S&P Global
Ratings

RatingsDirect®

Australia Sovereign Downgrade Would Only Affect 'AAA' Rated States And Territories

Primary Credit Analyst:
Anthony Walker, Melbourne (61) 3 9631 2019; anthony.walker@spglobal.com

Secondary Contact:
Craig R Michaels, Melbourne (613) 9631 2082; craig.michaels@spglobal.com

MELBOURNE (S&P Global Ratings) Feb. 7, 2017--A one-notch sovereign downgrade on Australia to 'AA+' would only affect the states and territories with 'AAA' long-term foreign currency ratings, according to a recently published article by S&P Global Ratings. The article, titled "The Link Between Australian Sovereign And State Ratings," addresses frequently asked questions we receive from market participants about how a potential sovereign rating downgrade would affect our ratings on Australia's states and territories.

S&P Global Ratings would not downgrade the states and territories with long-term foreign currency ratings of 'AA+' or lower in the event of a one-notch sovereign downgrade. The State of New South Wales, State of Victoria, and Government of Australian Capital Territory currently have 'AAA' ratings.

"If we were to lower our rating on the Australian sovereign by one notch, then it would not automatically affect the State of Queensland ('AA+'), State of Western Australia ('AA+'), State of South Australia ('AA'), or State of Tasmania ('AA+')," said S&P Global Ratings analyst Anthony Walker. "This is because their credit ratings are lower than the Australian sovereign and already incorporate our view that their credit quality is slightly lower than that of the sovereign."

S&P Global Ratings in July 2016 revised to negative from stable its outlooks on the 'AAA' rated State of New South Wales, State of Victoria, and Government of Australian Capital Territory after a similar action on the Commonwealth of Australia (see "Australia Outlook Revised To Negative On Growing Fiscal

Vulnerabilities; 'AAA/A-1+' Ratings Affirmed," published on July 6, 2016).

The negative outlooks reflect our view that no state or territory in Australia would likely withstand economic conditions that result in a sovereign default better than the Australian sovereign. This is because we think states and territories' economies and finances are likely to deteriorate in line with the Australian sovereign during conditions that result in a sovereign default. The states and territories' own source revenues would likely deteriorate during a challenging economic environment, and they are financially reliant on grants from the central government to fund core public services.

While we consider the likelihood of a sovereign default to be low, it would likely occur during weak economic conditions nationwide. Such an event would directly weaken individual states and territories' financial positions through lower conveyance duties, payroll taxes, and goods and services taxation (GST) receipts, for example.

The sovereign rating effectively provides a cap on how high we view a state or territory's creditworthiness. It gives us a top-down view of the credit risks facing states and territories, complementing the fundamental analysis that is reflected in each state and territory's stand-alone credit profile; a sovereign downgrade therefore does not mean that every state and territory's creditworthiness is lower than before. There could be a convergence between the currently 'AAA' rated New South Wales, Victoria, and Australian Capital Territory and the 'AA+' rated Queensland, Western Australia, and Tasmania, for example, with all being rated 'AA+' if the sovereign rating were lowered by one notch to 'AA+'.

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@spglobal.com. Ratings information can also be found on the S&P Global Ratings' public website by using the Ratings search box located in the left column at www.standardandpoors.com. Members of the media may request a copy of this report by contacting the media representative provided.