S&P Global Ratings

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Styria (State of)

Primary Credit Analyst:
Michael Stroschein, Frankfurt (49) 69-33-999-251; michael.stroschein@spglobal.com

Secondary Contact:
Alois Strasser, Frankfurt (49) 69-33-999-240; alois.strasser@spglobal.com

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Styria (State of)

Key Rating Factors

Issuer Credit Rating
AA/Stable/A-1+

Credit context and assumptions

Resilient economic growth enabled Styria to continue its consolidation in 2019.

- Economic activity held up comparatively well in Austria and resulted in good tax revenue growth for the state.
- We believe Styria met its 2019 budgetary targets and further narrowed its deficit after capital accounts.
- A snap election in November confirmed Styria's governing coalition.

Base-case expectations

We expect the major parts of a planned Austrian national tax reform to become effective in 2021 and 2022.

- This would reduce tax revenue growth sharply during the introductory years for Styria, as well.
- As a consequence, we now anticipate a marginal increase in the state's deficit after capital accounts.
- We continue to assume a slow expansion of the amount of outstanding debt and, thanks to its access to market and government funding, we expect Styria's exceptional liquidity position to remain unchanged.

Outlook

The stable outlook reflects our expectation that Styria will continue to limit expenditure growth and pursue its stated budgetary consolidation strategy, despite facing some fiscal headwinds from presumably softer economic growth and the political decisions taken at the Austrian federal level after the formation of a new Austrian national government.

Downside scenario

We could lower our rating if Styria deviated significantly from its clearly communicated ambition of budgetary consolidation and failed to contain deficits. This could result either from the administration weakening its focus on limiting expenditure growth, from a meaningful deterioration in the macroeconomic environment reducing tax revenue growth below current expectations, or from decisions taken at the Austrian federal level being fiscally more detrimental than we currently assume. If Styria then faced difficulties aligning expenditure with actual revenue 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, with the current tax reform plans and 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

Following the confirmation of its coalition government in a regional snap election, we do not expect any meaningful changes to Styria's general approach to financial management. The state has narrowed its deficits after capital accounts over the last few years, thanks to a supportive macroeconomic backdrop and control over expenditure increases.

However, slower economic growth and a change to the institutional framework for Austrian states, namely a national tax reform planned for 2021-2022, will likely weigh on Styria's future budgetary performance and cause a minor widening of deficits. We nevertheless continue to expect an average budgetary performance overall, after factoring in pension obligations.

Reflecting budgetary performance, Styria's debt burden, currently just above 80% of operating revenues, will grow slowly over our 2020-2022 forecast horizon. Following the sale of its residual banking stake in 2019, we view contingent liability risks for Styria as limited. The state's access to government funding via the Austrian debt management agency OeBFA, and via the capital and bank market, ensure an unchanged assessment of its liquidity position as exceptional.

Slower economic growth and a planned national tax reform create a more challenging environment for Styria

We now forecast real GDP growth of 1.4% per year for Austria for 2019-2022. While this is significantly lower than the 2.4% annual growth experienced in 2018, we consider the expected pace of economic expansion as relatively resilient compared with other countries, for example Germany. Estimated at almost €45,000 (equivalent to $51,600) for 2019, Austria's GDP per capita signals a very strong economy in an international comparison. Through the tax system, which collects practically all relevant taxes nationally and then distributes each state's revenue share according to its population, Styria's tax income remains directly linked to Austria's national economic performance.

Due to the high relevance of the local automotive sector and other export-oriented industries, we see Styria's economy as still exposed to global business cycle fluctuations, frictions in international trade, and disruptive changes in technology. However, the local unemployment rate of 7.8% in December 2019, measured according to the Austrian national definition and almost at the same level as in December 2018, and a resilient outcome of the Austrian Economic Chambers' December 2019 business climate poll in Styria, provide reassuring signals in this context.

A planned national tax reform probably constitutes the biggest near-term change in the institutional framework under which Styria operates. The newly formed national Austrian government recently confirmed its commitment to implement a substantial tax reform, inclusive of significant cuts to income and corporate tax rates. Simplifying this complex matter for financial modelling purposes, we assume that the various additional, not yet legislated measures could reduce annual government revenue by a total of €4.5 billion. Two-thirds of the measures would start to apply from 2021, while the remaining one-third would be implemented in 2022. Under the current tax revenue-sharing mechanism, 20% of the total cost would accrue to the states, of which about 14% would then hit Styria, based on its share in Austria's total population. In consequence, nominal tax revenue growth for Styria would be only minimal during the two introductory years, and overall collections permanently lower by the amount apportionable to the state.

We note in this context that the current formula for sharing tax revenue among the local, regional, and national levels ("Finanzausgleich") will expire by the end of 2021, theoretically giving the Austrian states an opportunity to negotiate for partial compensation for the revenue losses from the tax reform. However, we currently have no visibility on potential outcomes of such negotiations.

We do not believe that the November 2019 regional snap election in Styria will have a significant impact on the state's financial management. The coalition government between the conservative ÖVP and its junior partner SPÖ was confirmed, and the incumbent finance minister remains in place. Accordingly, we do not expect the previous objective of gradual budgetary consolidation and cost control to be abandoned, notwithstanding the impact of the tax reform.

Budgetary performance is predicted to marginally weaken, but not to cause any material deterioration of Styria's debt and liquidity situation

Styria managed to meet its budgetary target of further reducing its deficit in 2019, according to our preliminary estimate. While we understand that tax revenue was minimally below plan, small expenditure savings likely compensated for this. For the last year, we assume an operating margin of 6.2%, and a deficit after capital accounts of about 2.5%. This includes revenue of €52 million for the sale of Styria's residual 25% stake in Landes-Hypothekenbank Steiermark, which completed in the first quarter of 2019.

Against the backdrop of the planned national tax reform described above, we anticipate the recent trend of ever-narrowing deficits will come to a halt, and performance will marginally soften. For our 2020-2022 forecast horizon, we now predict operating margins of 5.2%-5.8%, and deficits after capital accounts of 4.1%-4.6%. Our estimate assumes a continuation of recent efforts to control cost increases, but does not incorporate any potential compensation for the upcoming tax reform by means of a realignment of the tax revenue-sharing formula from 2022.

Our overall view of Styria's budgetary performance as average remains unchanged, despite the expected softening, and continues to reflect an annual burden from pension payments to retired civil servants of €120 million-€150 million for the foreseeable future.

Long- and short-term funding from the Austrian debt management agency OeBFA, a renewal of €300 million of committed bank credit lines, and a cash-pooling agreement with its key subsidiaries under which it obtained in excess of €190 million of funds as of year-end 2019 characterize Styria's current liquidity arrangements. However, Styria continues to cover less than 80% of the next 12 months' expected maturities with cash and committed commercial facilities, if one adds an assumed maximum outstanding amount of €200 million of short-term debt for intra-year liquidity management purposes to the existing long-term debt maturities. It is therefore rather the state's access to government funding via OeBFA and to the capital market that drive our overall assessment of its liquidity position as exceptional.

Styria's slightly softer budgetary performance will only minimally influence the trajectory of its outstanding consolidated, tax-supported debt, which we anticipate will just exceed 90% of operating revenue by 2022. We note in this context that 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 debt maturities are now below €300 million in any given year.

With the residual stake in Landes-Hypothekenbank Steiermark having been sold in 2019, we see no need to adjust the state's debt burden for its exposure to contingent liability risk. The remaining grandfathered guaranteed debt of Landes-Hypothekenbank Steiermark of just below €800 million, and slightly more than €700 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 its 75% stake in local utility ESTAG, as rather limited.

Key Statistics

Table 1

State of Styria Selected Indicators

	--Fiscal year ended Dec. 31--					
(Mil. €)	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	5,179	5,358	5,412	5,517	5,647	5,809
Operating expenditures	4,835	5,018	5,077	5,197	5,331	5,507
Operating balance	344	340	335	320	317	302
Operating balance (% of operating revenues)	6.6	6.3	6.2	5.8	5.6	5.2
Capital revenues	228	255	283	231	231	231
Capital expenditures	811	836	760	798	790	813
Balance after capital accounts	(239)	(241)	(142)	(248)	(243)	(280)
Balance after capital accounts (% of total revenues)	(4.4)	(4.3)	(2.5)	(4.3)	(4.1)	(4.6)
Debt repaid	330	468	1,383	446	451	436
Gross borrowings	1,019	770	1,246	685	694	716
Balance after borrowings	(76)	31	(287)	(9)	0	0
Direct debt (outstanding at year-end)	4,255	4,547	4,398	4,625	4,856	5,124
Direct debt (% of operating revenues)	82.2	84.9	81.3	83.8	86.0	88.2
Tax-supported debt (outstanding at year-end)	4,645	4,742	4,585	4,811	5,043	5,311
Tax-supported debt (% of consolidated operating revenues)	89.7	88.5	84.7	87.2	89.3	91.4
Interest (% of operating revenues)	2.0	1.9	2.0	2.0	2.0	2.0
Local GDP per capita (single units)	38,400	40,000	41,080	42,148	43,202	44,282
National GDP per capita (single units)	42,209	43,720	44,905	46,077	47,233	48,418

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. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc—Upside case represents some but not all aspects of S&P Global Ratings’ scenarios that could be consistent with an upgrade. 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	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, Dec. 12, 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

- Full Analysis: Energie Steiermark AG, Dec. 3, 2019
- Summary: Austria, Sept. 13, 2019
- Default, Transition, and Recovery: 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Austrian State of Styria 'AA/A-1+' Ratings Affirmed; Outlook Remains Stable, Aug. 2, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Banking Industry Country Risk Assessment: Austria, June 19, 2019
- Public Finance System Overview: Austrian States, Sept. 6, 2018

Ratings Detail (As Of January 31, 2020)*	
Styria (State of)	
Issuer Credit Rating	AA/Stable/A-1+
Issuer Credit Ratings History	
01-Feb-2019	AA/Stable/A-1+
03-Feb-2017	AA/Negative/A-1+
11-Aug-2014	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.

Additional Contact:
EMEA Sovereign and IPF; SovereignIPF@spglobal.com