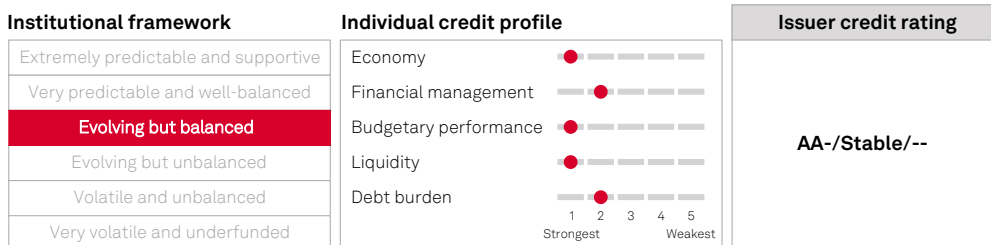


Autonomous Community of Navarre

March 25, 2024

This report does not constitute a rating action.

Ratings Score Snapshot



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Credit Highlights

Overview

Credit context and assumptions

The Autonomous Community of Navarre's special status makes it more exposed to the economic cycle, because it has own tax collection power.

The region operates under a predictable institutional framework, under which every five years, it and the central government renegotiate the agreement by which the flows between Navarre and the central government are calculated.

The region's financial management team is strongly committed to fiscal discipline and undertakes prudent choices in terms of debt and liquidity management.

Base-case expectations

We forecast Navarre will maintain sound operating performance through 2024-2026, in line with Spain's economic growth forecasts and lower inflationary pressure.

We expect the region to continue accelerating capital investments related to the EU's Recovery and Resilience Fund over 2024-2026.

Navarre's tax-supported debt ratios are falling, thanks to a declining direct debt burden and increasing operating revenue.

S&P Global Ratings expects Navarre's operating margin to remain robust, albeit declining moderately over 2024-2026, due to expected lower tax collection growth from the economic slowdown. The region's operating revenue was extraordinarily high in 2022 and 2023, thanks to strong economic growth, high inflation, and a more-favorable outcome of its agreement with the central government. Nevertheless, we expect weaker economic growth, which should translate into more-modest tax-revenue growth.

We forecast Navarre will continue its deleveraging path while maintaining a sound liquidity position. The region used accumulated surpluses to reduce its debt burden in 2023 by €173 million. We expect the region to continue deleveraging over the forecast period, supported by our expectation that it will post budgetary surpluses in that time.

Our rating on Navarre can be above that on Spain because, in our view, its credit characteristics would make it more resilient than the sovereign in a stress scenario. However, while the region's stand-alone credit profile (SACP) is 'aa', we think Navarre is highly sensitive to Spain's country risk, so we can rate it no more than two notches above the sovereign. The SACP is not a rating, but a measure of the intrinsic creditworthiness of a local or regional government before accounting for any constraint from the sovereign rating.

Outlook

The stable rating outlook mirrors that 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.

Downside scenario

We would downgrade Navarre if we downgrade Spain, or if we no longer consider that the region meets our conditions to be rated above the sovereign. We could also downgrade Navarre if its financial performance materially deviates from our base-case scenario, including structural deficits. This could be because of a weaker economy or lack of commitment to maintaining strong budgetary outcomes, and could result in deteriorated liquidity.

Upside scenario

We could upgrade Navarre if we upgrade Spain and the region continues to perform in line with our expectations, which point to balanced budgets and a gradual reduction of debt.

Rationale

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

Navarre, together with the Basque Country and other special-status provinces, have their own tax administration that collects the bulk of taxes. Therefore, these special-status regions do not participate in the regional financing system, which is based on advances from taxes collected and allows the central government to soften the impact of economic cycles on regional revenue. The framework under which Navarre operates makes it more vulnerable to economic downturns, but also allows for a faster recovery. We forecast a deceleration of Spain's real GDP in 2024 to 1.3% from 1.6% in 2023, and expect Navarre to perceive this more rapidly through a lower growth tax collection in 2024.

Navarre's special status implies a bilateral relationship with Spain's central government, and the region enjoys a different treatment compared with normal-status ones. The special agreement between Navarre and the Central government, "Convenio Economico," is updated typically every five years. This agreement determines the transfers between Navarre and central government, as well as the responsibilities Navarre has within the region. In late 2022, Navarre renegotiated its financial agreement for 2020-2024, which came out favorable for its revenue position. The agreement included an updated formula to determine the region's share of existing taxes and new sources of tax revenue. Given the technical and political complexity of these negotiations, it is typical for them to conclude with a delay. Nevertheless, if there is a delay due to unforeseen circumstances, as with the pandemic, or if there is a scenario under which Navarre thinks the outcome could be unfavorable, the region could oppose it; if the two parties cannot reach a new agreement, the previous one would prevail. We expect Navarre could start negotiations for the 2025-2029 agreement in the next two years, although we do not expect major changes.

Navarre's economy is wealthier, more competitive, and more export-oriented than Spain's. The region's GDP per capita was about 120% of the national average at year-end 2022. The industry sector represents about 30.8% of its total gross value added, compared with Spain's 17.4% as of year-end 2022. Its industrial sector features high value-added, export-oriented companies, making the economy more resilient to external shocks, in our view. Nevertheless, over the past year, Navarre has suffered from weaker European demand, which limited its growth in 2023. According to regional statistics, the region's economy expanded below Spain's average in 2023. Export declines are mainly linked to a fall in the automobile sector sales, which typically represents about 50% of total exports. However, other sectors like construction or services are performing well in Navarre, and we expect global economic growth to pick up by 2025, allowing its industry sector to recover gradually. Also, employment in the region is favorable, with rates being consistently below those of the national average, including at 9.3% versus 11.7% in 2023.

As part of Navarre's special status regime, the region negotiates its deficit targets with the central government. Navarre, like other European local and regional governments (LRGs), benefited from the suspension of fiscal rules in Europe for 2020-2023, which granted the region greater budgetary flexibility. Nevertheless, thanks to Navarre's prudent management practices, the region has continued to post budgetary surpluses. In 2024, it agreed with the central government a deficit target of 0.3% of GDP, upon which Navarre's management has built its budget. We believe that this deficit target is more flexible than that of normal-status regions because of their heavier exposure to economic downturns. Nevertheless, we forecast the region will outperform this target and post a small surplus in 2024. Navarre's management is very prudent and conservative when it comes to estimating operating revenue and expenditure. Also, management has a strong track record of sound budgetary performance and has used surpluses to reduce its debt burden.

Navarre will continue to post sound budgetary performance, allowing the region to continue its deleveraging path through 2026

Navarre outperformed our expectations in 2023 and posted a budgetary surplus of 5.3% of operating revenue, compared with our previous 2.5% estimate, mainly supported by higher tax collection growth than what we had anticipated. We expect Navarre to continue to post strong budgetary outcomes over our forecast period 2024-2026, albeit with lower surpluses owing to a slowdown in economic growth, which in our view could translate into lower tax collection growth.

In 2023, Navarre's tax collection rose 4.8%, owing to stronger economic dynamism in Spain than we had anticipated, and a lower adjustment to the portion of transfers that Navarre has to give to the central government. Some taxes, such as the value-added tax, were less dynamic as the central government reduced this tax for some items such as electricity, affecting Spanish regions tax collection growth. However, this was offset by growth in taxes such as the corporate tax, in which collections rose 26% in 2023.

Autonomous Community of Navarre

We expect Navarre to maintain solid operating performance throughout the forecast, with operating balance being consistently above 5% of operating revenue. Nevertheless, we expect operating balances to slightly decline in 2024 from 2022 and 2023 levels, as economic growth slows and inflation, which boosted tax collection growth in recent years, stabilizes. We expect Navarre's, operating expenditure to grow by about 4.4% in 2024, slightly below than the previous year, assuming inflation eases pressure on the budget and that the region, in a context of moderation of tax collection growth, would be able to put a grip onto operating expenditure growth.

Navarre's capital accounts are largely driven by trends in EU grants from the Recovery and Resilience Fund. The central government has allocated the region with €579 million of grants, which it has received gradually since 2021. It had used about 33% of these as of December 2023. The allocation of grants and actual spending do not follow the same calendar, which creates some mismatches up to 2026, the deadline by which the region must spend all the funds. As such, Navarre's capital accounts have benefited from large inflows of capital revenue in 2021-2023, while execution is taking time. We think the region had received most of its allocated funds before December 2023, so we expect investments to accelerate, and consequently Navarre's balance after capital accounts will decline. Nevertheless, this effect will be temporary and only to be seen in budgetary terms. In national accounting terms, official accounting system by the Ministry of Finance, the central government adjusts these mismatches when calculating the region's official surplus or deficit for the year.

Navarre's debt is low, particularly when compared with that of its Spanish peers, and is declining. We forecast the region's tax-supported debt ratio to reach 41.2% of consolidated operating revenue by 2026, supported by our expectation that Navarre will limit its debt intake and reduce its direct debt over the forecast period. Despite increasing interest rates, the region's interest payment bill was not affected as the region reduced its debt exposure and currently about 95% of its debt is fixed-rate. We forecast interest payments to reach 0.86% of Navarre's operating revenue in 2024.

We forecast the region's financing needs in 2024 at about €100 million, lower than its own estimates, because we expect Navarre to outperform its budgetary targets and post a surplus for the year. We expect the region to finance these debt resources through market debt, most likely a sustainable bond issuance, and short-term debt intake.

While the central government has made a clear statement that some Spanish regions could benefit from it absorbing some of the regions' debt, we believe this will only affect normal-status regions, leaving Navarre and the Basque Country out of scope. Therefore, we have not included any debt-absorption assumptions in our base-case scenario. Also, we understand the central government allocated a €20 billion fund from the Recovery and Resilience Mechanism in the form of loans for Spanish regions that will be managed by the European Investment Bank. We have low visibility on how many of these loans Navarre could take over the next three years, because the loans' terms are not defined. Hence, we have not included these in our assumptions.

Navarre's liquidity position is exceptional, owing to its strong budgetary discipline and continued receipt of EU funds. We expect the region's cash position could slightly decline as it spends EU funds, but we still expect Navarre to maintain a very strong liquidity position. Further supporting the region's liquidity is its €75 million of contracted credit lines, which adds an additional cash buffer for Navarre to manage its intra-year liquidity needs when necessary.

Autonomous Community of Navarre--Selected indicators

Mil. EUR	2021	2022	2023e	2024bc	2025bc	2026bc
Operating revenue	4,655	5,288	5,657	5,728	5,865	6,064

Autonomous Community of Navarre--Selected indicators

Operating expenditure	4,119	4,779	5,016	5,213	5,356	5,503
Operating balance	535	509	641	516	510	561
Operating balance (% of operating revenue)	11.5	9.6	11.3	9.0	8.7	9.3
Capital revenue	212	214	213	144	45	45
Capital expenditure	339	440	542	551	445	426
Balance after capital accounts	409	283	312	109	110	180
Balance after capital accounts (% of total revenue)	8.4	5.2	5.3	1.9	1.9	2.9
Debt repaid	607	381	224	234	336	214
Gross borrowings	150	406	50	100	150	50
Balance after borrowings	(48)	308	138	(25)	(76)	16
Direct debt (outstanding at year-end)	2,809	2,836	2,664	2,530	2,344	2,180
Direct debt (% of operating revenue)	60.4	53.6	47.1	44.2	40.0	36.0
Tax-supported debt (outstanding at year-end)	3,403	3,394	3,102	2,930	2,714	2,521
Tax-supported debt (% of consolidated operating revenue)	72.4	63.6	54.4	50.7	45.9	41.3
Interest (% of operating revenue)	1.6	0.8	0.7	0.9	0.7	0.7
Local GDP per capita (\$)	36,692.1	35,589.3	--	--	--	--
National GDP per capita (\$)	30,498.8	29,889.3	32,877.7	34,618.6	37,667.2	40,029.0

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. EUR--euro. \$--U.S. dollar. 'e'- estimate.

Autonomous Community of Navarre--Rating component scores

Key rating factors	Scores
Institutional framework	3
Economy	1
Financial management	2
Budgetary performance	1
Liquidity	1
Debt burden	2
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

- Research Update: Spain 'A/A-1' Ratings Affirmed; Outlook Stable, March 15, 2024

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

- Subnational Debt 2024: Spain: Lower borrowings, but bond issuances recover, Feb. 29, 2024
- Sovereign Risk Indicators, Dec. 11, 2023. Interactive version available at <http://www.spratings.com/sri>
- Institutional Framework Assessments For Local And Regional Governments Outside Of The U.S., Dec. 15, 2023
- Institutional Framework Assessment: Spanish Special Status Entities, July 21, 2022

Ratings Detail (as of March 15, 2024)*

Navarre (Autonomous Community of)

Issuer Credit Rating	AA-/Stable/--
Senior Unsecured	AA-

Issuer Credit Ratings History

25-Mar-2022	AA-/Stable/--
25-Sep-2020	AA-/Negative/--
27-Sep-2019	AA-/Stable/--

Ratings Detail (as of March 15, 2024)*

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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