

Autonomous Community of the Basque Country

Update

Ratings

Foreign-Currency Long-Term IDR	BBB+
Foreign-Currency Short-Term IDR	F2
Local-Currency Long-Term IDR	BBB+

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Autonomous Community of the Basque Country

	31 Dec 15	31 Dec 14
Operating revenue (EURm)	8,724.1	8,583.1
Debt (EURm)	8,227.2	7,748.2
Operating balance/operating revenue (%)	3.46	3.25
Debt service/current revenue (%)	10.47	8.48
Debt/current balance (yrs)	77.4	102.9
Operating balance/interest paid (x)	1.3	1.1
Capital expenditure/total expenditure (%)	8.09	10.12
Surplus (deficit) before debt variation/total rev. (exc. new debt) (%)	-5.99	-6.75
Current balance/capital expenditure (%)	12.93	7.40

Key Rating Drivers

Outlook Revised to Stable: Fitch Ratings has revised the Autonomous Community of the Basque Country's Outlook to Stable from Positive. The revision reflects a slower improvement in operating performance than we had expected in September 2014 when we placed the Basque Country's ratings on Positive Outlook.

Fiscal Autonomy: The Basque Country is formed of three historical territories that enjoy tax autonomy, and its government is involved in defining and coordinating fiscal policy. As such, in 2014, the government introduced a tax reform comprising an increase in the tax rate and reductions in deductions. The regional government is committed to complying with its new fiscal targets, although it failed to meet them in 2011.

Recent Large Deficits: The sudden downturn in the economy and the decision to maintain a high level of capital expenditure explain the large deficits in 2009-2011 (totalling 8.85% of regional GDP). In 2012-2016, the annual deficit narrowed and remained below 1.5% of GDP. Fitch expects deficits to continue to narrow in the medium term.

Debt to Stabilise: Direct debt leapt from below EUR500m before 2008 to EUR8.2bn at end-2015 and is expected to rise only gradually to EUR9.5bn at end-2018, which would be the equivalent of about 100% of the Basque Country's current revenue. Direct debt servicing has been growing and could represent as much as 10% of current revenue in the medium term.

Strong Liquidity: The regional government must report its average payments period on a monthly basis. In 2016, it was able to maintain the payment of invoices within 30 days.

Improving Operating Margin: Preliminary data for 2016 indicate 3.3% growth in operating revenue, thanks to the impact of the recovery of the economy on taxes. In the context of a moderate rise in operating spending, the operating margin improved only slightly to 3.8% in 2016. Under our base-case scenario, we expect stronger growth in operating revenue than spending, so the operating margin should remain slightly below 5% by 2018.

Strong Entrepreneurial Culture: The Basque government has coordinated business into clusters to enable innovation in its manufacturing sector. The labour market is much more attractive than in other regions, which may explain the increase in the Basque Country's population since 2011, while it declined in Spain. The Basque Country's employment rate averaged 50% in 2016, versus 48% for Spain.

Strong Economic Fundamentals: The Basque Country's nominal GDP fell by a cumulative 7.4% between 2008 and 2013 and began to start recovering in 2014 with a 2.0% rise and 4.1% in 2015 to reach EUR66.5bn. We expect nominal GDP to grow between 2% and 3% in the medium term. GDP per capita, at 31% above the national average in 2015, illustrates the region's wealthy profile.

Rating Sensitivities

Improving Performance: A positive rating action could result from the operating margin being structurally above 5% in the medium term, and the debt payback ratio improving to 20 years (2016: 50 years). An upgrade of the sovereign IDRs (BBB+/Stable/F2) would also result in an upgrade of the Basque Country's IDRs. A negative rating action could result from direct debt exceeding 120% of current revenue.

Related Research

Fitch Affirms Historical Territory of Alava at 'A'; Outlook Stable (March 2017)

Fitch Affirms Historical Territory of Gipuzkoa at 'A'; Outlook Stable (September 2016)

Fitch Affirms Historical Territory of Bizkaia at 'A'; Outlook Stable (September 2016)

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Appendix A

Autonomous Community of the Basque Country

(EURm)	2014	2015	2016p	2017f	2018f
Taxes	5.7	3.9	3.2	3.3	3.0
Transfers received	8,364.1	8,539.8	8,837.9	9,103.0	9,367.0
Fees, fines and other operating revenue	213.3	180.4	173.5	178.7	184.1
Operating revenue	8,583.1	8,724.1	9,014.6	9,285.0	9,554.1
Operating expenditure	-8,304.1	-8,422.1	-8,672.4	-8,889.2	-9,111.4
Operating balance	279.0	302.0	342.2	395.8	442.7
Financial revenue	48.1	35.4	36.1	36.1	36.1
Interest paid	-251.8	-231.1	-201.6	-192.7	-200.4
Current balance	75.3	106.3	176.7	239.2	278.4
Capital revenue	336.9	179.8	236.4	237.0	236.0
Capital expenditure	-1,017.8	-822.0	-914.5	-905.3	-887.2
Capital balance	-680.9	-642.2	-678.1	-668.3	-651.2
Surplus (deficit) before debt variation	-605.6	-535.9	-501.4	-429.1	-372.8
New borrowing	1,139.4	1,163.0	1,106.0	1,200.0	1,300.0
Debt repayment	-479.8	-686.3	-572.3	-788.0	-933.0
Net debt movement	659.6	476.7	533.7	412.0	367.0
Overall results	54.0	-59.2	32.3	-17.1	-5.8
Debt					
Short-term	-	-	-	-	-
Long-term	7,748.2	8,227.2	8,765.2	9,177.2	9,544.2
Direct debt	7,748.2	8,227.2	8,765.2	9,177.2	9,544.2
+ Other Fitch classified debt – pre-financing	-	-	-	-	-
Direct risk	7,748.2	8,227.2	8,765.2	9,177.2	9,544.2
- Cash, liquid deposits, sinking fund	358.0	563.3	560.4	560.0	550.0
Net direct risk	7,390.2	7,663.9	8,204.8	8,617.2	8,994.2
Guarantees and other contingent liabilities	725.8	626.9	534.9	-	-
Net indirect debt (public sector entities exc. gteed amount)	824.8	902.1	1,020.5	-	-
Net overall risk	8,940.8	9,192.9	9,760.2		
Memo for direct debt					
% in foreign currency	0.0	0.0	0.0	-	-
% issued debt	48.1	43.6	45.0		
% fixed interest rate debt	68.1	65.7	66.7	-	-

p: preliminary f: Forecast
Source: Issuer and Fitch calculations

Related Criteria

International Local and Regional
Governments Rating Criteria – Outside the
United States (April 2016)

Appendix B

Autonomous Community of the Basque Country

	2014	2015	2016	2017f	2018f
Fiscal performance ratios					
Operating balance/operating revenue (%)	3.25	3.46	3.80	4.26	4.63
Current balance/current revenue ^a (%)	0.87	1.21	1.95	2.57	2.90
Surplus (deficit) before debt variation/total revenue ^b (%)	-6.75	-5.99	-5.40	-4.49	-3.79
Overall results/total revenue (%)	0.60	-0.66	0.35	-0.18	-0.06
Operating revenue growth (annual % change)	n.a.	1.64	3.33	3.00	2.90
Operating expenditure growth (annual % change)	n.a.	1.42	2.97	2.50	2.50
Current balance growth (annual % change)	n.a.	41.17	66.23	35.37	16.39
Debt ratios					
Direct debt growth (annual % change)	n.a.	6.18	6.54	4.70	4.00
Interest paid/operating revenue (%)	2.93	2.65	2.24	2.08	2.10
Operating balance/interest paid (x)	1.1	1.3	1.7	2.1	2.2
Direct debt servicing/current revenue (%)	8.48	10.47	8.55	10.52	11.82
Direct debt servicing/operating balance (%)	262.22	303.77	226.15	247.78	256.02
Direct debt/current revenue (%)	89.77	93.92	96.85	98.46	99.52
Direct risk/current revenue (%)	89.77	93.92	96.85	98.46	99.52
Direct debt/current balance (yrs)	102.9	77.4	49.6	38.4	34.3
Net overall risk/current revenue (%)	103.59	104.95	107.84	92.45	93.79
Direct risk/current balance (yrs)	102.9	77.4	49.6	38.4	34.3
Direct debt/GDP (%)	12.11	12.48	-	12.75	12.83
Direct debt per capita (EUR)	3,541	3,758	-	4,175	4,338
Revenue ratios					
Operating revenue/budget operating revenue (%)	101.53	98.01	97.33	n.a.	n.a.
Tax revenue/operating revenue (%)	0.07	0.04	0.04	0.04	0.03
Modifiable tax revenue/total tax revenue (%)	100	100	100	100	100
Current transfers received/operating revenue (%)	97.45	97.89	98.04	98.04	98.04
Operating revenue/total revenue ^b (%)	95.71	97.59	97.07	97.14	97.23
Total revenue ^b per capita (EUR)	4,099	4,084	-	4,348	4,466
Expenditure ratios					
Operating expenditure/budget operating expenditure (%)	101.18	99.78	101.46	n.a.	n.a.
Staff expenditure/operating expenditure (%)	22.69	22.91	22.70	22.70	22.70
Current transfer made/operating expenditure (%)	37.74	37.80	38.11	38.11	38.11
Capital expenditure/budget capital expenditure (%)	85.74	81.56	75.32	n.a.	n.a.
Capital expenditure/total expenditure (%)	10.12	8.09	8.83	8.40	7.97
Capital expenditure/local GDP (%)	1.59	1.25	-	1.26	1.19
Total expenditure per capita (EUR)	4,595	4,642	-	4,902	5,060
Capital expenditure financing					
Current balance/capital expenditure (%)	7.40	12.93	19.32	26.42	31.38
Capital revenue/capital expenditure (%)	33.10	21.87	25.85	26.18	26.60
Net debt movement/capital expenditure (%)	64.81	57.99	58.36	45.51	41.37

n.a.: Not available

f: Forecast

^a Includes financial revenue

^b Excluding new borrowing

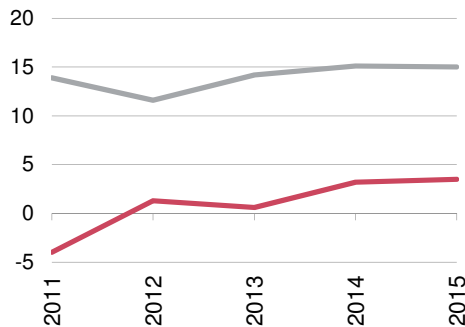
Source: Issuer and Fitch calculations

Appendix C

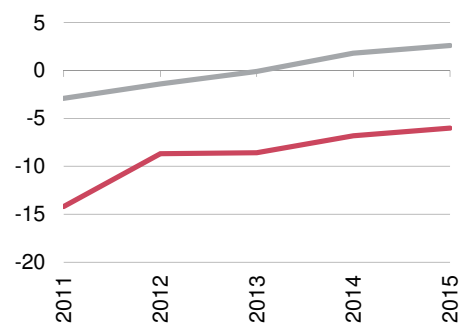
Autonomous Community of the Basque Country

Peer Comparison

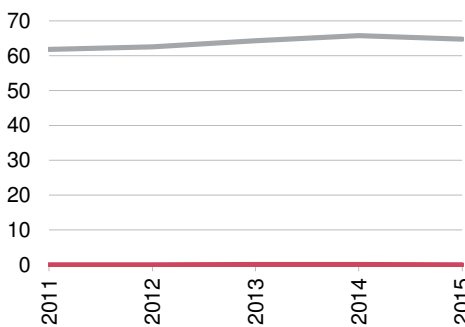
Operating Balance
% Operating revenue



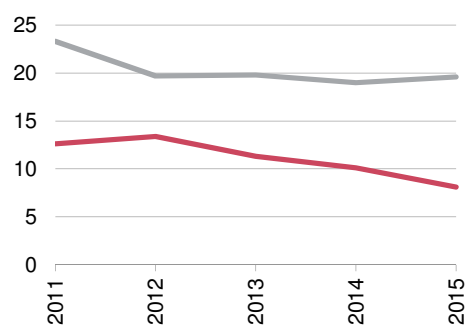
Surplus (Deficit)
% Total revenue



Taxes
% Operating revenue



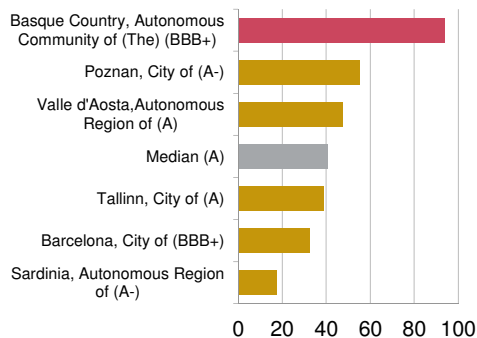
Capital Expenditure
% Total expenditure



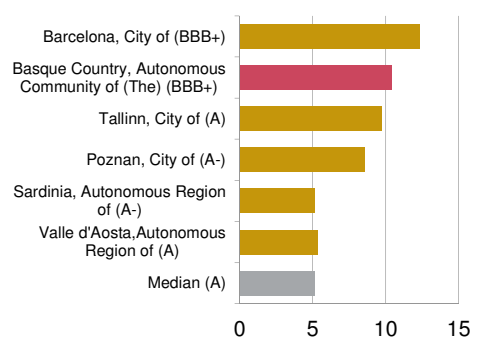
— Autonomous Community of the Basque Country

— A- Peer Group Median

Debt
To Current Revenue (%) 2015



Debt Servicing
To Current Revenue (%) 2015



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