

Research Update:

Argentine Province Of Mendoza Ratings Raised To 'CCC+' From 'SD' On Lower Default Risk, Outlook Stable

June 11, 2021

Overview

- On June 9, 2021, the Argentine province of Mendoza refinanced its 2021 domestic currency bond, significantly reducing the risk of new default in the short term.
- Therefore, we're raising our global scale issuer credit ratings on Mendoza to 'CCC+' from 'SD', where we placed them on June 19, 2020, following a missed debt payment on its international bond.
- The stable outlook balances the lower risk of default following the international debt restructuring and rollover of the domestic bond, with the risks stemming from limited access to funding sources and Argentina's limited economic growth prospects.

Rating Action

On June 11, 2021, S&P Global Ratings raised its global scale issuer credit ratings on the province of Mendoza to 'CCC+' from 'SD'. The outlook is stable. We also affirmed the issue-level rating of 'CCC+' on the province's 2029 international bond.

Outlook

The stable outlook on our 'CCC+' rating balances the lower risk of default following the international debt restructuring and repayment of the domestic bond, with the risks stemming from limited access to funding and limited economic growth prospects in Argentina that could pressure Mendoza's fiscal accounts and liquidity.

Downside scenario

We could downgrade the province if a sharply weaker-than-expected fiscal performance or

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liquidity position increases the risk of default or possibility of a distressed debt exchange in the next 12 months. In addition, a downward revision of our transfer and convertibility (T&C) assessment on Argentina would result in a downgrade of Mendoza, given scarcity of reserve levels and the limited access to sources of foreign currency for debt service payments.

Upside scenario

Given that we don't believe that Argentine local and regional governments (LRGs) meet the conditions to have ratings above that on the sovereign, we could only upgrade the province of Mendoza if we take a similar action on Argentina in the next 12 months. This would have to be accompanied by Mendoza's stronger budgetary performance and liquidity buffers, or greater certainty about its capacity to tap debt markets.

Rationale

Mendoza refinanced its domestic bond of ARP5.2 billion maturing on June 9, 2021, considerably reducing the risk of a new default in the short term. The province issued a short-term domestic currency bond for ARP6.397 billion that accepted the maturing bond in exchange (adherence was of 55.6% of its amount) as well as other existing short-term notes, with the remainder used to pay down the outstanding amount of the existing bond. While current financial conditions are still strained, we don't consider this as a distressed exchange because we believe a conventional default could have been avoided if bondholders didn't accept the exchange offer.

Mendoza was the first province to successfully restructure its international debt and reached an agreement with bondholders of its international bond for \$590 million in October 2020. At that point, we assigned a 'CCC+' rating to the new issuance but maintained the issuer credit rating (ICR) on the province at 'SD', given its plans for a broader restructuring, including the exchange of domestic currency debt, which we considered could be distressed and tantamount to default given the fragile economic and financial conditions, which are still present.

The 'CCC+' issuer credit rating ICR reflects our view that, while the international debt exchange has provided medium-term fiscal and liquidity relief, Argentina's weak economic recovery during the next two years, along with other challenges, will continue weighing on the province's creditworthiness.

The international debt exchange provided medium-term relief, but low liquidity buffers and limited access to financing underscore lingering risks

Spending pressures, stemming from public-servant salary negotiations and the province's resumption of its infrastructure program, are likely to weigh on the budget. However, we expect the province to post balanced results in 2021-2023 due to the economy slow recovery, rising tax revenue, and lower debt service following Mendoza's international bond restructuring. Our base-case scenario assumes that the province will post operating surpluses of about 5% of operating revenues and small deficits after capex during 2021-2023. Still, high inflation in Argentina and recession could lead to volatility in budgetary execution, as seen in the past.

Mendoza's fiscal results in 2020 were better than expected. The COVID-19 pandemic and lockdown measures caused the province's revenue to decline 30% in real terms, along with higher healthcare spending, which is a responsibility of local governments in Argentina. The offsetting factors were the extraordinary support from the national government, along with contained

spending, consisting of lower public-sector wages in real terms and capital expenditure (capex) cuts.

The province has been receiving capital transfers from the national government since October 2019 for a large hydroelectric dam project, Portezuelo del Viento, and expects to receive about \$950 million in 2021-2023. Given that the project's construction is financed through a trust fund separate from the provincial budget, we exclude these transfers from our fiscal estimates and only consider any spending for the project that's additional to these transfers.

We assume international debt markets will remain closed to Argentine LRGs, and Mendoza will cover its funding needs through pre-approved and potentially new loans from multilateral lending agencies, as well as through domestic market issuances. We believe that the lack of liquidity buffers remains a key risk to the creditworthiness of Argentine provinces. Along with the lack of access to external funding, a severe liquidity crunch in 2020 led the province to pursue a restructuring of its international debt. Based on our stressed estimates, Mendoza's free and available cash is currently low and doesn't cover debt repayment for the next 12 months.

Debt stock represented 60% of the province's revenue in 2020. About 62% of the debt is denominated in U.S. dollars, which underscores potential currency risk. Debt is also exposed to Argentina's high inflation, given that 13% of Mendoza's debt is tied to inflation-linked instruments. We expect debt level to drop close to 40% of revenue and interest payments to below 5% of operating revenue (from 7.4% in 2019) in coming years because financing conditions will remain limited. The province's debt service profile is smooth, with a tick up in 2023 as payments for the 2029 international bond become heftier.

A volatile institutional framework and limited growth in Argentina constrain the rating

The economic outlook for Mendoza is weak, in line with that for the sovereign. Argentina's GDP contracted 9.8% in 2020 and is likely to grow 6% in 2021 and about 2% in the medium term. To tackle its considerable economic challenges, Argentina needs to establish policy consistency and reduce fiscal and monetary imbalances, including lower inflation and a more stable exchange-rate regime (see "Argentina Faces Challenges And Opportunities After Its Restructuring," Sept. 18, 2020). Mendoza's socio-economic indicators are in line with the national average, and according to our estimates, the province's GDP per capita was \$5,340 in 2020, which was below the estimated national level of \$8,790.

The province has shown willingness to pursue fiscally prudent policies, but amid high inflation and weak economy, Argentine provinces have been unable to implement credible medium-term financial planning. Moreover, amid the increasingly strained financial conditions, including very limited access to external funding, the administration decided to prioritize operating and capital spending over timely debt payment obligations.

Finally, we believe that, amid eroding macroeconomic conditions, the sovereign could delay fiscal support measures to subnational governments, especially given Argentina's history of major policy swings. We assess the institutional framework for Argentina's local and regional governments as very volatile and underfunded, reflecting our perception of the sovereign's very weak institutional predictability and volatile intergovernmental system that has been subject to various modifications to fiscal regulations, and lack of consistency over the years, which jeopardize the LRGs' financial planning, and consequently, their credit quality.

Key Statistics

Table 1

Selected Indicators

	2018	2019	2020	2021bc	2022bc	2023bc
(MIL. ARP)						
Operating revenues	91,149	130,833	163,446	238,479	342,913	477,450
Operating expenditures	82,881	129,857	158,614	224,988	326,580	454,394
Operating balance	8,268	976	4,832	13,492	16,333	23,056
Operating balance (% of operating revenues)	9.1	0.7	3.0	5.7	4.8	4.8
Capital revenues	1,291	1,558	1,175	3,000	4,200	5,880
Capital expenditures	10,065	13,845	12,594	15,000	27,000	29,700
Balance after capital accounts	(506)	(11,312)	(6,586)	1,492	(6,467)	(764)
Balance after capital accounts (% of total revenues)	(0.5)	(8.5)	(4.0)	0.6	(1.9)	(0.2)
Debt repaid	3,629	1,930	4,113	14,522	15,807	36,448
Gross borrowings	6,658	6,266	7,327	12,000	18,040	32,534
Balance after borrowings	2,522	(6,976)	(3,373)	(1,030)	(4,234)	(4,678)
Direct debt (outstanding at year-end)	48,062	73,073	98,087	126,002	158,243	172,385
Direct debt (% of operating revenues)	52.7	55.9	60.0	52.8	46.1	36.1
Tax-supported debt (outstanding at year-end)	48,062	73,073	98,087	126,002	158,243	172,385
Tax-supported debt (% of consolidated operating revenues)	52.7	55.9	60.0	52.8	46.1	36.1
Interest (% of operating revenues)	7.3	7.4	4.9	2.9	2.4	2.5
Local GDP per capita (single units)	203,278	304,760	376,601	581,040	830,306	1,131,713
National GDP per capita (single units)	328,868	482,914	597,192	922,938	1,331,969	1,832,155

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

Rating Score Snapshot

Key rating factors	Scores
Institutional framework	6
Economy	5
Financial management	5
Budgetary performance	5
Liquidity	5
Debt burden	3
Stand-alone credit profile	ccc+
Issuer credit rating	CCC+

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

Sovereign Risk Indicators, April 12, 2021. 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. 20, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Latin American Local Governments Face Financial Strains Despite Sovereign Aid, June 2, 2021
- Institutional Framework Assessments For International Local And Regional Governments, Feb. 2, 2021
- Province Of Mendoza 'SD' Credit And 'CC' Debt Ratings Affirmed, New International Bond Rated 'CCC+', Oct 29, 2020
- Argentina Tightens Foreign Exchange Controls Amid Heightened Pressure On The Peso And International Reserves, Sept. 16, 2020

- Argentina Upgraded To 'CCC+' From 'SD' On Settlement Of Restructuring Of Foreign And Local Law Debt; Outlook Stable, Sept. 7, 2020
- Province of Mendoza Downgraded To 'SD' From 'CC' On Missed Interest Payment On Its 2024 Bond, June 19, 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

Not Rated Action

	To	From
Mendoza (Province of)		
Analytical Factors		
Local Currency	ccc+	SD

Mendoza (Province of)

Senior Unsecured	NR	CC
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Ratings Affirmed

Mendoza (Province of)

Senior Unsecured	CCC+	
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Upgraded; CreditWatch/Outlook Action

	To	From
Mendoza (Province of)		
Issuer Credit Rating	CCC+/Stable/--	SD/--/--

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. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating

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