Research Update:

Spain's Autonomous Community of Navarre Outlook Revised To Stable From Negative; 'AA-' Ratings Affirmed

March 25, 2022

Overview

- On March 18, 2022, we revised the outlook on our Spain long-term rating (unsolicited; A/Stable/A-1) to stable from negative.
- The Autonomous Community of Navarre's budgetary metrics improved strongly in 2021 thanks to the ongoing economic recovery as pandemic-related restrictions are gradually lifted.
- In our view, the region will maintain balanced budgets going forward.
- 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 rate Navarre up to two notches higher than Spain.
- We revised our Navarre outlook to stable from negative, reflecting the similar sovereign action, and affirmed our 'AA-' long-term rating.

Rating Action

On March 25, 2022, S&P Global Ratings revised its long-term rating outlook for Spain's Autonomous Community of Navarre to stable from negative. We also affirmed the 'AA-' long-term issuer credit rating.

Outlook

The stable rating outlook mirrors than on Spain (unsolicited; A/Stable/A-1). It also reflects our expectation that Navarre will continue to post balanced budgets and gradually reduce its debt burden.

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Downside scenario

We would downgrade Navarre 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 structural deficits, whether because of a weaker economy or regional management's lack of commitment to maintain strong budgetary outcomes. This could, in turn, lead its liquidity to deteriorate.

Upside scenario

We could upgrade Navarre if the region performs more strongly than we currently estimate, with an accelerated path of debt reduction while maintaining a strong liquidity position. Any upgrade of Navarre would be contingent on an upgrade of Spain, given that we do not rate the entity more than two notches above its sovereign.

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.

Navarre benefits from high fiscal autonomy but is more exposed than normal-status regions to the economic cycle

Navarre--along with Spain's other special-status entities, the Basque Country and Bizkaia--has unique tax 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 most 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 has received support from the Spanish central government to cope with the pandemic's negative effects on its accounts. In 2020, Navarre participated only partially in the special fund set up by the central government. It also received support to cover extraordinary expenses in health care and education. However, it did not receive compensation for the loss of its own tax receipts. That said, central government support was allocated to regions based on population in 2021, so special status entities benefited to a similar extent as others. For 2022, we do not expect any further central government support.

Spain's central government provided pandemic-related support on a voluntary basis, without any request from Navarre. It also did not entail any conditionality or restrictions about the use of funds. We therefore do not believe this transitory support interferes with the ability of special-status regions to maintain a rating above the sovereign. Similarly, we do not believe that the central government's temporary measures warrant a change in our institutional framework assessment. Should this type of support become a recurrent feature of special-status regions' relationship with the central government, in such a way that it undermines their autonomy and financial independence from the central government, 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 124% of the national average at year-end 2020. Although Navarre's GDP was hit by the pandemic, its 2020 contraction of 8.5% was less marked than the about 10.3% nationally.

Industry is a much bigger part of Navarre's economy than that of other regions, representing 29% of gross value added, compared with Spain's 16%. This makes the economy more resilient to external shocks, in our view. Navarre is much less dependent on tourism than other Spanish regions, and therefore has been comparatively less affected by pandemic-driven restrictions on mobility in the past two years.

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

Stronger-than-expected performance in 2021, due to robust tax collection recovery, central government support, and EU funds

Navarre's budgetary performance was stronger than we anticipated in 2021, according to our preliminary estimates, with a positive operating balance at about 12% of operating revenue and a balance after capital accounts of close to 8% of total revenue.

Last year, Navarre received direct support from the central government totaling about €193 million, compared with €187 million in 2020. At the same time, tax revenue increased an estimated 14% compared with 2020, as pandemic-related restrictions gradually eased. Given this increase in operating revenue, and despite Navarre's high COVID-19 case numbers during the year, it contained rising operating expenditure, leading to a marked improvement in operating balances.

Navarre also started benefiting from access to EU funds in 2021 (REACT-EU and Recovery and Resilience Facility), which boosted its capital revenue. However, capital expenditure did not increase in a commensurate way. In our opinion, this reflects difficulty in implementing investment projects in a short period but boosted budgetary results in 2021.

In 2022, we expect additional pressures on Navarre that should lead to a deterioration in budgetary figures. On the operating side, the absence of government COVID-19 funds will have a negative impact, which should be compensated by the continued economic recovery and nominal GDP growth that boosts tax collection. At the same time, we expect pressure on operating expenditure given higher expected inflation, which should translate into higher operating costs and pressure the operating balance. That said, we believe the deterioration will be moderate, with Navarre still posting a strong operating balance of 7% of operating revenue.

On the capital side, we believe Navarre will step up its execution of investments, making use in

2022 of EU funds already received in 2021. Although we estimate additional funds should be available, this will weaken balances after capital accounts, which should nevertheless be compatible with maintaining balanced budgets. We note that while this may lead to an apparent material deterioration in budgetary metrics between 2021 and 2022, the overall effect of EU funds should be neutral in the medium term. Moreover, such distortions will be eliminated when calculating Navarre's performance in national accounting terms, the central government's official benchmark.

We believe Navarre can maintain similarly strong budgetary metrics in the outer years of our forecast to 2024, barring a fundamental change in the economic outlook, for example, because of the Russia-Ukraine conflict.

Should our base-case expectations be met, this would lead to a gradual reduction in Navarre's tax-supported debt ratios, partly spurred by relatively strong revenue growth in nominal terms due to inflationary pressures. However, this trajectory would also be the result of Navarre's decision to moderate its debt issuance. After issuing more than €600 million in 2020 to prepare for the expected effects of the pandemic, Navarre decided to reduce its direct debt in 2021, with early amortizations of €370 million. This led to a more than 20-percentage-point reduction in its tax-supported debt metrics for the year. In the following years, we expect Navarre to continue moderating debt issuance, which, coupled with revenue expansion and the gradual amortization of its public sector entities' debt, should enable a material debt reduction in relative terms, reaching about 66% of consolidated operating revenue by 2024 absent any major changes in the economic outlook.

Navarre's liquidity levels were exceptionally high in 2021 due to the excess funding from 2020, and particularly until June, when it started early repayments. Although cash should decrease slightly during 2022, we expect the region to maintain a strong liquidity position in future years. We note that interest payments were abnormally high in 2021, reflecting the breaking costs associated with the early repayments, which will nevertheless generate future savings. Navarre also renegotiated the conditions on a further €250 million in outstanding loans, locking in substantial interest savings. In our view, this is evidence of the region's proactive approach to debt and liquidity management.

Key Statistics

Table 1

Navarre (Autonomous Community of) Selected Indicators

(Mil. €)	2019	2020	2021	2022bc	2023bc	2024bc
Selected Indicators						
Operating revenues	4,155	4,036	4,676	4,685	4,849	4,970
Operating expenditures	3,733	3,952	4,119	4,355	4,526	4,660
Operating balance	422	83	557	329	323	310
Operating balance (% of operating revenues)	10.1	2.1	11.9	7.0	6.7	6.2
Capital revenues	46	41	157	174	112	83
Capital expenditures	326	345	339	408	385	327
Balance after capital accounts	142	(221)	375	95	50	66

Table 1

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

(Mil. €)	2019	2020	2021	2022bc	2023bc	2024bc
Balance after capital accounts (% of total revenues)	3.4	(5.4)	7.8	2.0	1.0	1.3
Debt repaid	337	290	607	218	245	242
Gross borrowings	215	648	150	243	230	217
Balance after borrowings	20	138	(81)	120	35	40
Direct debt (outstanding at year-end)	2,903	3,264	2,809	2,834	2,819	2,793
Direct debt (% of operating revenues)	69.9	80.9	60.1	60.5	58.1	56.2
Tax-supported debt (outstanding at year-end)	3,570	3,875	3,403	3,427	3,384	3,329
Tax-supported debt (% of consolidated operating revenues)	85.0	95.2	72.1	72.5	69.2	66.4
Interest (% of operating revenues)	1.8	1.6	1.6	0.7	0.6	0.6
Local GDP per capita (single units)	32,030	29,314	N/A	N/A	N/A	N/A
National GDP per capita (single units)	26,512	23,703	25,383	27,978	29,546	30,767

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. N.A.--Not available. N.M.--Not meaningful.

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	1
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

- Spain Outlook Revised To Stable From Negative On Balanced Growth; 'A/A-1' Ratings Affirmed, March 18, 2022

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 7, 2022
- Public Finance System Overview: Spanish Special Status Entities, July 28, 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; Outlook Action

	To	From
Navarre (Autonomous Community of)		
Issuer Credit Rating	AA-/Stable/--	AA-/Negative/--
Ratings Affirmed		
Senior Unsecured	AA-	