Research Update:

Spain's Autonomous Community of Navarre 'AA-' Rating Affirmed; Outlook Negative

March 26, 2021

PRIMARY CREDIT ANALYST

Alejandro Rodriguez Anglada
Madrid
+ 34 91 788 7233
alejandro.rodriguez.anglada@spglobal.com

SECONDARY CONTACT

Marta Saenz
Madrid
+ 34 91 788 7231
marta.saenz@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF@spglobal.com

Overview

- Navarre's 2020 performance was stronger than we anticipated, but we expect some pressure in 2021 before the region gradually regains budgetary balance.
- The region's debt burden ratios should peak in 2021, before it resumes a trajectory of debt reduction.
- We believe Navarre's high fiscal autonomy, diversified economy, and independent liquidity management make it more resilient than Spain in a stress scenario, and therefore we rate Navarre up to two notches higher than Spain.
- We have affirmed our 'AA-' ratings on Navarre.
- The negative outlook mirrors that on Spain, and reflects the possibility that Navarre could post weaker budgetary performance metrics than we currently expect.

Rating Action

On March 26, 2021, S&P Global Ratings affirmed its 'AA-' long term issuer credit rating on Spain's Autonomous Community of Navarre. The outlook is negative.

Outlook

The negative outlook mirrors the outlook on Spain (unsolicited; A/Negative/A-1).

Downside scenario

We would downgrade Navarre over the next 18 months if we downgrade Spain, or if we no longer consider that Navarre meets our conditions to be rated above the sovereign. We could also downgrade Navarre if it materially deviates from our base-case scenario, posting larger-than-anticipated deficits, whether because of a weaker economy or a lack of commitment from the region's management to gradually improve budgetary outcomes. This could in turn lead to deterioration of its liquidity.

Upside scenario

We could revise our outlook on Navarre to stable over the next 18 months if we revise our outlook on Spain to stable, and at the same time we continue to expect that Navarre would perform in line with our base case, which assumes a rapid improvement of budgetary performance starting in 2022, debt stabilization, and strong liquidity.

Rationale

Our rating on Navarre can be above that on Spain because we estimate that the region's credit characteristics would make it more resilient than the sovereign in a stress scenario. However, in our view, Navarre is not immune to Spain's country risk; therefore, we rate it only up to a maximum of two notches above the sovereign.

Our rating on Navarre is at the same level as the stand-alone credit profile (SACP), which we assess at 'aa-'. The SACP is not a rating, but a measure of the intrinsic creditworthiness of a local or regional government (LRG) before considering any constraint arising from the sovereign rating.

Consequently, if we lower our rating on Spain, we would also downgrade Navarre. Therefore, we align our outlook on the region with that on the sovereign.

Navarre benefits from high fiscal autonomy, but its special status limits prospects for central government support in an emergency

Navarre--along with Spain's other special-status entities, the Basque Country and Bizkaia--has unique taxing powers compared with the rest of Spain's LRGs. These include legislative power over personal income and corporate taxes, which enable such entities to benefit from their comparatively wealthy economies. Unlike normal-status regions, special-status entities like Navarre have their own tax administrations that collect the bulk of taxes. Navarre then transfers a portion of them to Spain's central government in compensation for the services it provides in the region.

Navarre's special status implies a bilateral relationship with the government, and a differentiated treatment versus normal-status regions. Among other things, Navarre bilaterally negotiates its deficit targets with the central government.

Navarre participated only partially in the special fund set up by the central government to compensate regions for the effects of the COVID-19 pandemic in 2020. Navarre received support to cope with extraordinary expenses in health care and education. However, it did not receive compensation for the loss of its own tax receipts. The region's special status means it can benefit directly from upside in times of economic expansion but does not receive the same level of support as other regions in downturns like the current one. Special-status regions are responsible for managing their own revenue and have the flexibility and autonomy to modify their resources as needed.

Given the one-off and voluntary nature of central government support, its moderate impact on revenue, and the lack of any sort of conditionality, we do not believe it would interfere with the ability of special-status regions to maintain a rating above the sovereign, if this continues to be warranted by their own credit profiles. Similarly, we do not believe that the central government's temporary measure warrants a change in our institutional framework assessment. Should this type of support become a recurrent feature of the special-status regions' financial standing, or should the regions avail themselves of such support repeatedly, we might reconsider our institutional framework assessment, as well as our approach to rating these entities above the sovereign.

Navarre's economy is wealthier, more competitive, and more export oriented than Spain's. The region's GDP per capita was about 122% of the national average at year-end 2019. Navarre posted the second-highest 2019 real GDP growth among Spanish regions, at 2.5%, compared with 2.0% nationally.

Industry is a much bigger part of Navarre's economy than that of other regions, representing 31% of gross value added, compared with Spain's 16%. This makes the economy more resilient to external shocks, in our view. In particular, Navarre is much less dependent on tourism than other Spanish regions, and therefore comparatively less affected by the current restrictions on mobility.

In our opinion, Navarre's financial management demonstrates sound experience and is aware of the region's main external risks--in particular, regarding financial relationships with the central government. As the COVID-19 pandemic has unfolded, Navarre's financial management has taken a proactive approach to ensure sufficient liquidity resources.

Stronger-than-expected performance in 2020, but COVID-19 effects will linger in 2021 before allowing a recovery

Navarre's budgetary performance in 2020 was stronger than we anticipated, with a positive operating balance at about 2% of operating revenue. This compares favorably with our previous expectation of a negative operating balance of about 5% of operating revenue. Operating expenditure was very closely aligned to our estimate, but operating revenue was stronger than we anticipated--as the economy recovered partially in fourth-quarter 2020--and government support was slightly higher than we expected.

The stronger operating balance directly translated into better performance in terms of the balance after capital accounts, with a deficit of about 5.4% of total revenue, instead of our earlier estimate of about 12%. Capital revenue and expenditure were roughly in line with our previous estimates. Navarre did not exhaust the 2.6% of GDP reference deficit target for 2020 agreed with the central government, reaching a deficit of only about 1.1% of regional GDP instead.

In contrast, we believe the redressing of Navarre's finances may drag on for longer than we expected, with a slight worsening of overall performance in full-year 2021. The COVID-19 pandemic has lasted longer than anticipated, and associated restrictions on mobility and economic activity are also slowing the economic recovery.

We nevertheless expect economic growth to pick up during 2021, allowing Navarre's operating revenue to recover. However, we do not factor in any additional central government support this year. Navarre is also facing a one-off hit of €35 million related to past collection of personal income tax on maternity leave pay. Therefore, the recovery in Navarre's own revenue will only fill this gap.

Given the duration of the pandemic, and in line with the budget, we expect Navarre will maintain high levels of operating expenditure in 2021, which would only allow for a slight positive operating balance, in our view.

On the capital side, we expect Navarre to incorporate resources from the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) fund in its accounts. The exact timing of the cashing in and expenditure of such funds is still to be determined, although we expect a majority will be spent between 2021 and 2022. This would increase both capital revenue and expenditure, without any major net effect on budgetary outcomes. Navarre has agreed a deficit target of 2.2% of GDP with the central government, which we don't expect it will exhaust.

We think that once the economic recovery takes hold in 2022, Navarre may once again post larger operating surpluses, by allowing only modest increases in operating expenditure at the new higher level. Overall, we believe Navarre would still post a small deficit in 2022 but should be able to balance its budgets once again by 2023, with overall results still weaker than those posted in pre-COVID-19 years.

This budgetary trajectory would lead to Navarre's tax-supported debt peaking at about 100% of consolidated operating revenue in 2021, before resuming a trajectory of gradual deleveraging, as was the case before COVID-19. We expect Navarre's debt may reduce to about 90% of consolidated operating revenue by 2023, still slightly higher than pre-COVID-19 levels.

During 2020, Navarre decided to allow taxpayers to defer payments (intrayear) to provide liquidity to companies and citizens, thereby mitigating damage to the economy and consumption. This led to a temporary mismatch between recognized tax revenue and cashed tax revenue, which Navarre bridged by increasing its credit lines to €725 million and signing short-term loans worth €237.5 million but repaid before year-end 2020. Navarre also raised excess debt during 2020, to shore up its liquidity, and continued to pay suppliers in line with official targets. We expect the region's liquidity may face some pressure arising from the deficit in 2021, but it should maintain an overall strong liquidity position, which would only improve over time assuming continued budgetary consolidation.

Key Statistics

Table 1

Navarre (Autonomous Community of) Selected Indicators

(Mil. €)	2019	2020	2021bc	2022bc	2023bc
Operating revenues	4,155	4,033	4,013	4,266	4,457
Operating expenditures	3,733	3,952	4,000	4,069	4,138
Operating balance	422	81	14	197	319
Operating balance (% of operating revenues)	10.1	2.0	0.3	4.6	7.2
Capital revenues	46	43	117	103	59
Capital expenditures	326	345	410	396	358
Balance after capital accounts	142	(221)	(279)	(96)	21
Balance after capital accounts (% of total revenues)	3.4	(5.4)	(6.7)	(2.2)	0.5
Debt repaid	337	290	235	248	245
Gross borrowings	215	648	500	344	225
Balance after borrowings	20	137	(14)	0	0
Direct debt (outstanding at year-end)	2,903	3,264	3,529	3,625	3,605
Direct debt (% of operating revenues)	69.9	80.9	87.9	85.0	80.9

Table 1

Navarre (Autonomous Community of) Selected Indicators (cont.)

(Mil. €)	2019	2020	2021bc	2022bc	2023bc
Tax-supported debt (outstanding at year-end)	3,569	3,874	4,101	4,145	4,073
Tax-supported debt (% of consolidated operating revenues)	84.7	94.7	100.8	95.9	90.2
Interest (% of operating revenues)	1.8	1.6	1.2	1.2	1.1
Local GDP per capita (single units)	32,141	N/A	N/A	N/A	N/A
National GDP per capita (single units)	26,520	23,662	25,390	27,498	28,746

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. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Navarre (Autonomous Community of) Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	3
Economy	1
Financial management	2
Budgetary perfomance	2
Liquidity	2
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

- Spain 'A/A-1' Ratings Affirmed; Outlook Remains Negative On Fiscal And Structural Challenges, March 20, 2021

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, March 3, 2021
- Public Finance System Overview: Spanish Special Status Entities, July 28, 2020
- Local And Regional Governments Outlook 2021: Gradual Recovery Will Test Rating Resilience, Dec. 10, 2020
- Outlook On Spain's Autonomous Community of Navarre To Negative Following Sovereign Rating Action; Affirmed At 'AA-', Sept. 25, 2020

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

Navarre (Autonomous Community of)	
Issuer Credit Rating	AA-/Negative/--
Senior Unsecured	AA-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of

S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.