S&P Global
Ratings

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Research Update:

Nine Argentine Provinces And The City of Buenos Aires Downgraded On Similar Action On Sovereign

August 20, 2019

Overview

- On Aug. 16, 2019, we lowered our long-term foreign and local currency ratings on Argentina to 'B-' from 'B' and assigned a negative outlook.
- The downgrade reflects the pronounced financial market turbulence, with significant depreciation of the peso and a spike in interest rates, following the August 11 primary elections in Argentina, which has meaningfully weakened the sovereign's already vulnerable financial profile. The negative outlook reflects a greater than one-in-three chance of a downgrade in 2020 amid very complex economic and financial market dynamics exacerbated by the timing of the electoral calendar.
- We believe that despite its improvements, the very weak institutional predictability and volatile intergovernmental system of the Argentine local and regional governments (LRGs) prevents local governments from having higher ratings than on the sovereign.
- We're lowering our ratings on the provinces of Buenos Aires, Córdoba, Entre Rios, La Rioja, Mendoza, Neuquén, Rio Negro, and Salta, and on the city of Buenos Aires to 'B-' from 'B'. We're also downgrading the province of Jujuy to 'CCC+' from 'B-'. The outlook on these entities is negative, mirroring the one on the sovereign.

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Rating Action

On Aug. 20, 2019, S&P Global Ratings lowered its foreign and local currency issuer credit ratings on the city of Buenos Aires and the provinces of Cordoba, Entre Ríos, La Rioja, Mendoza, Neuquén, Rio Negro, Salta, and Buenos Aires to 'B-' from 'B'. Also, we downgraded the province of Jujuy to 'CCC+' from 'B-'. The outlook on the 10 LRGs is negative.

Outlook

The negative outlook on the 10 Argentine LRGs mirrors the negative outlook on the sovereign. In a more complex internal and external environment for Argentina, domestic LRGs are considerably vulnerable, while having a limited room to maintain fiscal health in the next few years. Sharp and consistent depreciation of the domestic currency has increased pressures on LRGs' budgetary performance, which are likely to continue rising for the remainder of the year. Demands for higher salaries for public-sector employees, due to persistently high inflation, and LRGs' ability to contain operating pressures will remain a main source of concern for the next 12 months.

Downside scenario

We could lower the ratings on the Argentine LRGs if we were to lower the ratings on the sovereign. Also, we could lower the rating on Argentine LRGs if their stand-alone credit profiles deteriorate beyond our base-case assumptions. This could occur, for example, if poor decisions lead to unsustainable fiscal deficits amid debt obligations in foreign currency and weak liquidity positions. Also, growing concerns about the LRGs' capacity to refinance existing debt in foreign and domestic currencies and/or their unwillingness to service debt obligations could prompt us to lower rating in the next 12-18 months.

Upside scenario

We could revise the outlook on the LRG ratings to stable in the next 12 months if we were to take the same action on the sovereign. We don't believe that Argentine LRGs can have higher ratings than on the sovereign because they operate under a very weak and volatile institutional framework that constrains their ratings.

Rationale

Rating constraints for Argentine LRGs are the weak institutional framework and economic woes. We expect economic contraction of 2.3% in 2019, following a 2.5% decline in 2018, and growth of only about 0.5% in 2020. However, other credit factors--budgetary performance, quality of financial management, liquidity position, and debt burden—influence LRGs' stand-alone credit profiles (SACPs). We use the latter to assess the LRG's intrinsic creditworthiness, absent the sovereign rating cap.

We assess the SACPs at:

- 'b+' for the city of Buenos Aires and province of Cordoba;
- 'b' for the provinces of Mendoza, Salta, Neuquén, Entre Rios, and La Rioja;
- 'b-' for the provinces of Buenos Aires and Rio Negro; and
- 'ccc+' for the province of Jujuy.

However, we cap our rating on the provinces and the city of Buenos Aires at the 'B-' foreign currency long-term rating on Argentina, because these entities don't meet our criteria for having a higher rating than on the sovereign.

In our view, the institutional framework for Argentine LRGs is characterized by very weak institutional predictability, volatile intergovernmental system, and fiscal imbalances. However, we consider that the framework has improved during the Macri administration, and we don't expect these gains to be reversed in the next 12-18 months. Since 2016, automatic transfers to the provinces have increased following various agreements between the central and provincial governments.

Debt burden among Argentine LRGs has increased over the past few years; however, we don't consider it a rating constraint. Still, the plummeting Argentine peso is making payments on the LRGs' foreign debt more expensive, raising our concerns about their budgetary performance, weak liquidity positions, and refinancing risks in the coming years. However, LRGs have managed their reserve funds to pay debt in 2018, and we believe that they will be able to cover debt-servicing costs in 2019.

In 2018, Argentine LRGs were able to post stronger revenues and lower growth in spending. For 2019, we expect weaker fiscal results under harsher macroeconomic conditions. To offer more details on credit quality of each Argentine LRG that we rate, here are some relevant factors:

The city of Buenos Aires

- We revised downwards our SACP on Buenos Aires to 'b+' from 'bb-', given that Argentina's deteriorating economy will likely weigh on the city's individual credit profile in 2019 and 2020.
- However, we believe the city will continue to adhere to fiscal austerity, resulting in operating surpluses close to 10% of operating revenue and a deficit after capital expenditures (capex) of slightly less than 5% of total revenue over the next few years. The city of Buenos Aires' wealth and its higher infrastructure spending than among other Argentine LRGs, should enable it to maintain sustainable fiscal results.
- Debt burden and debt service will still be subject to market conditions, namely the peso's depreciation and reference interest rates, but debt should remain just above 30% of operating revenue towards 2021. Finally, while liquidity should remain weak given low cash reserves, the city has access to external funding sources in order to refinance significant debt maturities.

The province of Cordoba:

- We lowered our SACP on Cordoba to 'b+' from 'bb-', as Argentina's recession will likely dent provincial revenue, while the weaker peso pressures the province's liquidity position.
- We expect Cordoba to remain committed to sound fiscal policies and to post relatively high operating surpluses in the next two years. We expect the province to delay investment plans in order to post low deficits after capex.
- Weaker fiscal results and the peso's further depreciation could drag down Cordoba's cash position, because almost all of the province's debt is denominated in dollars. In addition, the province's liquidity could be subject to volatility because Cordoba faces a $725 million bullet amortization in June 2021.

The province of Mendoza:

- We revised downwards our SACP on Mendoza to 'b' from 'b+'. Fiscal constraints will remain for the next two years, with limited room to increase revenue amid pressure to raise public-sector wages. Nonetheless, we expect sound fiscal policies to remain after the September provincial election.
- Economic contraction will harm Mendoza's fiscal performance. Therefore, we expect liquidity to remain relatively low and subject to volatility for the next two years.
- Mendoza's debt is exposed to foreign currency, mitigated by revenue linked to the dollar, such as hydrocarbon royalties. The peso's slide hasn't substantially worsened Mendoza's debt

profile.

The province of Salta

- Salta's 'b' SACP balances fiscal consolidation, increased liquidity, and improvement in financial management, with some uncertainty over the continuity of recently implemented policies, which could weaken budgetary performance.
- Salta has a track-record of issuances in the international capital market of both plain vanilla and structured bonds backed by hydrocarbon royalties. Debt burden remains manageable, about 30% of revenues. The debt service profile is relatively smooth, with a hike in 2022-2024 due to the amortization in three tranches of the $350 million bond issued in 2016.
- Salta has structural constraints such as a low GDP per capita and high infrastructure gaps, which limit its flexibility, and are likely to remain in the coming years.

The province of Entre Ríos

- Entre Rios' 'b' SACP reflects our expectations of prudent fiscal policies and moderate deficits after capex, despite Argentina's economic instability.
- Entre Rios has improved its fiscal performance in the past two years. This was the result of the prudent management, additional transfers from the federal government, and the gradual erosion of real expenditures amid high inflation.
- Fiscal sustainability should reduce the province's debt burden over the next few years, although the latter and debt service will remain vulnerable to market conditions, particularly the currency's depreciation.

The province of La Rioja

- La Rioja's 'b' SACP balances prudent fiscal policies with the provincial structural weaknesses, such as an unfavorable socioeconomic profile that hampers the budgetary flexibility.
- Operating surpluses below 5% of operating revenues and decreasing deficits after capex for the next three years should preserve the province's cash position, which is stronger than those of other provinces in Argentina, as seen in sufficient cash to cover 2x of La Rioja's debt service for the next 12 months.
- Argentine peso's steep depreciation raised La Rioja's debt stock to 55% of the 2019 projected operating revenues from 38% in 2017. We expect a gradual reduction in debt because financing needs will be limited. However, debt burden will remain vulnerable to market conditions, because 80% of the debt stock is denominated in foreign currency.

The province of Neuquén

- The province's 'b' SACP reflects an economy that's stronger than the nation's. However, the provincial economy is highly concentrated in the hydrocarbon industry, which exposes Neuquen to swings in commodity cycles.
- The combination of the peso's sharp depreciation and increased hydrocarbon production

improved the provincial finances. However, we expect budgetary performance to remain volatile because of the province's exposure to cyclical revenues, namely hydrocarbon royalties, and weak revenue and expenditure management.

- Low debt burden and limited exposure to contingent liabilities, with a track record of managing exposure to foreign currency risk, support creditworthiness.

The province of Buenos Aires

- We lowered the province's SACP to 'b-' from 'b', the same level as the final rating. Although the province has adhered to its fiscal consolidation plan since 2016, the worsening economy make it more difficult for the province to continue at a similar pace as in the past year, especially given its very large spending constraints.
- Budgetary performance is likely to remain weaker than those of most domestic LRGs in 2019 and beyond, and we expect capex to diminish given that financing conditions remain tight.
- The peso's sharp depreciation lifted the debt to operating revenue ratio to almost 70% in 2019. We expect debt to decrease gradually over the next few years. The province has more than $1 billion in amortizations coming due in the next 12 months, and we consider that the province could receive support from the central government if market uncertainty remains for the remainder of 2019 and in 2020.

The province of Rio Negro

- We revised downward Rio Negro's SACP to 'b-' from 'b', because recession will likely crimp revenue. This, coupled with spending restraints, will make further fiscal consolidation difficult to implement.
- Nonetheless, we believe that Rio Negro's commitment to fiscal discipline, coupled with increasing resources from royalties, will prevent fiscal deficits. We expect Rio Negro to post operating surpluses of about 1.7% of operating revenues and deficits after capex of about 4% of total revenues for 2019 and 2020.
- Although 67% of Rio Negro's debt is in foreign currency, the risk is mitigated by revenues linked to the dollar, such as hydrocarbon royalties. The peso's recent depreciation hasn't substantially worsened Rio Negro's debt profile.

The province of Jujuy

- We lowered Jujuy's SACP to 'ccc+' from 'b-' as a result of unfavorable economic and political conditions in Argentina, and greater challenges to maintain fiscal sustainability.
- Jujuy's budgetary constraints will result in substantial fiscal deficits during 2019 and 2022, which is likely to keep Jujuy's liquidity very weak.
- These factors and exacerbating market volatility increase risks for a province, about 90% of whose debt is denominated in foreign currency. Although Jujuy may not face a payment crisis for the next 12 months, it's more vulnerable than other Argentine provinces.

In the coming months, we will publish full analyses for each LRG with the corresponding financial stats and rating score snapshots.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 11, 2019. An interactive version is available at http://www.spratings.com/sri

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. 19, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Argentina Long-Term Sovereign Ratings Lowered To 'B-' As Market Turbulence Weakens Creditworthiness; Outlook Negative, Aug. 16, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Public Finance System Overview: Argentine Municipalities And Provinces, June 30, 2017

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

Downgraded

	To	From
Buenos Aires (City of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	B-	B
Buenos Aires (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	B-	B
Cordoba (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	**B-**	**B**
Entre Rios (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	**B-**	**B**
Jujuy (Province of)		
Issuer Credit Rating	CCC+/Negative/--	B-/Stable/--
Senior Unsecured	**CCC+**	**B-**
La Rioja (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	B-	B
Mendoza (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	**B-**	**B**
Neuquen (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Secured	B-	B
Senior Unsecured	**B-**	**B**
Province of Rio Negro		
Issuer Credit Rating	**B-/Negative/--**	**B/Stable/--**
Senior Unsecured	**B-**	**B**
Salta (Province of)		
Issuer Credit Rating	B-/Negative/--	B/Stable/--
Senior Unsecured	B-	B
Senior Secured	B-	B

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