Research Update:

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

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Overview

- Styria's financial planning for 2019-2022 aims to gradually improve budgetary performance toward compliance with the Austrian national stability pact by containing expenditure growth.
- We predict Styria will markedly improve its balance after capital accounts, but that a slightly less supportive macroeconomic and national political backdrop, and possible minor slippage in budget execution, will cause small deficits to remain.
- We expect Styria's ratio of tax-supported debt to operating revenues will remain broadly unchanged.
- We are affirming our 'AA/A-1+' ratings on Styria. The outlook remains stable.

Rating Action

On Aug. 2, 2019, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on the Austrian State of Styria. The outlook remains stable.

Outlook

The stable outlook reflects our expectation that Styria will continue to limit expenditure growth and pursue its stated budgetary consolidation strategy, despite potentially facing some fiscal headwind from softer economic growth and political decisions taken at the Austrian federal level ahead of the September 2019 general elections.

Downside scenario

We could lower our rating if Styria deviated significantly from its clearly communicated ambition of budgetary consolidation and failed to reduce deficits. This could result either from the administration weakening its focus on containing expenditure growth, from a meaningful deterioration in the macroeconomic environment reducing tax revenue growth below current expectations, or from fiscally detrimental decisions taken at the Austrian federal level ahead of the September 2019 elections. If Styria then faced difficulties aligning expenditures with actual revenues and implementing the steps outlined in its budgetary plan, we could also revise our assessment of the state's financial management downward.

Upside scenario

We could consider taking a positive rating action on Styria if the state meaningfully outperformed its financial planning, characterized by sustainable surpluses after capital accounts and a quick reduction of outstanding debt volumes. However, given that it is an ongoing challenge for Styria to contain structural expenditure growth, we regard such developments as unlikely over the next 24 months.

Rationale

Since 2016, Styria has posted sizable deficits after capital accounts, been noncompliant with the Austrian national stability pact's deficit target, and experienced rising debt. However, the state's financial management obtained parliamentary approval for a consolidation-focused budget for 2019/2020 that aims to limit expenditure growth and gradually reduce deficits, with the goal of balancing the budget by 2021. We make some conservative adjustments to the state's budgetary planning, but believe that Styria will nonetheless manage to reduce its deficits markedly. Overall, we conclude that budgetary performance will be average after factoring in the burden from Styria's unfunded pension obligations. Based on our expectations for budgetary performance, we forecast Styria's debt burden will remain fairly stable, and at an average level relative to peers'.

While the Austrian economy's very strong recent performance has so far provided great support to Styria's consolidation efforts, we now note slightly softer growth expectations and less visibility on the institutional framework under which Styria will operate. We attribute the latter to a snap election becoming necessary at the national level in Austria, after the previous government was ousted by a vote of no confidence in May, effectively derailing implementation of the proposed tax reform.

Styria's access to funding from the Austrian federal debt management agency, OeBFA, and from commercial banks and the capital market, is the key to our view of its exceptional liquidity position.

The recent economic backdrop has supported consolidation, but the future could be more challenging

The recently observed macroeconomic developments in Austria have provided strong support for Styria's targeted budgetary consolidation, but forecast lower growth rates could dampen tax revenue growth going forward. Through the tax system, which collects practically all relevant taxes nationally and then distributes revenue by relative population, Styria has been participating directly in Austria's high national GDP of almost €44,000 per capita in 2018 (equivalent to more than $51,000) and the observed strong real GDP growth of 2.7% during past year. However, we now forecast GDP growth of only 1.7% in 2019 and 1.6% in 2020 for Austria. We expect Styria's fiscal revenues will mirror these developments, with a time lag due to the tax assessment and collection mechanics.

At least in its most populous and dynamic core region around Graz, Styria benefits from an advanced economy that is export-oriented, and focused on technology and knowledge, with a particularly strong local automotive industry. This has resulted in comparatively low local unemployment of only 5.2% in May 2019 (as per the Austrian national definition). However, it presumably also increases Styria's exposure to global business cycle fluctuations compared with regions that are more isolated. Additionally, it requires the state to undertake significant capital expenditures to cope with population growth and provide the required infrastructure. We note that justifying cuts to the public service infrastructure, particularly hospitals, in the more remote regions of Styria appears to be a major political challenge, when at the same time such infrastructure is strengthened in Styria's urban centers.

The political situation at the Austrian federal level currently reduces our visibility regarding future fiscal resources for Styria, despite the predictability that the well-established and robust institutional framework for Austrian states otherwise affords. Prior to being ousted by a vote of no confidence in May 2019, the national government coalition between the conservative ÖVP and populist FPÖ announced a tax reform that would have caused tax revenue losses for Styria from 2021. We still believe that a meaningful reform will eventually be implemented, but with a snap election now scheduled for September of this year and currently little clarity on the composition of government thereafter, the timing of such reform is likely to be delayed and its impact may change. Additionally, we cannot rule out that, as was observed in similar situations in the past, populist decisions by the outgoing parliament ahead of the upcoming federal election could produce revenue losses for Styria.

Styria's strong financial management successfully negotiated and obtained the required parliamentary approval for a consolidation-focused budget for 2019/2020. Full implementation of the new budget, which we consider a challenge and therefore discount slightly for our financial forecast, would limit overall expenditure growth to below projected revenue growth and gradually reduce the currently still-elevated deficits to levels compatible with the Austrian national stability pact by 2020. By agreeing to bring forward the publication date for 2019 results to April 2020, which is ahead of the next state election in May of that year, Styria's financial management has increased its political commitment to actually execute its budgetary plan. Nonetheless, while Styria's ruling coalition between the social-democratic SPÖ and the conservative ÖVP has so far displayed great harmony, we would expect some differences to surface in the run-up to the 2020 state election, which may make steering the budget more challenging.

Smaller deficits and broadly unchanged debt burden forecast

In 2018, Styria's budgetary performance yielded an operating margin of 6.3% of operating revenues and a deficit after capital accounts of 4.3% of revenues, according to our cash-focused calculation approach. Thanks to healthy tax revenues and restraint on the expenditure side, the state outperformed the operating result targeted by its supplementary budget by €90 million. However, ignoring the offsetting contribution from extra-budgetary units that are consolidated for deficit calculation purposes, the negative result after capital accounts still implies that Styria remained in breach of the deficit target of the inner-Austrian stability pact with its core budget in 2018.

For 2019-2022, we now expect that Styria will achieve operating margins of 6.1%-7.2% of operating revenues, and deficits after capital accounts of 2.5%-3.3% of total revenues. This continues to reflect our belief that Styria will largely implement its targeted budgetary consolidation strategy, with only minor fiscal slippage. However, compared to our last research update, published Feb. 1, 2019, we now incorporate a slightly weaker economic growth assumption and the possibility of federal lawmakers making popular, but expensive, decisions ahead of the 2019 general election into our forecast for 2021-2022. Accordingly, we expect that achieving compliance with the Austrian national stability pact's deficit target will present a challenge for Styria.

Overall, we assess Styria's budgetary performance as average. Its entirely unfunded pension obligations, with an estimated net present value of about €3 billion, weigh on our assessment. While new hires generally no longer obtain a direct pension claim against the state, we note that payments to retired special status civil servants will continue to burden Styria's budget by about €120 million-€150 million per year for years to come.

Styria's established access to funding from OeBFA, and from commercial banks and the capital market, is key to our view of its liquidity position as exceptional. Styria introduced a policy of maintaining €300 million of committed bank credit lines early this year. However, despite Styria's subsidiaries KAGes and LIG having provided the state with €170 million in liquidity in 2018, under the newly established cash pooling agreements, pure cash and committed bank credit lines together cover less than 80% of the next 12 months of expected maturities. We believe that this is fully offset by the state's ability to also access other sources of financing and its remaining, and in our view pivotal, cash-advance facility with OeBFA.

We continue to forecast that Styria's ratio of tax-supported debt to operating revenues will remain broadly stable at about 90%, in line with similarly rated peers. Debt is denominated only in euros, and mostly long-term and fixed-rate. We note that Styria continues to voluntarily refinance near-term maturities with ultra-long, fixed-rate debt sourced from OeBFA. For 2019, we expect that Styria will effectively extend the maturity of over €700 million of debt instruments in this way. By doing so, the state aims to reduce its annual maturities to less than €500 million.

Our assessment of Styria's overall debt burden is not significantly affected by the state's contingent liabilities. In particular, following the completion of the sale of its last remaining 25% stake in Landes-Hypothekenbank Steiermark to Raiffeisen-Landesbank Steiermark AG in the first quarter of 2019, we understand that it is now the contractual obligation of the bank's new sole owner to ensure its proper capitalization. We also believe that the contingent liability risk created by Styria's 75% stake in local utility ESTAG; its participations in about 40 other, much smaller entities; and various guarantees outstanding is limited in materiality.

Key Statistics

Table 1

State of Styria Key Statistics

	--Fical year ending Dec. 31--					
(Mil. €)	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	5,179	5,358	5,429	5,602	5,743	5,954
Operating expenditures	4,835	5,018	5,097	5,227	5,363	5,524
Operating balance	344	340	332	375	381	430
Operating balance (% of operating revenues)	6.6	6.3	6.1	6.7	6.6	7.2
Capital revenues	228	255	283	231	231	231
Capital expenditures	811	836	760	798	790	823
Balance after capital accounts	(239)	(241)	(145)	(193)	(179)	(163)
Balance after capital accounts (% of total revenues)	(4.4)	(4.3)	(2.5)	(3.3)	(3.0)	(2.6)

Table 1

State of Styria Key Statistics (cont.)

	--Fical year ending Dec. 31--					
(Mil. €)	2017	2018	2019bc	2020bc	2021bc	2022bc
Debt repaid	330	468	1,220	546	551	536
Gross borrowings	1,019	770	1,389	739	730	699
Balance after borrowings	(75.9)	30.8	(5.9)	(0.0)	(0.4)	0.0
Direct debt (outstanding at year-end)	4,255	4,547	4,704	4,885	5,052	5,203
Direct debt (% of operating revenues)	82.2	84.9	86.6	87.2	88.0	87.4
Tax-supported debt (outstanding at year-end)	4,645	4,742	4,891	5,062	5,219	5,360
Tax-supported debt (% of consolidated operating revenues)	89.7	88.5	90.1	90.4	90.9	90.0
Interest (% of operating revenues)	2.0	1.9	2.0	2.0	2.0	2.0
Local GDP per capita (single units)	38,100	39,533	40,675	41,769	42,809	43,875
National GDP per capita (single units)	42,164	43,764	45,037	46,257	47,417	48,606

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.

Ratings Score Snapshot

Table 2

State of Styria Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
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, July 11, 2019. Interactive version 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

- Guidance: Methodology For Rating Local and Regional Governments Outside The U.S., July 15, 2019
- Banking Industry Country Risk Assessment: Austria, June 19, 2019
- Austrian Coalition Collapse: Implications For Sovereign Ratings, May 20, 2019
- Austria Affirmed At 'AA+/A-1+'; Outlook Stable, March 15, 2019
- Local Government Debt 2019: Slower Debt Reduction For German States And Little Change For Swiss And Austrian LRG Debt, March 1, 2019
- Austrian Utility Energie Steiermark Outlook Revised To Stable On Revision Of State of Styria Outlook; Affirmed At 'A', Feb. 6, 2019
- Austrian State of Styria Outlook Revised To Stable On Consolidation Efforts And Improved Liquidity; 'AA/A-1+' Affirmed, Feb. 1, 2019
- Institutional Framework Assessments For International Local And Regional Governments, Nov. 6, 2018
- Public Finance System Overview: Austrian States, Sept. 6, 2018
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 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+