstanding at year-end)	5,144	4,886	5,861	6,122	6,405	6,666
Tax-supported debt (% of consolidated operating revenues)	87.9	73.8	83.6	77.9	77.5	78.5
Interest (% of operating revenues)	1.8	1.3	1.2	1.8	1.9	2.0
Local GDP per capita (€)	41,500	44,600	47,013	48,940	50,648	52,219
National GDP per capita (€)	45,366	49,807	52,521	54,499	56,364	58,064

Note: Adjusted operating revenue and operating expenditure figures revised upward by an equal amount to align with gross presentation of federally reimbursed salary and pension payments to (former) teachers under current Austrian public sector accounting standard VRV 2015. This leads to insignificantly different performance and debt ratios compared with our previous calculations. 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

Table 2

State of Styria--Ratings score snapshot

Key rating factors	
Institutional framework	2
Economy	1
Financial management	2
Budgetary perfomance	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, July 8, 2024. Interactive version available at http://www.spratings.com/sri

Related Criteria

- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Eurozone Q3 2024: Growth Returns, Rates Fall, July 24, 2024
- Subnational Debt 2024: Fiscal Policy Differences Influence Borrowing In Developed Markets, March 4, 2024
- Subnational Debt 2024: Focus on debt sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Austria, Feb. 26, 2024
- Bulletin: Austrian State of Styria's Full Ownership Of Energie Steiermark Is Likely Temporary,

Feb. 21, 2023

- Institutional Framework Assessment: Austrian States, Dec. 30, 2022

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+