Basque Country, Autonomous Community of (The) (/gws/en/esp/issr/82986125)

FitchRatings

Fitch Upgrades the Basque Country to 'A-'; Outlook Stable

Link to Fitch Ratings' Report(s): Autonomous Community of the Basque Country - Rating Action Report (https://www.fitchratings.com/site/re/10019234)

Fitch Ratings-Barcelona/London-02 February 2018Fitch Ratings has upgraded the Autonomous Community of the Basque Country's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'A-' from 'BBB+'. The Outlooks are Stable. Fitch has also upgraded the Short-Term Foreign-Currency IDR to 'F1' from 'F2'. The bond issues and senior unsecured ratings have also been upgraded to 'A-' from 'BBB+'.

The upgrade follows the upgrade of the Spanish sovereign as the Basque Country's ratings were constrained by the sovereign's. The Basque Country can be rated higher than the Spanish sovereign, albeit by a maximum three notches, because of its financial and fiscal autonomy, as recognised by the Spanish Constitution, which mitigates sovereign unilateral interference in the Basque Country's activities. Reports on provincial tax collection also indicate a strong result in 2017, and it is likely that the region's fiscal performance will continue to improve in 2018. Consequently the debt payback ratio may trend towards 20 years over the medium term (about 50 years in 2016).

The ratings reflect the Basque Country's special status, strong socio-economic profile, rigidity of its expenditure considering the scope of its responsibility, and relatively weak debt coverage. The ratings also take into account the Basque Country's prudent management and satisfactory financial reporting.

KEY RATING DRIVERS
The upgrade of the Basque Country's IDR reflects the following key rating drivers and their relative weights:

High
The upgrade reflects the upgrade of Spain's IDRs to 'A-' from ' BBB+' on 19 January 2018 (see 'Fitch Upgrades Spain to 'A-'; Outlook Stable'; Outlook Stable' at www.fitchratings.com):

The Basque Country's 'A-' IDRs also reflect the following key rating drivers:

Budgetary Performance - Neutral / Stable
2017 monthly results indicate promising results although Fitch has yet to see December results. For 2016, results indicated an operating margin of 3.9%, confirming the slight improving trend after negative operating balances in the 2009-2011 period. Under Fitch's base case scenario, the Basque Country's operating balance should continue to gradually improve while its deficit should continue to narrow.

High Debt but Sound Liquidity - Neutral /Stable
The expected improvement in fiscal performance will slow direct debt growth, which Fitch now estimates will reach EUR9.5 billion by end-2019 which will be almost the size of its forecast 2019 current revenue, versus 97% in 2016. Liquidity risk is limited as provincial administrations frequently transfer tax revenue to the Basque Country. Cash reserves increased again in 2017 to EUR844 million, from EUR358 million in 2014, covering 76% of the region's 2018 budgeted debt repayment.

The Basque Country's debt metrics should further benefit from the central government's decision in May 2017 to reduce the contribution of the Basque public sector (regional government and three provincial governments) over the next five years. Fitch has not yet assessed this impact on the regional government's credit metrics.

Economy - Strength/Positive
With 2016 GDP estimated at about EUR68.9 billion and GDP per capita above 32.7% of the national average, the Basque Country's economy is strong and diversified. According to data from National Statistics, its nominal GDP grew 3.5% in 2016 after a 4.1% rise in 2015, and under Fitch's base case scenario nominal GDP should continue to grow at a similar pace, due in part to inflation. Its registered population was 2.194 million in 2017 and has gradually increased since 2010 (0.7% rise between 2010 and 2017), in contrast with a decline in population observed in the other regions located in North of Spain.

Job creation slightly improved in 2H17, although the around 938,000 thousands jobs in December 2017 is still well below the 980,000 recorded in 2008. Nevertheless, the employment rate continues improving , reaching an estimated 50.4% in 2Q17 (49.1% nationally), and the government expects job creation to continue in the medium term (1.5% in 2018). A third quarter salary survey indicate a 1.1% rise of the gross salary in the Basque Country, which are 20% above national average, another indication of the strong economy.

Management and Administration - Strength /Neutral
The scope of responsibility of regional governments (healthcare, education university, implies some spending rigidity. The regional government has a strong intention to maintain its level of public services.

RATING SENSITIVITIES
According to Fitch's criteria, the Basque Country's IDRs could be upgraded to 'A' if its standalone rating is assessed at least two notches above Spain's IDR (A-/Stable), which would be due to a sustained improvement of its operating performance combined with a stabilisation of its debt level over the medium term.

A downgrade - unlikely at present- could result from an increase in debt to about 120% of its current revenue. A downgrade of the sovereign could also prompt a similar action in the Basque Country's IDR.

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Applicable Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/878660)

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