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CREDIT OPINION
4 April 2024

Update

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RATINGS

Basque Country (The)

Domicile	Spain
Long Term Rating	A3
Type	LT Issuer Rating - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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The Basque Country (Spain)

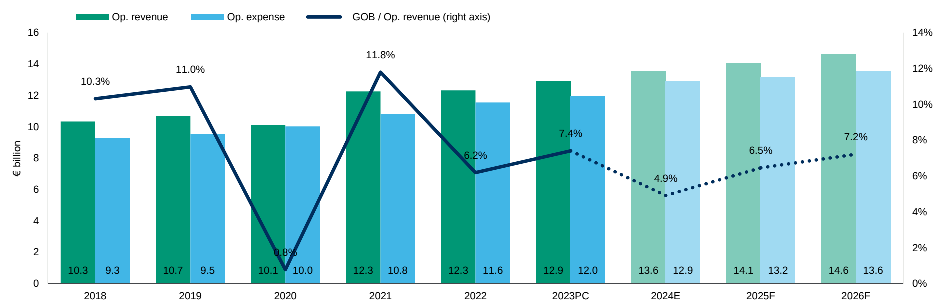
Update following outlook change to positive and rating affirmation

Summary

The credit profile of the Basque Country (A3 positive) exceeds the Government of Spain's Baa1 rating by one notch, reflecting the region's unique and constitutionally protected tax regime, which provides it with a higher degree of fiscal flexibility than other Spanish regions under the so-called "Common Regime". The region's credit profile also reflects moderate and declining debt levels and very good liquidity. The region's gross operating balance (GOB) and debt stock were equivalent to 7.4% and 84% of operating revenue in 2023, respectively. We expect the region to continue to deliver operating surpluses until 2026.

Exhibit 1

Basque Country's operating margin is likely to remain strong for the next two to three years



PC = Pre-Closing; E = Estimate; F = Forecast based on Moody's Ratings estimations.
Sources: Issuer and Moody's Ratings

Credit strengths

- » A high degree of fiscal flexibility derived from its unique legal status
- » Strong fiscal performance
- » A strong and diversified economic base

Credit challenges

- » Moderate debt burden that is expected to decline

Rating outlook

The rating outlook is positive, reflecting Spain's more balanced economic growth prospects. This could result in higher tax revenue than initially expected, enhancing the region's fiscal and debt metrics.

Factors that could lead to an upgrade

The strengthening of Spain's credit profile, as reflected by an upgrade of the sovereign rating, could have positive credit implications for the Spanish sub-sovereigns in general in the form of further reductions in systemic risk. Furthermore, an upgrade of the sovereign rating, would likely have the same effect on the Basque Country's rating.

Factors that could lead to a downgrade

Large financing deficits, covered by a rapid increase in debt, would exert downward pressure on the region's rating. Any downgrade of Spain's rating would likely have similar implications for the Basque Country's rating.

Key indicators

Exhibit 2
The Basque Country

	2018	2019	2020	2021	2022	2023PC	2024E	2025F	2026F
Gross Operating Balance as a % of Operating Revenue	10.3	11.0	0.8	11.8	6.2	7.4	4.9	6.5	7.2
Capital Expenses as a % of Total Expenses	9.6	9.6	9.8	9.4	11.5	12.8	15.9	_	_
Self Financing Ratio	1.2	1.2	0.2	1.7	0.9	0.8	0.9	_	_
Financing Surplus(Deficit) as % of Total Revenue	2.2	2.3	-8.4	5.9	-0.8	-2.6	-1.9	0.0	0.0
Interest Expenses as a % of Operating Revenue	1.7	1.7	1.4	1.2	1.2	1.5	1.5	1.7	1.8
Gross Borrowing Need as a % of Total Revenue	9.4	10.3	15.1	0.0	6.6	8.4	6.3	_	_
Net Direct and Indirect debt as a % of Operating Revenue	99.8	90.1	109.0	92.7	89.5	84.0	79.5	76.8	73.9

PC = Pre-Closing; E = Estimate; F = Forecast based on Moody's Ratings estimations.
Sources: Issuer and Moody's Ratings

Detailed credit considerations

The credit profile of the Basque Country, as expressed in the region's A3 positive rating, combines a Baseline Credit Assessment (BCA) of a3 and a high likelihood of receiving extraordinary support from the Government of Spain in the event that the entity faces acute liquidity stress.

On 21 March 2024, we changed the outlook on Basque Country's rating to positive from stable and affirmed the rating at A3. The revision of the outlook to positive followed the change of the outlook on the Government of Spain's rating to positive from stable and the affirmation of its rating at Baa1 on 15 March 2024. Should the country's medium-term economic growth prospects be higher and less volatile than what we currently assume — reflecting the upside risks underpinning the change in Spain's outlook to positive from stable — the increase in tax revenue could be more significant for the Basque Country.

Baseline Credit Assessment

A high degree of fiscal flexibility stems from its unique legal status

The region and its three constituent provinces (Guipuzcoa, Alava and Biscay) benefit from a unique tax regime outlined in the Spanish Constitution and the Basque Country's Statute of Autonomy. The three Basque provinces set and collect their own taxes, and redistribute the bulk of the proceeds to the Basque Country and its municipalities under pre-established agreements with the central government. Close relationships among the three Basque provinces and the Basque Country are formalised through the Basque Financial Council (Consejo Vasco de Finanzas Públicas).

The three Basque provinces make an annual payment, or “cupo”, to the central government in recognition of the services provided by the Spanish state. The “cupo” is set through negotiations between the central government and the region every five years, and is independent of the Basque Country's annual financial performance.

The share of tax revenue transferred to the region is usually negotiated for a five-year period. Generally, the region receives around 70% of the total tax revenue raised in the Basque provinces. The methodology for calculating this share has changed little since its inception in 1985, ensuring a relatively stable and predictable revenue stream. This arrangement is unlikely to change in the medium term.

Strong fiscal performance

The Basque Country has traditionally had operating surpluses. In 2023, the region posted a positive GOB of €956 million, or 7.4% of its operating revenue, which compares with a GOB of €762 million or 6.2% of operating revenue in 2022. The increase in the region's GOB was mainly because of a 4.9% year-over-year growth in operating revenue, which surpassed operating expenditure growth of 3.5%. Higher tax revenue collected by the three basque provinces was the main driver of operating revenue growth.

Including capital revenue and spending, the region reported a financing deficit of €351 million, equivalent to around 2.6% of its total revenue in 2023, from a deficit of €107 million or 0.8% of its total revenue in 2022. The increase in the region's deficit was mainly driven by a 29% decrease inn capital revenue while capital expenditure increased by around 17%. The majority of this capital expenditure increase was caused by transfers and investments which will be funded with Next Generation EU funds.

Under European System Accounts (ESA), the Basque Country closed 2023 with an estimated deficit-to-GDP of 0.08% (€73 million), compared with the 2022 deficit of 0.02% of its GDP (€19 million). In 2024, budgetary stability objectives will be resumed, having to comply with an equilibrium target, which we believe The Basque Country will meet.

We expect the Basque Country to continue to record positive GOBs of 5%-7% of operating revenue in the next two to three years and comply with the deficit limit targets established by the central government, mainly supported by Spain's positive economic prospects and the region's strong budget management, which is reflected in the Governance score (G-1) in its ESG Credit Impact Score.

In addition, the Basque Country will receive around €1.6 billion of NextGenerationEU funds until 2026, of which around €1.2 billion were assigned as of November 2023.

A strong and diversified economic base

Situated on the north coast of Spain, the Basque Country has 2.2 million inhabitants (4.6% of the country's population in 2023) and is the country's second-wealthiest region (after Comunidad Autonoma de Madrid), with a GDP per capita of €35,832 in 2022 (latest available data at the regional level), well above the Spanish average of €28,162.

The Basque Country's economy is diversified and has traditionally benefited from a strong export-oriented industrial base, led by the automotive sector, which is mainly exposed to the trading between France and Germany. Also, other relevant economic activities include energy, railway and shipbuilding industries. In 2022, the industrial sector accounted for 23% of the regional GDP, well above the national average of 15.9%. According to estimations from the Basque Country's statistical institute, the region's real GDP grew to around 1.6% by year-end 2023, consolidating its recovery to pre-pandemic levels, which was mainly supported by the industry sector. In addition, the region forecasts real GDP growth of 1.6% in 2024 and 2.1% in 2025.

As of year-end 2023, the Basque Country registered an unemployment rate of 6.3%, the lowest in last decade as well as among those of other Spanish regions we rate, and far below the national average of 11.8% in 2023.

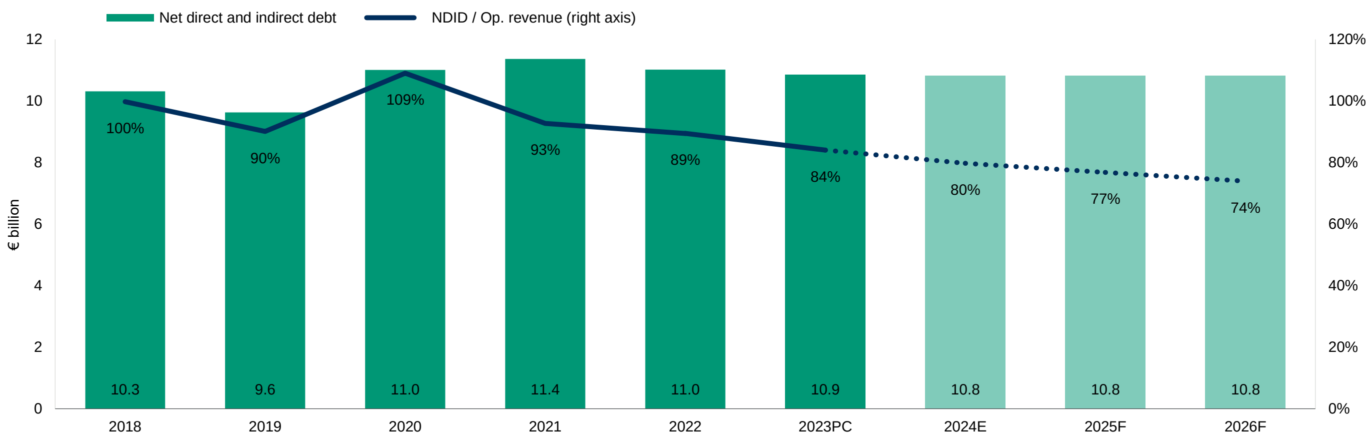
Moderate debt burden that is expected to decline

Although the region's direct debt stock has been historically low, it increased rapidly in the last decade, rising to a record-high of €10.6 billion in 2021 from €7 billion in 2013. However, for the second year in a row, the region's direct debt decreased by €78 million to around €10.3 billion in 2023.

The Basque Country's indirect debt in 2023 also decreased mainly because of lower indirect debt from its public sector of €291 million (€376 million in 2022) and decreasing guarantees of €285 million from €288 million in 2022. These guarantees were largely provided directly to the public administration or through mutual-guarantee companies (Sociedades de Garantía Recíproca), which pose very low risk to the region's finances.

As a result of the Basque Country's lower debt stock, its net direct and indirect debt-to-operating revenue ratio decreased to 84% in 2023 from 90% in 2022. We forecast the region's debt-to-operating revenue ratio to decrease to around 80% in 2024, on the back of likely lower debt levels and higher tax revenue collection in the year. We also believe the region's debt levels will stabilise from 2024 onward, with the debt burden declining to around 74% by 2026, as Spain's positive economic prospects boost operating revenue.

Exhibit 3
The Basque Country's debt burden will continue to decrease in the next three years



PC = Pre-Closing; E = Estimate; F = Forecast based on Moody's Ratings estimations.
Sources: Issuer and Moody's Ratings

In addition, the region's prudent debt management is reflected in its low average debt cost of 2.25% and an average debt life of 8.8 years as of year-end 2023. Also, all of its debt is euro denominated and most of its debt stock is contracted at fixed rates, with moderate exposure to variable-rate debt of just 17% as of year-end 2023.

Since 2018, the Basque Country has been a regular issuer of sustainable bonds in capital markets, which has fostered positive relationships with financial institutions. In 2023, the region covered part of its annual funding needs via bond issuances, including a sustainable bond of €700 million issued in February 2023. For 2024, the Basque Country covered a high portion of its annual funding needs with the issuance of a €600 million sustainable bond in February 2024. We do not expect the region to issue more debt in the financial markets during this year.

The Basque Country has a very strong cash position, with cash reserves of around €3.9 billion as of year-end 2023, equivalent to 30% of its operating revenue and 38% of the region's direct debt in 2023. The region also had an additional €800 million in available credit facilities, which were not drawn as of December 2023.

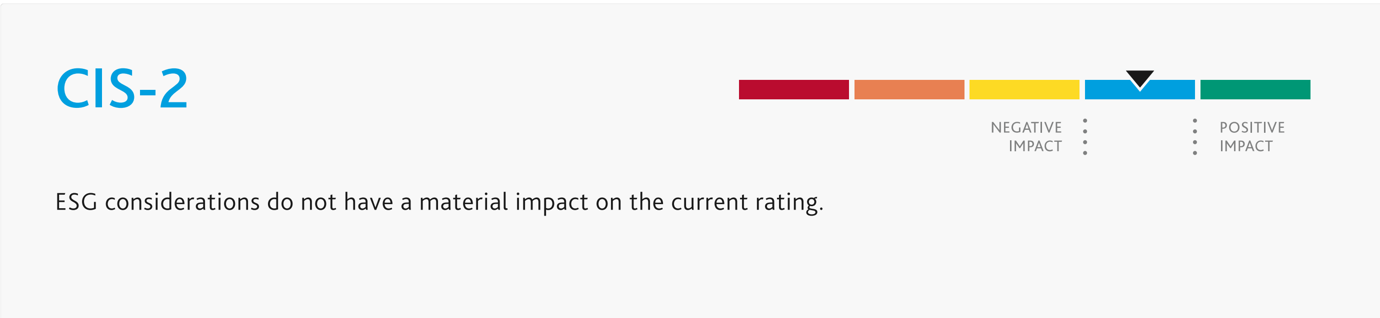
Extraordinary support considerations

We view the Basque Country as having a high likelihood of receiving extraordinary support from the Government of Spain in the event that it faces acute financial distress, reflecting our assessment of the risk to the government's reputation if the region were to default. The region's role in providing crucial services, such as healthcare and education, and its presence in the capital markets are further incentives for the central government to provide support, if necessary. This assessment is corroborated by the consistent track record of central government support for Spanish regions in recent years, as illustrated by the launch of the regional liquidity facilities, the Fondo de Liquidez Autonomico and the Fondo de Facilidad Financiera, as well as the extraordinary transfers from the central government to mitigate the effects of the coronavirus pandemic on the regions' finances in 2020 and 2021.

ESG considerations

Basque Country (The)'s ESG credit impact score is CIS-2

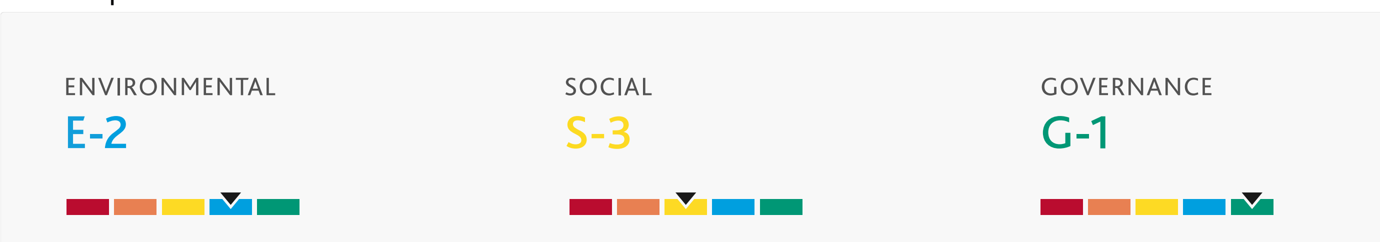
Exhibit 4
ESG credit impact score



Source: Moody's Ratings

The Basque Country's ESG considerations do not have a material impact on the current rating. Its ESG Credit Impact Score (**CIS-2**), reflects low exposure to environmental risks, moderate exposure to social risks and very strong governance and in general strong capacity to respond to shocks.

Exhibit 5
ESG issuer profile scores



Source: Moody's Ratings

Environmental

The Basque Country's exposure to environmental risks are not material in differentiating credit quality.

Social

The Basque Country has a moderate credit exposures to social risks. We have assigned an issuer profile score of (**S-3**), reflecting good housing availability, education, health & safety, and access to basic services. However, the region faces moderate credit exposure with regards to population ageing, which puts pressure on healthcare and social spending. Spanish regions are responsible for healthcare, which typically represents around 40% of their expenses.

Governance

The Basque Country's governance profile is captured by a positive G issuer profile score (**G-1**). This is underpinned by its strong budget management by implementing budgetary control plans. The region also provides transparent and timely financial reports. This contributes to its relatively strong resilience to S risks, along with very high wealth levels.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of a3 is in line with the scorecard-indicated BCA. The matrix-generated BCA of a3 reflects an Idiosyncratic Risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of A2. In the case of the Basque Country, the Systemic Risk of A2 exceeds the sovereign bond rating by two notches, which reflects the fiscal flexibility derived from its unique institutional framework.

For details about our rating approach, please refer to our Regional and Local Governments rating methodology, published on 16 January 2018.

Exhibit 6

Basque Country (The)

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**2.20**	**20%**	**0.44**
Economic Strength [1]	1	123.32%	70%			
Economic Volatility	5		30%			
Factor 2: Institutional Framework				**2**	**20%**	**0.40**
Legislative Background	1		50%			
Financial Flexibility	3		50%			
Factor 3: Financial Position				**2.50**	**30%**	**0.75**
Operating Margin [2]	3	7.68%	12.5%			
Interest Burden [3]	3	1.37%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	5	84.04%	25%			
Debt Structure [5]	1	7.58%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**1.89 (2)**
Systemic Risk Assessment						**A2**
Suggested BCA Score						**a3**
Assigned BCA						**a3**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Ratings; Fiscal 2023.

Ratings

Exhibit 7

Category	Moody's Rating
BASQUE COUNTRY (THE)	
Outlook	Positive
Baseline Credit Assessment	a3
Issuer Rating	A3
Senior Unsecured -Dom Curr	A3

Source: Moody's Ratings

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