State of Mato Grosso 'BBB-' Ratings Affirmed; Outlook Remains Stable

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Overview

- The 2012 fiscal performance of the Brazilian state of Mato Grosso benefited from a debt liability transaction with Bank of America, which dropped debt service by about R$900 million during 2012-2014.
- We are affirming our 'BBB-' global scale issuer credit ratings on the state.
- The state faces the challenge to accelerate the pace of its public works, especially in light of the need to improve the state's infrastructure to help diversify its economic base, while improving its competitiveness.

Rating Action

On June 3, 2013, Standard & Poor's Ratings Services affirmed its 'BBB-' global scale issuer credit ratings on the state of Mato Grosso. The outlook is stable.

Rationale

The state's creditworthiness reflects its moderate debt, which compares favorably with its national and international peers, and its sound budgetary performance with strong operating surplus. The rating also reflects the state economy's reliance on the agriculture sector and its relatively limited budgetary flexibility, which we expect to deteriorate amid rising infrastructure needs. However, during 2013 and 2014 this would be partly offset by lower debt service after the state concluded an agreement with the Bank of America which includes a grace period regarding its debt maturity with the bank until the end of 2014.

Mato Grosso generates about 70% of its total revenues—in line with most Brazilian states--though it's lower than that of the largest states, such as Sao Paulo and Rio de Janeiro. Its own source revenues increased by almost 18% in 2012 amid a booming local economy and due to some minor changes in the tax structure (related to the agriculture sector).

Mato Grosso generated an operating surplus of 12% of operating revenues in 2012 and a surplus after capital expenses of 5% of total revenues. We expect the operating balance to continue to be strong, thanks to a recent debt liability transaction with Bank of America, which has reduced debt service by about R$900 million for 2012-2014. We expect the operating balance in the next two years at above 5% of operating revenues.

Given the state's infrastructure needs in light of upcoming international sporting events, our base-case scenario for 2013 and 2014 estimates capital expenditures will increase to about 10% of total expenses from 8.2% in 2012. This could slightly pressure the state's budgetary performance in the next three years, as it still has to cover significant education and security expenses, which are essential for the state well-functioning. Still, we expect the state to post only small deficits (after capital expenditures) of below 5% of total revenues, given the ambitious infrastructure projects. The pace at which the state has carried out its public works has been moderate in the past two years despite its initial ambitious plans, mainly due to delays in the disbursements of credits and bureaucratic red tape. The state faces the challenge to accelerate the pace of its public works to improve the state's infrastructure to help diversify its economic base, while improving its competitiveness. Education also remains a key aspect for local competitiveness as it plans to invest in improving educational outcomes.

The state's debt levels are moderate. Debt reached R$4.5 billion as of Dec. 31, 2012, equivalent to 41.5% of total 2012 operating revenues. This debt level compares favorably with most Brazilian states, as opposed to the bigger states'--Sao Paulo and Rio de Janeiro--debt of 142% and 122%, respectively. Also, the state's debt compares positively with international peers. The state legislature authorized a debt increase of R$4 billion to develop state infrastructure over the next few years. In our base-case scenario, we included this authorized debt and that debt levels will continue to compare favorably with both national and international peers.

Mato Grosso closed a liability management transaction with Bank of America for R$1 billion, which the state used to restructure its debt with the federal government in September 2012. The transaction involved replacing debt with the central government with new a loan from Bank of America at better terms. Because the transaction implied a net value gain for the state and a prepayment of debt with the central government, it had both the approval from the central government and a federal guarantee on this new external debt.

Mato Grosso generates approximately 1.5% of Brazilian GDP and 5% of total exports. Since 2007, Mato Grosso's economy has been growing at a faster pace than that of Brazil due to high commodities prices and increasing agriculture production levels. This resulted in higher own source revenue collection levels, compared with fund transfers from the central government.

Liquidity

Mato Grosso has good liquidity levels, in our view, with regards to financial obligations. The state's liquidity is sufficient to cover its 2013 financial obligations, offset by its limited access to external funding sources. According to state data, net cash reached R$1.4 billion as of the end of 2012, allowing the state to cover 167% of its 2013 debt service.

Debt service accounted historically for a relatively high 10.5% of Mato Grosso's total revenues. However, after the transaction with Bank of America, we project debt service over total revenues to decline to 7% in 2013, down from 17.6% in 2012 (2012 numbers include debt restructure) and 10.5% in 2011.

The state's ability to set its liquidity policy is restricted to a large extent by the national fiscal responsibility law and the fact that most of its revenues are already earmarked for specific spending responsibilities. Plus, under the intra-governmental scheme in Brazil, states face significant restrictions to issue new debt. They can only do it with authorization of the national government under certain specific rules and compliance with fiscal targets, and cannot maintain contingent credit lines open with banks.

Outlook

The stable outlook reflects our expectation that Mato Grosso will maintain an adequate fiscal balance in 2013 and 2014, reflected in slight deficits after capital expenses. In our base case scenario, this deficit should be consistently below 5% of total revenues. Slippage on the implementation of the infrastructure spending plan or a fiscal deterioration above our expectations could put downward pressure on the rating. If the state maintains its strong fiscal performance, as well as an increase in economic diversification, together with an improvement in its infrastructure development plan, could lead us to take a positive rating action.

Related Criteria And Research

- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

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