

REPUBLIC OF AUSTRIA

Rating Analysis - 5/6/14

*EJR Sen Rating(Curr/Prij) A/ A-

*EJR CP Rating: A1

EJR's 5 yr. Default Probability: 1.7%

Little Growth - like Germany, Austria is among the European Union's top economy. However, Austria has been shouldering the burdens of other EU countries and their banks via its exposure to the EFSF and indirectly via the ECB. The country's debt to GDP of 76.0% as of 2013 (expect near 76% for 2014) and a deficit to GDP near 1.6%, are weak and are understated due to exposures to the EU periphery and Austria's financial institutions. Unemployment was near 5% which is low but might increase as many EU countries implement austerity measures. Because of the weakness in Southern Europe and China, Austria's balance of trade deficit was EUR355M in 2013 with exports totaling EUR10.4B and imports EUR10.8B. Inflation is near 1.4% currently (per Statistik Austria) and will probably remain low with the adjustments in southern Europe.

The markets have cheered the support of the ECB and the decision to provide EUR100B directly to Spain's banks and to forego seniority for bailout funds. However, the market provides few gifts; the northern European countries will absorb the cost of providing support via tepid growth. Furthermore, with Spain's and probably Italy's seeking support from the EFSF and ESM, two major economies will switch from providers to users of funds. We are affirming.

(Note, other

Annual Ratios (source for past results: IMF)

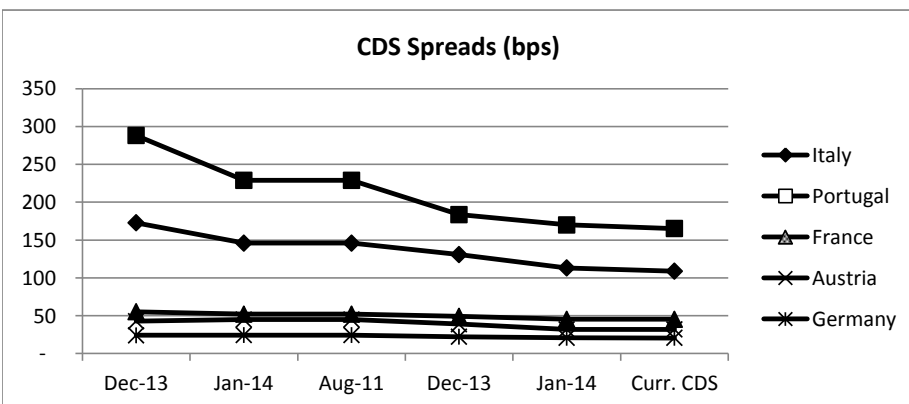
CREDIT POSITION	2010	2011	2012	P2013	P2014	P2015
Debt/ GDP (%)	76.7	76.3	76.0	77.3	77.3	76.1
Govt. Sur/Def to GDP (%)	-2.5	-2.6	-1.5	-1.6	-0.4	0.8
Adjusted Debt/GDP (%)	76.7	85.6	85.0	86.9	86.9	85.4
Interest Expense/ Taxes (%)	9.7	9.5	9.3	8.9	8.9	8.7
GDP Growth (%)	0.4	1.3	1.1	2.3	2.3	2.5
Foreign Reserves/Debt (%)	2.1	2.4	2.6	2.5	2.5	2.4
Implied Sen. Rating	BBB+	BBB+	BBB+	BBB+	BBB+	BBB

INDICATIVE CREDIT RATIOS

	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	45.0	55.0	75.0	85.0	95.0	145.0
Govt. Sur/Def to GDP (%)	4.0	1.0	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	40.0	50.0	60.0	80.0	120.0	150.0
Interest Expense/ Taxes (%)	7.0	9.0	12.0	15.0	22.0	26.0
GDP Growth (%)	4.0	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	25.0	20.0	15.0	12.0	9.0	7.0

PEER RATIOS

	S&P Sen.	Debt as a % of GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio- Implied Rating*
Government Of Canada	AAA	28.5	-3.0	28.5	14.1	2.5	A+
Federal Republic Of Germany	AAA	83.6	0.1	91.2	11.1	1.4	BB+
French Republic	AA	99.7	-4.3	119.9	9.5	0.8	B+
Republic Of Italy	BBB	130.9	-3.0	138.0	16.7	-0.9	B
Portugal Republic	BB	123.8	-4.9	128.6	13.0	1.7	B+



Country (EJR Rtg*)	Current CDS
Italy (C)	109
Portugal (CCC+)	165
France (BBB)	45
Austria (A-)	32
Germany (A-)	21

* Projected Rating

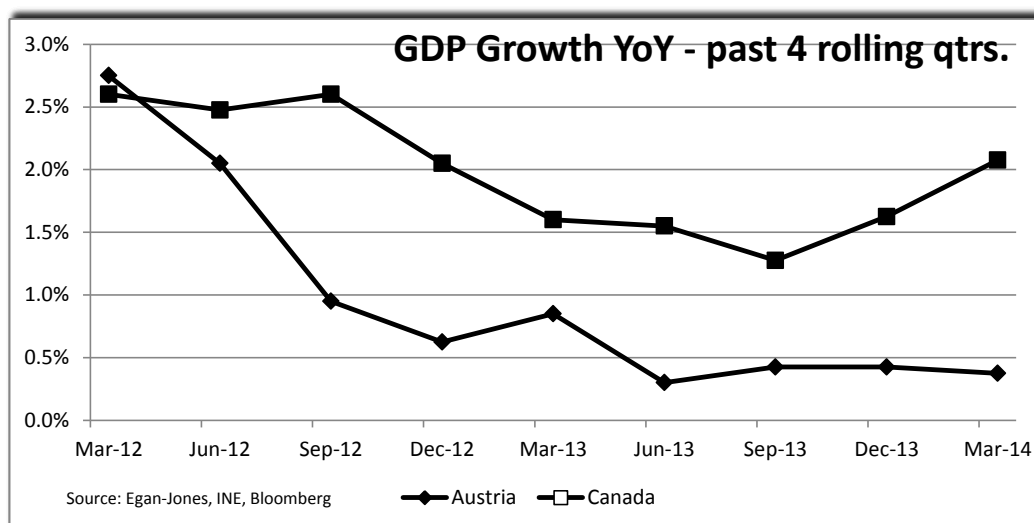
* EJR's targeted CDS based on rating

* Note, non-NRSRO rating. Copyright Egan-Jones Ratings Co.; no secondary distribution.

Economic Growth

From an economic perspective, Austria has historically been among the strongest EU countries with growth of 3% two years ago, but has slipped recently. The likely stimulus of the ECB will help further stoke growth as the EU is searching for ways to avoid deflation and reduce unemployment. However, imports will cost more and the economies of other EU countries are likely to remain weak and Austria will be expected to contribute support.

As can be seen from the below chart, Austria's recent GDP growth has more or less near .5%, which is down considerably from prior periods. In contrast, Canada's growth has improved recently. We expect the GDP growth for 2014 to be positive but slower than 2012. Our major concern is the growth of the weaker EU countries and Austria's exposure.



Fiscal Policy

Austria's deficit to GDP of 1.5% is lower than other peers other than Germany. Over the last several fiscal years (that is from 2010 through 2012), total sovereign revenues rose a total of 4.8% while expenses rose a total of 2.8%, thereby reducing its deficit. However, after including interest expense, Austria ran a deficit. As can be seen from the chart at right, Austria's debt to GDP was 76% which is moderate but understated due to its indirect support to Greece, Spain and other weak countries.

	Deficit-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Austria	1.5	76.0	32
Canada	3.0	28.6	N/A
Germany	-	83.6	21
France	4.3	99.7	45
Italy	3.0	130.9	113
Portugal	4.9	123.8	170

Sources: Bloomberg and IFS

Unemployment

As can be seen from the chart, Austria is at the lowest rate of the peer countries and rose by 30 basis points from 2012 to 2013. For the more recent periods, Austria's unemployment rate has been near 5.0%. With the moderate unemployment rates relative to other EU countries, Austria might see more immigration.

	Unemployment (%)	
	2012	2013
Austria	4.7	5.0
Canada	7.1	7.2
Germany	6.9	6.8
France	10.2	10.2
Italy	11.4	12.6
Portugal	16.9	15.3

Source: Intl. Finance Statistics

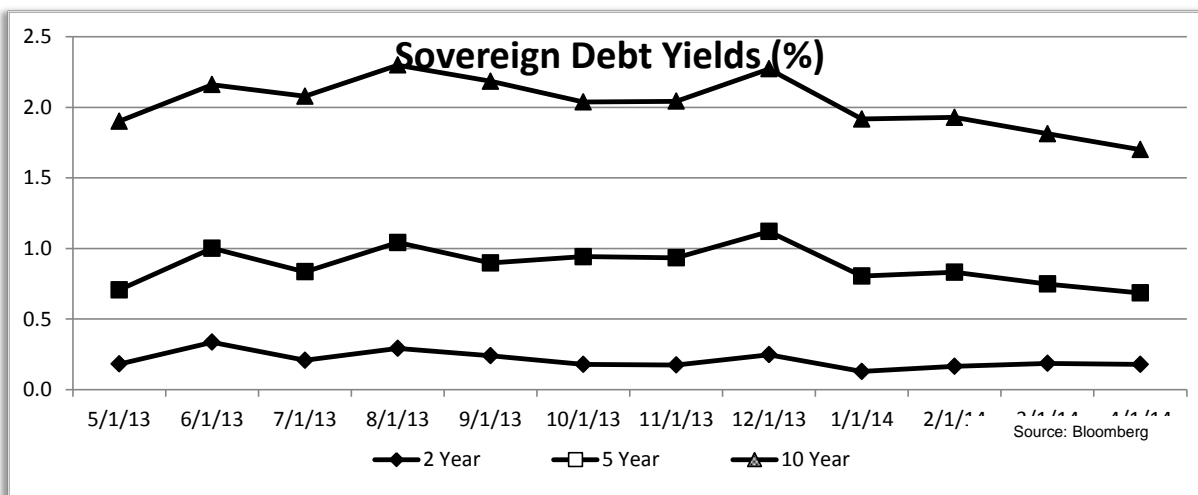
Banking Sector

History has shown that country and bank obligations are linked during times of economic distress. Austria has significant exposure to its banking sector because the bank's large aggregate size measured in assets. The top five banks have assets equal to 125% of GDP, vs. 124% for Germany, and 477% for the UK, which is at the high end. Our concern is that Austrian support for weaker EU banks will be at the detriment of Austrian state finances. Watch the results of the ECB stress tests.

Bank Assets (billions of local currency)		
	Assets	Cap/Assets %
ERSTE GROUP BANK	200	7.4
RAIFFEISEN INTL	131	7.9
OEST VOLKSBANKEN	21	5.8
OBERBANK AG	18	8.1
VORARLBERG LAN-P	15	5.4
Total	383	
EJR's est. of cap shortfall at 10% of assets less market cap		28
Austria's GDP		307

Funding Costs

Low yields - as has been the case for most European countries, yields for Austria has been modest. As illustrated in the below graph, the bond yields have declined over the last six months along with other EU countries. The major issue for Austria and most other northern European countries is the cost of supporting and improving the periphery countries and stoking growth throughout Europe.



Ease of Doing Business

Major factors for growing the economy are the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 30 (1 is best) is strong.

The World Bank's Doing Business Survey*			
	2014	2013	Change in
	Rank	Rank	Rank
Overall Country Rank:	30	28	-2
Scores:			
Starting a Business	138	133	-5
Construction Permits	94	83	-11
Getting Electricity	28	26	-2
Registering Property	36	34	-2
Getting Credit	28	24	-4
Protecting Investors	98	95	-3
Paying Taxes	79	79	0
Trading Across Borders	19	21	2
Enforcing Contracts	6	6	0
Resolving Insolvency	14	12	-2

* Based on a scale of 1 to 183 with 1 being the highest ranking.

Economic Freedom

As can be seen below, Austria is above average in its overall rank of 72.4 for Economic Freedom with 100 being best.

Heritage Foundation Index of Economic Freedom				
World Rank 72*				
	2014	2013	Change in	World
	Rank**	Rank	Rank	Avg.
Overall Score	72.4	71.8	0.6	60.3
Property Rights	90.0	90.0	0.0	42.6
Freedom From Corruption	75.5	78.0	-2.5	39.3
Fiscal Freedom	51.0	51.1	-0.1	77.6
Government Spending	23.5	23.5	0.0	62.5
Business Freedom	76.3	73.6	2.7	64.6
Labor Freedom	80.5	80.4	0.1	61.7
Monetary Freedom	79.5	79.3	0.2	73.9
Trade Freedom	87.8	86.8	1.0	74.8
Investment Freedom	90.0	85.0	5.0	54.9
Financial Freedom	70.0	70.0	0.0	48.7

*Based on a scale of 1-100 with 100 being the highest ranking.

**The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).

Source: The Heritage Foundation

Assumptions for Projections

Income Statement	Peer	Issuer	Base Case	
	Median	Average	Yr 1&2	Yr 3,4,5
Taxes Growth%	4.2	4.7	4.7	4.7
Social Contributions Growth %	1.4	4.6	5.0	5.0
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	6.8	1.5	4.2	4.2
Other Operating Income Growth%	0.0	0.0		
Total Revenue Growth%	3.1	4.4	4.8	4.3
Compensation of Employees Growth%	2.0	2.6	2.0	2.0
Use of Goods & Services Growth%	5.3	2.8	2.2	2.2
Social Benefits Growth%	1.7	3.7	3.0	3.0
Subsidies Growth%	(3.7)	5.7		
Other Expenses Growth%	14.1	14.1	2.0	2.0
Interest Expense	0.0	3.4	3.4	
GDP Growth%			2.3	2.5
Currency and Deposits (asset) Growth%	(20.7)	0.0		
Securities other than Shares LT (asset) Growth%	(2.2)	(0.5)	2.4	2.4
Loans (asset) Growth%	7.5	14.2	4.7	4.7
Shares and Other Equity (asset) Growth%	(1.7)	4.3	4.3	4.3
Insurance Technical Reserves (asset) Growth%	3.0	0.0		
Financial Derivatives (asset) Growth%	0.0	(73.6)	1.0	1.0
Other Accounts Receivable LT Growth%	3.0	2.3	2.3	2.3
Monetary Gold and SDR's Growth %	0.0	0.0	1.0	1.0
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.2			
Currency & Deposits (liability) Growth%	(1.8)	0.0		
Securities Other than Shares (liability) Growth%	7.3	10.0	2.0	2.0
Loans (liability) Growth%	3.1	8.5	3.0	3.0
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	0.5	(41.7)	1.0	1.0
Addl debt. (1st Year) million EUR	0.0	0.0		

Base Case

ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)

	Dec-10	Dec-11	Dec-12	PDec-13	PDec-14	PDec-15
Taxes	77,874	82,170	86,064	90,109	94,344	98,779
Social Contributions	46,588	48,659	50,901	53,446	56,119	58,924
Grant Revenue	0	0	0	0	0	0
Other Revenue	13,302	13,751	13,952	14,542	15,157	15,798
Other Operating Income	0	0	0	0	0	0
Total Revenue	137,764	144,579	150,917	158,097	165,620	173,501
Compensation of Employees	27,806	28,286	29,016	29,596	30,188	30,792
Use of Goods & Services	12,897	12,994	13,353	13,647	13,947	14,254
Social Benefits	72,588	73,920	76,652	78,952	81,321	83,760
Subsidies	9,911	10,308	10,898	10,899	10,900	10,901
Other Expenses	16,706	15,623	17,821	18,177	18,541	18,912
Grant Expense	0	0	0	0	0	0
Depreciation	3,655	3,723	3,792	3,792	3,792	3,792
Total Expenses excluding interest	143,562	144,855	151,531	155,062	158,688	162,410
Operating Surplus/Shortfall	-5,798	-275	-614	3,035	6,932	11,091
Interest Expense	7,569	7,795	8,030	8,030	8,352	8,553
Net Operating Balance	-13,367	-8,071	-8,644	-4,995	-1,420	2,538

Sources: Historical - IMF, Projections - EJR

Base Case

ANNUAL BALANCE SHEETS (MILLIONS EUR)

	Dec-10	Dec-11	Dec-12	PDec-13	PDec-14	PDec-15
ASSETS						
Currency and Deposits (asset)						
Securities other than Shares LT (asset)	7,257	7,236	7,200	7,369	7,542	7,720
Loans (asset)	24,191	25,941	29,625	31,017	32,475	34,002
Shares and Other Equity (asset)	49,526	49,440	51,565	53,781	56,093	58,504
Insurance Technical Reserves (asset)				0	0	0
Other Accounts Receivable LT	7,185	7,519	7,692	7,869	8,050	8,235
Monetary Gold and SDR's						
Additional Assets	12,037	14,922	14,070			
Total Financial Assets	100,829	106,491	110,531	114,490	118,617	122,921
LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)				0	0	0
Securities Other than Shares (liability)	185,860	197,248	216,998	221,338	225,765	230,280
Loans (liability)	33,996	38,838	42,137	47,132	48,552	46,014
Insurance Technical Reserves (liability)						
Financial Derivatives (liability)	1,788	1,483	865	874	882	891
Other Liabilities	2,562	2,782	2,615	2,225	2,225	2,225
Liabilities	224,206	240,351	262,615	271,569	277,116	278,881
Net Financial Worth	(123,377)	(133,860)	(152,084)	(157,079)	(158,499)	(155,961)
Total Liabilities & Equity	100,829	106,491	110,531	114,490	118,617	122,921

Sovereign Rating Methodology (Non-NRSRO)

Scope and Limitations: Sovereign Issuer Credit Quality Ratings (CQR) are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

Key Rating Drivers: EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that the its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings

For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.