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Research Update:

Outlook On State of South Australia Revised To Positive On Stronger Liquidity Coverage; 'AA/A-1+' Ratings Affirmed

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Research Update:

Outlook On State of South Australia Revised To Positive On Stronger Liquidity Coverage; 'AA/A-1+' Ratings Affirmed

Overview

- South Australia has improved its liquidity coverage, which we consider the state may maintain over the next few years should it keep to its recently revised financial strategy.
- As a result, we are revising the outlook on the long-term rating to positive from stable.
- At the same time, we are affirming our 'AA' long- and 'A-1+' short-term ratings on the state.

Rating Action

On Sept. 22, 2016, S&P Global Ratings revised its outlook on the State of South Australia to positive from stable. At the same time, we affirmed the 'AA' long- and 'A-1+' short-term ratings on the state.

Rationale

The positive outlook reflects our view that South Australia may maintain the improvement in its liquidity coverage over the next two-to-three years should it keep to its recently revised financial strategy.

The ratings on South Australia reflect our view of the extremely predictable and supportive institutional framework benefiting state and territory governments in Australia, plus the state's strong financial management, very strong economy, exceptional liquidity, and low contingent liabilities. South Australia's average budgetary performance and budgetary flexibility, and moderate debt burden partially offset these strengths.

South Australia's improving budgetary performance underscores its strong financial management. This improvement comes after a number of years of weak budgetary outcomes, which previously led to a deterioration in its credit quality. In addition, the state is strengthening its liquidity policies, which would ensure a higher level of coverage compared with the past few years'. We forecast operating surpluses would average 4% between 2015 and 2019 as the state's share of goods and services tax (GST) grows and the government maintains tight control of its expenditure. In 2015, South Australia achieved its first operating surplus since 2010.

Furthermore, the state's after-capital account deficits would average about 0.4% of total revenues between 2015 and 2019, after falling sharply in 2015 from more than 10% of total revenues between 2010 and 2014. This improvement should stabilize the state's debt burden at between 75% and 80% of operating revenues and interest remaining well below 5% of operating revenues.

Lower capital expenditure and income from the sale of its compulsory third-party insurer--the Motor Accident Commission (MAC)--are supporting this turnaround. We consider the transfer of funds from MAC to be one-off, and therefore, treat it as capital revenue. Our after-capital account forecasts also incorporate a 14% underspend on the state's infrastructure spending forecasts, which is consistent with the state's level of capital expenditure since 2010.

Over the past two years, South Australia's budgetary performance reflected its slow economic growth and rising unemployment. Real growth averaged 1.2% per year from 2012-2015, and unemployment peaked at about 8% in 2015, before declining to 6.30% in June 2016. With a gross state product (GSP) of US$53,400 per capita over the past three years, the economy is wealthy in a global context.

However, the state's economy has struggled compared with domestic peers' due to the closure of several major manufacturing plants (GM Holden and Ford are closing between 2016 and 2017) and smaller mining companies hit by the high Australian dollar (about parity with the U.S. dollar from 2010-2014), and low commodity prices.

The state government's budget focuses on providing a business-friendly environment through tax incentives to encourage jobs and investment and support the economy, while maintaining a surplus. The 2016-2017 budget seeks to support jobs and develop future industries, and investment in health and education services and infrastructure. Previous budgets focused on infrastructure investment and tax reforms, such as abolishing nonresidential conveyance duties, increasing payroll tax rebates, and reducing compulsory third party premiums.

These tax reforms and policies focus on stimulating economic activity that could increase tax receipts, rather than substantially increasing tax rates that could further stifle growth. Like other Australian states, South Australia has average budgetary flexibility and limited ability to raise additional revenues, given that modifiable revenues would average 40% of operating revenues from 2015-2019.

We consider Australia's institutional framework that underpins the ratings on South Australia to be one of the strongest in the world. Policy settings are very predictable, and accountability and transparency standards are world class. The country's fiscal system aims to equalize the fiscal burden of the states and territories. The Commonwealth government distributes revenues from the goods and services tax (GST) to the states and territories, which introduces a degree of structural imbalance between revenue powers and expenditure responsibilities, and limits states' budgetary flexibility.

We expect South Australia's total tax-supported debt to reach about 82% of operating revenues in 2017 when the new A$2.8 billion Royal Adelaide Hospital private-public partnership (PPP) is completed and comes onto the state's balance sheet. A delay in completing the hospital would result in a re-profiling of South Australia's debt, but no change to its magnitude; and a change in some of its expenditures. We expect the state's contingent liabilities to remain low.

Furthermore, we consider the government's plan to extinguish its superannuation liability (currently 50% of operating revenues) by 2034 as credible and does not affect South Australia's moderate debt burden.

Liquidity

We consider South Australia's liquidity to be exceptional. Its debt-servicing ratio would be 120% over the next 12 months, comprising cash and liquid assets as a percentage of debt maturities and interest payments. In addition, the state has strong access to external liquidity and potential Commonwealth support.

South Australia has updated its liquidity policies, which should ensure the state maintains a higher level of coverage than in the past, where its debt-servicing ratio was between 40% and 60% since 2012. The updated liquidity policies should ensure the state can meet 100% of its upcoming commitments on a 12-month rolling basis.

We forecast that South Australia would hold on average about A$3.6 billion of liquid assets (after SP Global Ratings' haircuts) over the next 12 months to cover upcoming maturities of A$2.4 billion and interest payments of about A$620 million.

South Australia's access to external liquidity is strong, in our view. Similar to Germany and Canada, the Australian states utilize a well-developed capital market for their funding. The capital markets in Australia are deep and liquid, and we expect them to remain so. South Australia's individual characteristics support its access to external liquidity. South Australia has not experienced difficulty in accessing Australian and international markets, and our expectation is that this will continue. We also expect the Commonwealth to provide support if needed, such as the federal guarantee of Australian state government debt during the 2008 2009 financial crisis.

The state's financing authority, South Australian Government Financing Authority (SAFA), manages the state's borrowing by matching the debt profile with its clients' borrowing needs. Also, SAFA's select lines and floating rate notes are required to be of a certain size to be liquid. That said, we consider South Australia's liquid assets to be highly marketable, providing ample flexibility if required.

Outlook

The positive outlook reflects our view that the state would continue to achieve its financial strategy and may maintain the recent improvement in its liquidity coverage at more than 100% of the next 12 months' debt maturity and interest payments over a prolonged period.

We could revise the outlook to stable if we considered South Australia's improved liquidity coverage isn't sustainable, or if its budgetary performance weakens compared with our forecasts, resulting in higher borrowings.

Key Statistics

Table 1

State of South Australia's Key Statistics Table

	--Year end June 30--				
Nonfinancial public sector	**2015 A**	**2016 E**	**2017 BC**	**2018 BC**	**2019 BC**
Adjusted cash figures (mil. A$)					
Operating revenue					
Tax receipts	4,077	4,070	4,146	4,252	4,364
Sales of goods and services nonmodifiable	1,551	1,501	1,452	1,497	1,534
Sales of goods and services modifiable	2,383	2,387	2,465	2,566	2,622
Current grants	3,170	3,139	3,405	3,438	3,572
GST	5,027	5,573	6,101	6,424	6,479
Dividends	45	64	41	31	33
Interest income	33	28	25	25	27
Other revenue	364	538	545	516	530
~of which mining royalties	253	222	252	261	261
Total operating revenue	16,903	17,521	18,431	19,010	19,423
Operating expenditure					
Staff costs	8,799	9,278	9,493	9,624	9,725
Payments for goods and services	4,508	4,486	5,022	5,128	5,271
Interest costs	509	512	623	622	539
Grants	2,509	2,571	2,681	2,592	2,471
Other	166	97	109	141	100
Total operating expenditure	16,491	16,944	17,928	18,107	18,106
Cash operating balance	412	577	503	904	1,316
Purchases of nonfinancial assets	1,403	1,802	2,088	2,379	1,762
Capital grants	202	327	740	884	522
Sales of nonfinancial assets	735	658	670	508	153
Net cash from investing	(466)	(817)	(678)	(987)	(1,087)
After-capital account balance (cash surplus/deficit)	(54)	(240)	(175)	(84)	229
Balance sheet					

Table 1

State of South Australia's Key Statistics Table (cont.)					
	--Year end June 30--				
Nonfinancial public sector	**2015 A**	**2016 E**	**2017 BC**	**2018 BC**	**2019 BC**
Tax-supported debt	12,344	12,569	15,019	15,060	14,819
Unfunded superannuation liability	8,509	8,793	8,643	8,468	8,266
RATIOS					
Modifiable revenues/Adjusted operating revenues (%)	41.87	41.19	40.19	39.95	40.04
Capital expenditure/Total expenditure (%)	7.84	9.61	10.43	11.61	8.87
Operating balance/Adjusted operating revenues (%)	2.44	3.29	2.73	4.75	6.78
After-capital account balance/Total revenues (%)	(0.30)	(1.30)	(0.88)	(0.41)	1.14
Interest expense/Adjusted operating revenue (%)	3.01	2.92	3.38	3.27	2.78
Total tax-supported debt/Consolidated operating revenues (%)	73.03	71.74	81.49	79.22	76.30
Unfunded superannuation liability/Adjusted operating revenues (%)	50.34	50.18	46.89	44.54	42.56

A--Actual. BC--Base case. E--Estimate.

Table 2

South Australia's Key Economic Statistics			
	2013	**2014**	**2015**
Population (mil)	1.67	1.69	1.70
Population growth (%)	0.9	0.9	0.8
GSP per capita (local currency)	56,814	57,849	58,306
GSP growth (%)	1.7	0.8	1.6
Unemployment rate (%)	5.7	6.7	6.9

*Data source: Australian Bureau of Statistics. GSP--Gross state product.

Ratings Score Snapshot

Table 3

Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Average
Budgetary performance	Average
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Low

*S&P Global Ratings' issuer credit ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators, July 6, 2016. An interactive version is available at http://www.spratings.com/sri

Related Criteria And Research

Related Criteria

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009

Related Research

- Public Finance System Overview: Australia's Institutional Framework For States And Territories Is One Of The Strongest In The World, Feb. 12, 2015
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

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; CreditWatch/Outlook Action

	To	From
South Australia (State of)		
Issuer Credit Rating	AA/Positive/A-1+	AA/Stable/A-1+

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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.