MOODY'S
RATINGS

Rating Action: Moody's changes outlook on the ratings of 14 Spanish sub-sovereigns to positive; ratings affirmed

21 Mar 2024

Madrid, March 21, 2024 -- Moody's Ratings ("Moody's") has today changed the outlook of 14 Spanish sub-sovereigns to positive from stable, while affirming their long-term issuer and debt ratings. The short-term ratings for the Ayuntamiento de Madrid ("city of Madrid"), the Principado de Asturias ("Asturias"), the Generalitat de Catalunya ("Catalunya") and the Generalitat de Valencia ("Valencia"), were also affirmed. At the same time, Moody's has also upgraded by one notch the Baseline Credit Assessment (BCA) of the Junta de Comunidades de Castilla-La Mancha ("Castilla-La Mancha"), Catalunya, the Comunidad Autonoma de Murcia ("Murcia"), and the region of Valencia.

Today's rating action on outlook changes follows Moody's decision to change the outlook on the rating of the Government of Spain to positive from stable on 15 March 2024. For additional information, please refer to sovereign press release: https://ratings.moodys.com/ratings-news/416989 .

The one-notch upgrade to the BCAs of the regions of Castilla-La Mancha, Catalunya, Murcia, and Valencia was driven by Moody's forecasts of stronger fiscal situation than it previously expected over the next three years, building on an improvement in fiscal situation already visible in 2023. The affirmation of the ratings for these four regions reflects their persistently high deficit levels and debt levels that are higher than those of their national peers.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL486859 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

RATIONALE FOR THE OUTLOOK CHANGES

Moody's anticipates that Spain's regional and local governments' fiscal situation will improve in the next two to three years. According to the rating agency's forecasts, their gross operating balances will improve and deficit and debt burdens will reduce. Moody's also expects Next Generation EU funds to have a positive impact on local economies, to be reflected from 2024 onward.

Moody's decision to change the Spanish sub-sovereign rating outlooks to positive from stable reflects the outlook change on the sovereign's rating. Moody's believes that, should the country's medium-term economic growth prospects be higher and less volatile than what Moody's currently assumes – reflecting the upside risks underpinning the change in Spain's outlook to positive from stable – the increase in tax revenue could be more significant. This could, in turn, lead an increase in state transfers to Spanish sub-sovereigns beyond Moody's baseline forecast, thereby assisting these entities in rebalancing their budgets in the future.

There is a strong correlation between the sovereign's macroeconomic performance and the sub-sovereigns' tax bases as around 60% of regional operating revenue are from taxes which are very sensitive to macroeconomic trends, such as Personal Income Tax, Value Added Tax and Special taxes. Moreover, transfers from the central government constitute a significant portion of sub-sovereigns' operating revenue, accounting for approximately 30% for regions and around 45% for municipalities.

RATIONALE FOR THE RATING AFFIRMATIONS

ENTITIES RATED ABOVE THE SOVEREIGN LEVEL

-THE BASQUE COUNTRY AND THE DIPUTACION FORAL DE BIZKAIA

Moody's decision to affirm the Basque Country's and the province of Bizkaia's ratings at A3, reflects their unique and constitutionally protected tax regime. This regime currently allow them to retain enough credit strength to maintain their ratings one notch above the sovereign. The Basque Country and the province of Bizkaia have a significantly higher fiscal flexibility than their national peers under the common regime and they also have comfortable liquidity positions, reducing their refinancing risk. Over the past few years, both entities have recorded positive operating balances, very low financing deficits or financing surpluses, and low debt burdens. Moody's anticipates that these two entities will maintain their strong fiscal performance over the next three years.

The A3 ratings of the two Basque entities combine a BCA of a3 with a high support assumption from the Government of Spain.

ENTITIES RATED AT THE SOVEREIGN LEVEL

-CITIES OF BARCELONA AND MADRID

Moody's affirmation of Barcelona's long-term issuer rating of Baa1 and the Ayuntamiento de Madrid's long-term issuer and debt ratings of Baa1 and short-term issuer rating of P-2, reflects their prudent budgetary management, high gross operating balances and financing surpluses, low debt burdens and strong liquidity.

Moody's considers the credit profiles of Madrid and Barcelona as very strong. However, their financial strength is largely dependent on transfers from the national government. This reliance makes it unlikely for these cities to possess a credit quality stronger than that of the sovereign itself. The central government maintains control over Spanish municipalities through legislation. This control restricts their fiscal flexibility in terms of tax revenues, operating transfers, and personnel costs.

These two cities' Baa1 ratings reflect the combination of their standalone credit profiles, as reflected in their BCAs of baa1, and Moody's assumption of a strong likelihood of extraordinary support from the Government of Spain.

-REGIONS OF ASTURIAS, CASTILLA Y LEON, GALICIA AND MADRID

Moody's decision to affirm the Baa1 long-term issuer ratings of Galicia and the long-term issuer and debt ratings of Asturias, Castilla y Leon, and Madrid, which are on par with the sovereign rating, reflects their strong fiscal and financial performance. At the same time, Asturias' short-term issuer rating of P-2 reflects the region's very good liquidity profile. All these regions have improved their operating performance and financing deficits in recent years. According to the rating agency's forecasts, it anticipates operating and financing surpluses for the next three years, thus limiting debt growth in the coming years. Furthermore, all these four regions have moderate debt levels, with net direct and indirect debt to operating revenue ratios below the average for rated regions of 166% at year-end 2023 (around 93%, 132%, 108% and 151% for Asturias, Castilla y Leon, Galicia and Madrid, respectively). Additionally, these regions benefit from very good market access and their ratings also capture these regions' prudent debt management practices.

The Baa1 ratings of these four regions reflect the combination of their standalone credit profiles of baa3, and Moody's assumption of a high likelihood of extraordinary support from the Government of Spain.

ENTITIES RATED BELOW THE SOVEREIGN LEVEL

-REGIONS OF ANDALUCIA AND EXTREMADURA

The affirmation of the Baa2 long-term issuer ratings for Extremadura, and the long-term issuer and debt rating for Andalucia, reflect the low debt burden compared with national peers (102% and 109% in 2023, for Extremadura and Andalucia, respectively) and adequate liquidity profile of these two regions. While Extremadura's fiscal position has improved in recent years, a trend that is expected to continue, Andalucia experienced a budget deterioration in 2023 due to some one-off expenditures. Despite this, Moody's expects its budgetary ratios to improve from 2024 onward.

The Baa2 rating for Extremadura and Andalucia reflects the combination of these regions' standalone credit profiles, as reflected in their BCAs of ba2 and ba1 respectively, and Moody's assumption of a high likelihood of extraordinary support from the Government of Spain.

-REGIONS OF CASTILLA-LA MANCHA, CATALUNYA, MURCIA AND VALENCIA

Moody's decision to affirm the Ba1 ratings of Castilla-La Mancha, Murcia, Valencia and Catalunya, reflects these four regions' ongoing fiscal challenges despite improvements in 2023. The rating agency believes that the fiscal positions of these regions will remain weak for the next two years, as evidenced by persistently high deficit levels and debt levels higher than their national peers. Moody's anticipates that these regions' debt stock will continue to grow over the next two years due to ongoing financing deficits, which will be financed through new debt. However, the pace of the debt stock increase is expected to slow.

These four regions continue to extensively rely on the Fondo de Liquidez Autonomico (FLA), the central government's liquidity mechanism. As of December 2023, debt from the FLA made up approximately 89% of the aggregated debt for these regions. This data underscores the high extraordinary support from the central government to these regions. The rating agency believes that this liquidity support from the central government will be maintained in the coming years.

The standalone credit profiles, or BCAs, of these four regions have been upgraded by one notch, reflecting Moody's expectations of a continued fiscal improvement over the next two to three years, driven by increased operating revenue from higher central government transfers. Furthermore, the BCAs upgrade also reflects an improvement of these regions' fiscal positions in 2023. This is based on information from pre-closing execution budgets, which show that their operating performances and debt burdens improved last year. Their net direct and indirect debt to operating revenue ratio decreased in 2023 compared to 2022: from 202% to around 192% for Castilla-La Mancha, from 244% to 231% for Murcia, from 245% to 227% for Catalunya, and from 353% to 321% for Valencia.

Moody's believes that the region of Catalunya could see further improvement if the agreed partial debt cancellation of €15 billion between the pro-independence political party ERC and the socialist party materializes. This proposal has the potential to reduce Catalunya's debt burden from the 227% recorded in 2023 to around 190%. Additionally, the potential savings on interest expenses could contribute to the fiscal consolidation of the region. If this measure were to be extended to other Spanish regions, the rating agency would then assess the impact on the credit profiles of these regions.

The Ba1 ratings for these four regions reflect the combination of these regions' standalone credit profiles, as reflected in their BCAs of ba3 for Castilla-La Mancha, Murcia and Catalunya and b2 for the region of Valencia, and Moody's assumption of a high likelihood of extraordinary support from the Government of Spain, as corroborated by the central government's track record of liquidity support since the FLA was created in 2012, which partially offsets their weak standalone creditworthiness.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

The overall impact of ESG risks on the ratings of rated Spanish RLGs varies. For the majority, ESG considerations do not materially impact their current ratings (CIS-2). However, there are some regions where the impact on their current ratings is limited, but with potential for a greater negative impact over time (CIS-3). This reflects a high credit exposure to environmental risks, and an average social and governance risk profile. Balancing these risk exposures, the overall resilience is moderate, due to our assessment of high support from the central government in case of need.

The majority of Spanish RLGs are highly exposed to environmental risks, primarily heat stress, water stress, and drought scenarios. Physical climate risks and difficulties in water management present significant challenges for many regions, particularly those located in the south and east of the country. These challenges negatively impact their Environmental (E) issuer profile scores. Nonetheless, the costs of the RLGs' investments in infrastructure to bolster resilience against these risks are expected to be partially offset by funding from the central government and EU funds.

For the majority of Spanish RLGs, exposure to social risks does not materially differentiate credit quality (S-2). However, some regions have high credit exposure to social risks (S-4), primarily due to a significant portion of the ageing population. This demographic factor increases social and healthcare expenditures that these regions are responsible for. Certain regions are also significantly exposed to unfavorable labor market conditions. On the other hand, positive social aspects in these areas include good housing availability, high-quality health and safety standards, and access to basic services.

For the majority of rated Spanish RLGs, the governance profile does not significantly differentiate credit quality, as they are predominantly rated G-2. These RLGs typically exhibit robust budget management strategies, often implementing stringent budgetary control plans. Additionally, they are known for their transparency and promptness in providing financial reports. However, there are exceptions, such as the region of Valencia, which has a higher credit exposure to governance risks (G-3). This is reflected on its weak budget management practices, as demonstrated by its elevated levels of financing deficits and debt burdens.

The specific economic indicators, as required by EU regulation, are not available for these entities. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: Spain, Government of

GDP per capita (PPP basis, US$): 47,711 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 5.8% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 5.5% (2022)

Gen. Gov. Financial Balance/GDP: -4.7% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: 0.6% (2022) (also known as External Balance)

External debt/GDP: 175.7% (2022)

Economic resiliency: a1

Default history: No default events (on bonds or loans) have been recorded since 1983.

SUMMARY OF MINUTES FROM RATING COMMITTEE

On 18 March 2024, a rating committee was called to discuss the rating of the Andalucia, Junta de; Asturias, Principado de; Barcelona, City of; Bizkaia, Diputacion Foral de; Basque Country (The); Castilla y Leon, Junta de; Castilla-La Mancha, Junta de Comunidades de; Catalunya, Generalitat de; Extremadura, Junta de; Galicia, Comunidad Autonoma de; Madrid, Ayuntamiento de; Madrid, Comunidad Autonoma de; Murcia, Comunidad Autonoma de; Valencia, Generalitat de. The main points raised during the discussion were: The issuers' economic fundamentals, including their economic strength, have materially increased. The issuers' fiscal or financial strength, including their debt profile, has materially increased. The systemic risk in which the issuers operate has materially decreased.

The sovereign action required the publication of this credit rating action on a date that deviates from the previously scheduled release date in the sovereign release calendar, published on https://ratings.moodys.com.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The strengthening of Spain's credit profile, as reflected by an upgrade of the sovereign rating, would have positive credit implications for the Spanish sub-sovereigns in general via reduction in the systemic risk. In addition, upward pressure would develop on the ratings below the sovereign bond rating if their fiscal and financial performance were to improve, reflected in positive and growing gross operating balances, financing surpluses and a significant reduction in their debt burdens.

Similarly, a deterioration of sovereign credit strength would exert downward pressure on the ratings of Spanish RLGs. Factors such as fiscal slippage, rapidly rising debt levels, or the emergence of significant liquidity risks could also exert downward pressure on the ratings of Spanish sub-sovereigns.

The principal methodology used in these ratings was Regional and Local Governments published in January 2018 and available at https://ratings.moodys.com/rmc-documents/66129 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are a mix of solicited and unsolicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL486859 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

• EU Endorsement Status

• UK Endorsement Status

• Rating Solicitation

• Issuer Participation

• Participation: Access to Management

• Participation: Access to Internal Documents

• Lead Analyst

• Releasing Office

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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