S&P Global Ratings

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Research Update:

Province of Mendoza's Stand-Alone Credit Profile Revised Up To 'b-' On Improved Liquidity, 'CCC+' Ratings Affirmed

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Overview

- The recently accumulated cash and continued commitment to fiscal containment measures should enable Mendoza to cover its debt service payments in 2022-2024.
- However, the province's ability to service its foreign currency debt continues to be constrained by Argentina's restrictions on accessing foreign exchange and our 'CCC+' transfer and convertibility (T&C) assessment of the sovereign.
- We affirmed our 'CCC+' long-term issuer credit ratings on the province of Mendoza.
- The stable outlook on the province mirrors the one on the sovereign. The outlook on the latter captures the challenges in strengthening fundamentals with the renegotiation of an IMF program and access to official financing.

Rating Action

On June 8, 2022, S&P Global Ratings affirmed its 'CCC+' global scale issuer credit and issue-level ratings on the province of Mendoza. The outlook remains stable.

Outlook

The outlook on our ratings on Mendoza mirrors that on the sovereign. Argentine athorities face challenges in strengthening weak fundamentals and imbalances in the economy given political disagreement on policy and limited room to maneuver ahead of the 2023 election. The stable outlook also reflects the renegotiation of an IMF program and access to official financing. We also expect the province of Mendoza to maintain balanced results after capital expenditures (capex) and its debt to continue declining in the next 12 months.

Downside scenario

We could downgrade the province of Mendoza in the next 12 months if we downwardly revise our T&C assessment of Argentina because of tighter foreign exchange restrictions amid scarce reserves that could dent the local and regional governments' (LRGs) ability to service debt. Finally, we could lower the long-term ratings on the province if a sharply weaker-than-expected fiscal performance or liquidity position increases the risk of default or the likelihood of a distressed debt exchange in the next 12 months.

Upside scenario

While the province's intrinsic creditworthiness is stronger than the current 'CCC+' ratings, we cap our ratings on the province to those on Argentina (CCC+/Stable/C) and the 'CCC+' T&C assessment. As a result, we could only upgrade Mendoza if we upgrade Argentina and upwardly revise the T&C assessment.

Rationale

We revised upward the province's stand-alone credit profile (SACP) to 'b-' from 'ccc+', reflecting our expectation that the recently accumulated cash and continued commitment to fiscal containment measures should enable Mendoza to cover its debt service payments in 2022-2024. Debt service in U.S. dollars will increase from $40 million in 2021-2022 to $125 million annually in 2023-2025, which our base-case scenario assumes to be manageable. However, risks will stem from uncertainty in the province's capacity to access sufficient foreign currency to bulk up needed sums to service debt in U.S. dollars, as well as potential macroeconomic instability that could strain its fiscal flows and cash position. This is reflected in our T&C assessment and sovereign rating cap on the ratings on Mendoza.

Better fiscal results should allow Mendoza to maintain recently accumulated cash levels

We expect Mendoza to post operating surpluses averaging 9.5% of operating revenue in 2022-2024 and balanced results after capex as the province's spending on infrastructure continues to recover from the pandemic-related cuts in 2020. The economic rebound last year and inflation boosted the province's revenue collection, while spending remained under control. Mendoza posted a surplus of 12.3% of operating revenue and after capex surplus of 5.4% of total revenue in 2021, which allowed for a recovery in cash levels after the liquidity crunch in 2020.

Our forecast assumes increases in Mendoza's own-source revenue and transfers from the national government (57% of total revenue) to be broadly in line with nominal GDP growth. We incorporate potential pressures on operating spending, particularly payroll (50% of the government's outlays) amid high inflation and given that public-sector salaries haven't recovered in real terms since the wage freeze in 2020. We believe that high inflation can lead to volatility in fiscal performance. We also believe that Mendoza's budgetary flexibility is limited due to a relatively rigid operating spending structure, while increases in taxes are unlikely.

The province has been receiving capital transfers from the national government since October 2019 for a large hydroelectric dam project, Portezuelo del Viento, which currently total about US$400 million (from a total US$1 billion). There's uncertainty on whether the project will move forward--in which case Mendoza would solicit using funds for other hydro or energy projects. Given that the project's construction is financed through an account 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 funding needs with pre-approved loans from multilateral lending agencies, as well as with the financing from the national government. The province currently doesn't have outstanding short-term notes, which could also be a funding source in the future (up to 2.5% of the budgeted revenues for the year of about ARP10 billion) and don't require legislative approval.

Given limited access to credit markets, building cash buffers and maintaining their value in real terms is a key challenge for Argentine provinces. Improved fiscal performance allowed the province to accumulate cash. Based on our estimates, Mendoza's free and available cash should cover 80% of debt repayment for the next 12 months. Nevertheless, the ratio could fluctuate, given that expected increases in infrastructure spending and because higher debt service could dent cash accumulated in 2021.

The province's debt stock dropped to 46% of the province's operating revenue in 2021 from 60% in 2020. About 63% 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 15% of Mendoza's debt is tied to inflation-linked instruments. We expect the debt burden to diminish in coming years and interest payments to below 5% of operating revenue, largely because financing conditions remain limited. The province's debt service profile will tick up in 2023 as payments for the 2029 international bond become heftier.

Argentina's sluggish economic growth and a weak institutional framework constrain the rating on the province

We forecast Mendoza's economy to remain feeble, in line with that for the sovereign. Following a 10% rebound in Argentina's economic growth, we expect it to slow to about 2% per year in 2022-2024. Pronounced macroeconomic imbalances, a moderate pace of planned fiscal consolidation, and volatile global economic conditions underscore challenges in securing new deficit financing and smooth rollovers in the small peso-debt market (see "Full Analysis: Argentina," published May 12, 2022). Mendoza's socio-economic indicators are in line with the national average, and according to our estimates, the province's GDP per capita was $6,500 in 2021, which was below the estimated national level of $10,700.

The provincial administration has a track record of pursuing fiscally prudent policies, while it has maintained commitment to lower tax pressure. At the same time, 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 of its international bond in 2020, which was restructured.

Finally, we assess the institutional framework for Argentina's LRGs 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. This jeopardizes the LRGs' financial planning and consequently their credit quality.

Key Statistics

Table 1

Selected Indicators

	2019	2020	2021	2022bc	2023bc	2024bc
(Mil. ARP)						
Operating revenues	130,833	163,446	255,466	400,859	607,082	848,253
Operating expenditures	129,857	158,614	224,035	358,278	551,861	772,172
Operating balance	976	4,832	31,431	42,580	55,221	76,081
Operating balance (% of operating revenues)	0.7	3.0	12.3	10.6	9.1	9.0
Capital revenues	1,114	827	1,487	2,370	3,129	3,755
Capital expenditures	13,845	6,238	19,012	39,012	65,012	77,012
Balance after capital accounts	(11,756)	(579)	13,906	5,939	(6,662)	2,824
Balance after capital accounts (% of total revenues)	(8.9)	(0.4)	5.4	1.5	(1.1)	0.3
Debt repaid	1,930	4,113	7,336	16,495	47,259	47,941
Gross borrowings	6,266	7,327	8,939	14,790	21,750	28,274
Balance after borrowings	(7,420)	2,635	15,509	4,233	(32,172)	(16,842)
Direct debt (outstanding at year-end)	73,073	98,087	118,375	175,173	205,705	232,364
Direct debt (% of operating revenues)	55.9	60.0	46.3	43.7	33.9	27.4
Tax-supported debt (outstanding at year-end)	73,073	98,087	118,375	175,173	205,705	232,364
Tax-supported debt (% of consolidated operating revenues)	55.9	60.0	46.3	43.7	33.9	27.4
Interest (% of operating revenues)	7.4	4.9	3.6	3.4	2.4	1.7
Local GDP per capita (USD)	6,016	5,287	6,566	7,274	N.A.	N.A.
National GDP per capita (USD)	10,138	8,610	10,708	11,919	12,186	12,501

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

Province of Mendoza

Key rating factors	Scores
Institutional framework	6

Table 2

Province of Mendoza (cont.)

Key rating factors	Scores
Economy	5
Financial management	5
Budgetary performance	3
Liquidity	5
Debt burden	3
Stand-alone credit profile	b-
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 11, 2022. An interactive version is available at http://www.spratings.com/sri
- Argentina, May 12, 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: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Argentine Provinces Will Have To Navigate Rough Waters To Remain Afloat , Nov 11, 2021
- Argentine Province Of Mendoza Ratings Raised To 'CCC+' From 'SD' On Lower Default Risk, Outlook Stable, Jun 11, 2021

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		
Mendoza (Province of)		
Issuer Credit Rating	CCC+/Stable/--	
Mendoza (Province of)		
Senior Unsecured	CCC+	
	To	**From**
Mendoza (Province of)		
Analytical Factors		
Stand-Alone Credit Profile	b-	ccc+

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 action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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