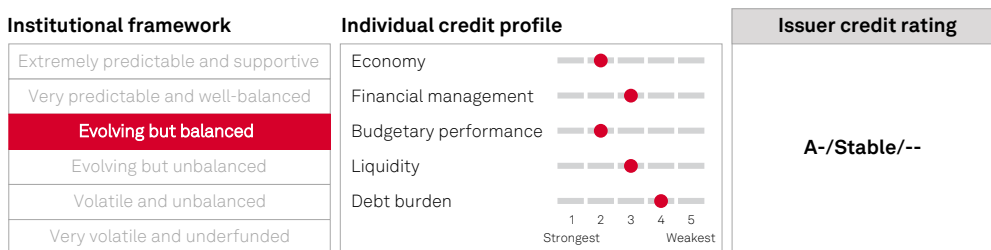


# Balearic Islands

November 11, 2024

This report does not constitute a rating action.

## Ratings Score Snapshot



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## Credit Highlights

### Overview

Credit context and assumptions	Base-case expectations
We expect regional governments to continue pursuing balanced budgets in national accounting terms, thereby limiting debt growth.	Operating performance will remain sound through 2026, even in the context of lower revenue growth stemming from the financing system.
We believe the Balearic Islands' economy will continue to perform strongly, possibly exceeding the national average.	We forecast some deficits in budgetary terms over 2024-2026, partly funded with available liquidity.
The Balearic Islands benefit from an overall supportive institutional framework.	Moreover, we forecast debt to decline to about 140% of operating revenue in 2026 from 160% in 2023.

**The economy of the Balearic Islands (Balears) could continue to outperform the national average mainly due to high tourism flows.** We expect Spain's economy to expand by 2.7% in 2024 and by about 2.0% in 2025 and 2026.

**S&P Global Ratings anticipates continuous sound operating performance for Balearic Islands, despite lower growth of the main revenue items.** We expect Balears to continue posting sound operating margins over our forecast horizon mainly on the back of stricter cost control in a context of lower growth of resources stemming from the financing system, which represents more than 75% of the region's operating revenue.

## Outlook

The stable outlook reflects our expectation that the Balearic Islands will continue to generate a sound operating performance by reining in costs, despite expected lower growth of the main revenue items stemming from the financing system. We also expect improved debt burden ratios through 2026. The economy of the Balearic Islands (Balears) could continue to outperform the national average mainly due to high tourism flows. We expect Spain's economy to expand by 2.7% in 2024 and by about 2.0% in 2025 and 2026.

### Downside scenario

We could downgrade the Balearic Islands if the region's management decided to manage its budgets in a way that interrupted its ongoing deleveraging process. This would likely occur if the region failed to adjust its expenditure in a less favorable revenue scenario, putting pressure on its liquidity.

### Upside scenario

We could upgrade the Balearic Islands if budgetary outcomes surpass our current expectations, with consistent surpluses after capital accounts. This, in turn, would likely enable the region to deleverage faster than we currently expect and give way to stronger liquidity metrics.

## Rationale

### Strong economic fundamentals and sound managerial practices underpin the rating in the context of a supportive institutional framework

Spain's economy will continue to outperform the European average. We project it to expand by 2.7% in real terms by the end of 2024 and by more than 2.0% in 2025 and 2026. In this context, Balears' tourism flows could continue to exceed the national average. This year, revenue per tourist has continued to increase, up 12% in the first eight months compared to the same period in 2023. In 2020, the Balearic Islands' real GDP contracted by about 20% due to the pandemic, which was a steeper drop than Spain's average. But the region recovered strongly once mobility restrictions were lifted, with growth surpassing 11% in 2021 and 14% in 2022, largely thanks to improving tourism inflows.

We view the region's management as prudent and experienced. We believe Balears' management will preserve the region's budgetary performance and continue deleveraging. Even though we expect revenue growth to slow down, we believe tax bases will remain strong in Balears. The main taxes that feed into the financing system--personal income tax (PIT), value added tax, and excises--will continue to increase, although not as strongly as in 2023 and 2024, reflecting the strength of the economy. We expect Balears to contain costs, given the deceleration revenue, to preserve performance.

We see the institutional framework in which Balears operates as generally supportive. The financing system guarantees stable resources that protect regions from adverse economic cycles. For example, despite the adverse impact of the pandemic on the Balearic Islands' economy, strong central government support helped contain the impact on the region's budgetary performance. The system, is however, quite complex and there are differences in resource allocation across regions.

## Balearic Islands

The region benefits from a special fiscal regime, agreed with the central government in 2022 for the 2023-2028 period. In this agreement, the Balearic Islands receive a direct transfer ("Factor de Insularidad") from the central government to compensate for the extra costs that insularity implies, helping to fund transport and infrastructure projects. The fiscal tax regime also includes benefits from the corporate tax for foreign direct investments and deductions to PIT for nonresidents. The region expects this special fiscal tax regime to attract foreign investments and therefore support economic activity.

### **Continuous strong margins and some deficits, only partly funded through debt, will support Balearic Islands' deleveraging process**

We expect Balearic Islands' operating margin to stay higher than 6% of operating revenue over 2024-2026, although we forecast revenue from the financing system to increase by only 0.2% in 2025 and follow nominal GDP growth of 4% in 2026. This represents a sharp slowdown after revenue grew by close to 20% annually in both 2023 and 2024.

The Balearic Islands' government has reduced PIT, real estate transaction taxes, and inheritance taxes. This leads to a decrease of these revenue items but this is not material enough to alter the revenue growth trajectory. The main reason for slower revenue growth in 2025 is the deceleration of revenue from the financing system.

In this context, we expect Balearic Islands' financial management to moderate discretionary spending growth to continue improving the structural balance between operating revenue and expenditure. The region cannot fully control personnel expenditure, since salary increases are determined by the central government. Personnel costs will also rise due to the need to renew professional contracts in the health care sector and to compensate public-sector workers for delayed payment increases due to the pandemic.

On the capital side, the Balearic Islands' accounts will be influenced by the timing of receipt and spending of funds from the EU's Recovery and Resilience Facility (RRF). Having received funds in advance in 2021 and 2022, the region will step up execution of investments mostly in 2024 and 2025. We assume this will cause an apparent deterioration of balances after capital accounts, but only in budgetary accounting terms. The official figures (national accounting terms) will adjust for those mismatches. In any case, and given that the revenue and expenditure associated with the RRF are matched over time, use of RRF funding will not generate any meaningful budgetary pressure on the region.

We expect the region's debt burden, although clearly declining, will remain high in an international context. Considering that investments are largely financed by already received EU funds, we do not believe the Balearic Islands will cover its gross financing needs in full. As such, we expect tax-supported debt to reach about 143% of consolidated operating revenue by 2026, down from 163% in 2023.

Given the sudden increase in interest rates between 2022 and 2023, the Balearic Islands suffered a moderate increase in interest expenditure from 2023, and this has risen to 2% of operating revenue in 2024 from 1% in 2021. However, we believe the region's interest burden has likely peaked, due to the European Central Bank's policy change. We note, however, that the region's debt portfolio is well protected against interest rate rises, since close to 95% of its debt is at fixed rates. The region is using the central government liquidity mechanisms in 2024 to finance its needs, and we expect it will continue to do so in the future.

We view the Balearic Islands' liquidity as adequate. The region's temporarily large cash reserves will continue to decrease in 2024 and 2025 as it steps up capital spending from the RRF funds.

## Balearic Islands

However, our view on the region's liquidity remains supported by Balearic Islands' access to central government funding and a total of €650 million in credit lines.

### Autonomous Community of the Balearic Islands Selected Indicators

Mil. EUR	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenue	5,705	4,622	5,267	5,737	5,784	5,994
Operating expenditure	4,908	4,431	4,827	5,236	5,412	5,574
Operating balance	797	192	440	500	372	420
Operating balance (% of operating revenue)	14.0	4.2	8.4	8.7	6.4	7.0
Capital revenue	264	701	434	367	298	284
Capital expenditure	602	621	831	909	942	762
Balance after capital accounts	459	271	44	(42)	(272)	(58)
Balance after capital accounts (% of total revenue)	7.7	5.1	0.8	(0.7)	(4.5)	(0.9)
Debt repaid	2,690	1,180	1,153	983	911	849
Gross borrowings	2,650	1,102	918	838	990	906
Balance after borrowings	418	193	(190)	(187)	(192)	(0)
Direct debt (outstanding at year-end)	8,752	8,656	8,405	8,260	8,339	8,396
Direct debt (% of operating revenue)	153.4	187.3	159.6	144.0	144.2	140.1
Tax-supported debt (outstanding at year-end)	9,235	9,075	8,757	8,554	8,627	8,675
Tax-supported debt (% of consolidated operating revenue)	159.9	193.1	163.3	146.8	146.9	142.6
Interest (% of operating revenue)	1.0	1.1	1.3	2.0	2.2	2.0
Local GDP per capita (\$)	30,064.2	31,172.0	--	--	--	--
National GDP per capita (\$)	30,498.8	29,889.3	32,873.6	34,810.1	37,605.8	39,453.6

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. EUR--euro. \$--U.S. dollar.

### Autonomous Community of the Balearic Islands-- Rating Component Scores

Key rating factors	Scores
Institutional framework	3
Economy	2
Financial management	3
Budgetary performance	2
Liquidity	3
Debt burden	4
Stand-alone credit profile	a-
Issuer credit rating	A-

## Autonomous Community of the Balearic Islands-- Rating Component Scores

Key rating factors	Scores
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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, Oct. 7, 2024. An interactive version is available at [www.spratings.com/sri](http://www.spratings.com/sri)

## 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Institutional Framework Assessment For Spanish Normal Status Regions: Strong Government Support, Weakening Predictability, Aug. 1, 2024
- Emerging Challenges Cloud Spanish Regions' Short-Term Stability, July 3, 2024
- Spanish Regions' Higher Expenditure May Limit Their Deleveraging, April 24, 2024
- Subnational Debt 2024: Spain: Lower Borrowings, But Bond Issuances Recover, Feb. 29, 2024

### Ratings Detail (as of November 11, 2024)\*

#### Balearic Islands (Autonomous Community of) (The)

Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-
<b>Issuer Credit Ratings History</b>	
10-Nov-2023	A-/Stable/--
12-May-2023	BBB+/Positive/--
13-May-2022	BBB+/Stable/--
13-Nov-2020	BBB+/Negative/--
15-Nov-2019	BBB+/Stable/--

## Balearic Islands

### Ratings Detail (as of November 11, 2024)\*

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\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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