Credit Outlook

3 February 2022

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The Crossover Zone refers to the ratings closest to the line between speculative grade and investment grade. Potential fallen angels in the Crossover Zone fell to 70 in Q4 from 94 in 3Q.

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FIRST READS

Mattarella's re-election as Italy's president supports reform in 2022 amid longer-term political challenges

Originally published on 31 January 2022

On 29 January, lawmakers in Italy (Baa3 stable) re-elected Sergio Mattarella as President of the Republic, avoiding any immediate return to political instability. The government led by Mario Draghi, who had been tipped as Mattarella's successor, will likely remain in power until the next general election, which must take place no later than spring 2023.

An additional year of political stability will allow the government to make progress on implementing the country's National Recovery and Resilience Plan (NRRP), a package of reforms and investments to support Italy's recovery from the economic and social impact of the coronavirus pandemic under the aegis of the Next Generation EU (NGEU) programme.

However, maintaining reform momentum and, more broadly, cohesion among the coalition parties will become increasingly difficult as the general election approaches. Reform progress will be central to the evolution of Italy's credit profile over the coming years given the historic opportunity presented by NGEU.

Political parties, none of which has a majority in the electoral assembly that comprises 1,009 deputies, senators and regional delegates, were unable to agree on a presidential candidate in the first seven rounds of voting. One reason for the impasse was a desire among lawmakers to avoid an early parliamentary election, which could have been called if Draghi had been elected president. His election would have required him to step down as prime minister, likely triggering a return to political instability. A constitutional reform approved by referendum in September 2020 will reduce the number of members of parliament to 600 from 945 after the next parliamentary election, greatly increasing their incentive to avoid an early election.

For this reason, we expect the Draghi government to remain in place until the next general election. The current political setting, with around 80% of parliamentarians supporting the government, provides a window of opportunity for progress on a number of structural reforms that we believe would be more difficult to legislate on in the run-up to or after a general election.

Under the current administration, Italy reported that it was able to meet all the milestones and targets in its NRRP planned for 2021 and submitted a request to the European Commission for a first instalment of €21 billion of NGEU funds on 30 December. However, its commitments in 2022 and 2023 are likely to be more difficult to achieve than those for last year.

Indeed, the presidential election exposed waning cohesion among political parties that could slow the implementation of some reforms that have been actively opposed by some parties or groups of parliamentarians for years. Areas of reform that could face major challenges over the next two years include government administration, the judiciary and the tax system. Overcoming these difficulties will be key to the success of the NRRP and Italy's long-term growth prospects.

Beyond the 2023 general election, the return of political instability poses a significant risk. Current polling suggests a majority government would be difficult to form and the return of a more eurosceptic government led by Lega Nord would risk slowing the implementation of the NGEU beyond 2023. That said, we expect the reduction in the number of members in the two chambers of parliament to lead to a swifter and more efficient legislative process.

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FIRST READS

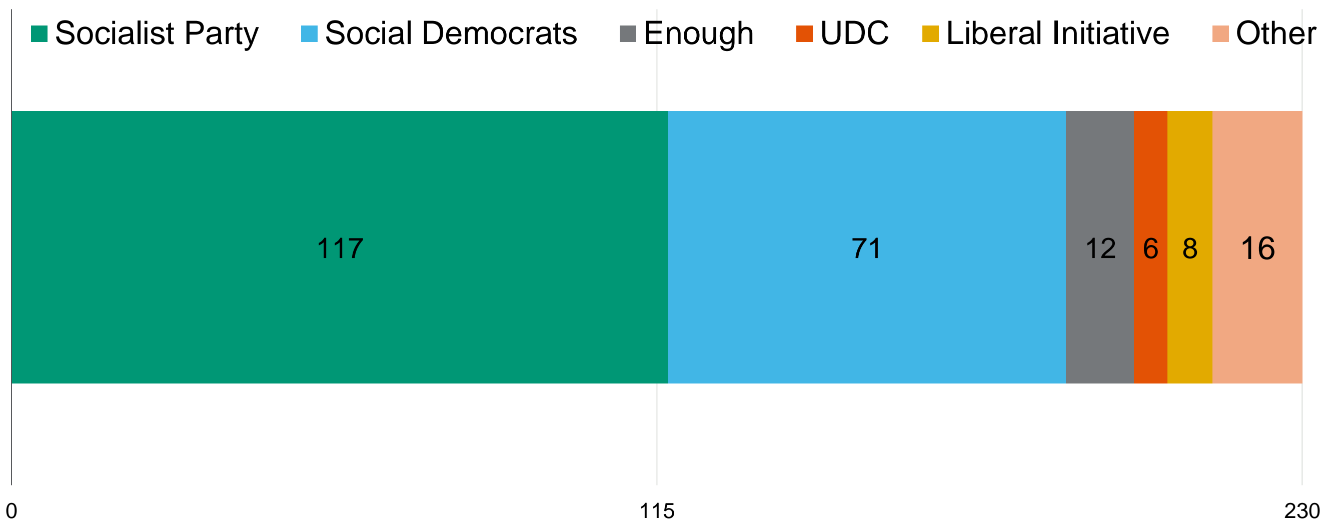
Portugal's general election outcome clears way for implementation of Next Generation EU programme

Originally published on 31 January 2022

On 30 January, Portugal (Baa2 stable) held a general election that resulted in Prime Minister António Costa's centre-left Socialist Party (SP) winning an absolute majority of seats in parliament. This election result is credit positive because it removes the political uncertainty that was associated with the previous *geringonça* arrangement, whereby the minority SP relied on other more left-leaning parties to pass key pieces of legislation.

Having a majority government (see exhibit) bodes well for the Portuguese government's ability to meet the National Recovery and Resilience Plan (NRRP) milestones and targets that have been agreed with the European Union (EU) as part of the Next Generation EU (NGEU) programme. NGEU projects and funding are crucial to Portugal's short-term growth outlook and longer-term improvements in the economy's growth potential.

The Socialist Party won a majority in Portugal's 230-seat parliament



Others: Left Bloc, Pending, Madeira, People-Animals-Nature, Açores, Livre
Sources: Poll of Polls and Moody's Investors Service

These positive political developments alleviate risks to NGEU implementation that emerged because of a political impasse last year that triggered these snap elections. Given this government's strengthened mandate, Portugal is now very likely to receive the €3 billion in EU funding this year, which will support economic growth.

However, the country's longer-term growth potential is contingent on the complete implementation of the NRRP that will take place over 2022-26. Despite significant reform progress since the global financial crisis, Portugal's potential growth remains constrained by structural rigidities in labour and product markets, while subdued investment, low skill levels and weak innovation have widened the productivity gap with peers. The NRRP addresses some of Portugal's investment gap in skills, infrastructure and innovation, which in itself will be growth-enhancing.

More robust economic prospects should accelerate positive debt dynamics; in 2021, we think that Portugal's debt burden already started to decline, and stronger growth potential should support this trend continuing in the coming years. By 2024 we expect that the pandemic-related debt increase will have been completely unwound.

Costa's previous governments have enacted prudent fiscal policies, and the country entered the pandemic with a balanced fiscal position. The prime minister has already announced that he will move forward with the 2022 budget plan, and we still project that the fiscal deficit will continue to narrow to 3.1% of GDP this year from an estimated 4.2% of GDP in 2021.

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Boyne's proposed debt add-on is credit negative

Originally published on 02 February 2022

On 2 February, Boyne USA, Inc. (B1 stable) announced a $100 million add-on to its existing $540 million senior unsecured notes due 2029. Proceeds from the add-on will be used to fund growth capex for planned capital upgrades at various resorts and facilities.

Although the increase in debt is credit negative, the proposed add-on has no impact on Boyne's B1 Corporate Family Rating (CFR), B1-PD Probability of Default Rating (PDR), the B1 rating for the senior unsecured notes, as well as its stable outlook. Pro forma for the $100 million add-on, Moody's adjusted debt-to-EBITDA will increase from the high 4x to high 5x for 2021. We expect debt-to-EBITDA leverage will decline to below 5x – within the leverage range we expect for the company at a B1 CFR – over the next 12 to 18 months with solid earnings growth.

Boyne's operating performance for 2021 was stronger than our expectation. Total revenue and earnings both surpassed 2019 (pre-COVID) as the result of a rebound in ski volume, strong yield management through dynamic pricing, cost discipline, continued investment in transformational upgrades as well as strong performance from non-ski related activities (20%-25% of total revenue, primarily golf and other summer activities). Looking into 2022, we expect continued good growth in both revenue and earnings given strong performance in the season to date, which will result in the company's ability to de-lever quickly after the proposed debt add-on.

We expect Boyne to maintain very good liquidity over the next year, reflecting its ample cash balance of about $187 million at the end of 2021 (pro forma for the proposed transaction) and access to an undrawn $90 million revolver facility due 2026 (unrated). For 2022, we anticipate free cash flow will be roughly break-even with the assumption of about $140 million in capex (the majority of which is growth capex to upgrade facilities and resorts). The unrated revolver has a financial maintenance covenant (secured leverage of less than 3x). We expect a significant cushion with regard to this covenant over the next year since the company has less than $30 million of secured debt.

Boyne USA, Inc, headquartered in Petoskey, Michigan, operates 10 mountain resorts (four with golf courses) and two non-ski properties consisting of one attraction (Gatlinburg Sky Lift) and one hotel/convention center with a 45 hole golf course (the Inn at Bay Harbor). The company is private and does not publicly disclose its financials. Boyne is also family owned by the Kircher family, direct descendants of the founder. The company generated revenue of approximately $487 million for 2021.

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Increase in Livret A interest rate is credit negative for French banks

On 1 February, the interest rate on France's Livret A, the main regulated savings product and a benchmark for rates on most regulated savings products, increased to 1% from 0.5%, as announced by the Banque de France on 14 January. The increase is credit negative because we estimate that the revised rate will increase systemwide funding costs by around €1.3 billion annually, or 4.3% of the combined 2020 pre-tax profit for France's six largest banks, BNP Paribas (Aa3/Aa3 stable, baa1[1]), Societe Generale (A1/A1 stable, baa2), Groupe Credit Agricole, Groupe BPCE, Credit Mutuel Alliance Federale and La Banque Postale.

Total regulated savings directly affected by the higher rate were €506 billion at year-end 2020 (most recent available data)[2]. Excluding the share of savings centralised at Caisse des Depots et Consignations (Aa2/Aa2 stable[3]) for financing social housing, the stock of regulated savings directly managed by the banks was €231 billion at year-end 2020, or 6.2% of their consolidated customer deposit base. La Banque Postale and, to a lesser degree, Groupe BPCE, are most affected by the rate increase because their share of regulated savings in their deposit base is larger than that of peers.

Livret A is a liquid product that depositors can use at any time without a penalty. It is tax-free and benefits from a government guarantee, as well as the protection of a domestic deposit insurance scheme. The interest rate is revised twice a year by the Banque de France and is calculated based on short-term interbank rates and average inflation over the preceding six months.

However, the government can deviate from the formula, as it is currently doing (setting the rate at 1% instead of 0.8%), and notes that a 1% formula-based rate is likely in the next six months. The highly sensitive move comes a few months ahead of presidential elections and at a time when inflation is becoming a cause for concern for French households. The government in recent years has repeatedly set the rate higher than the formula-based rate to preserve households' savings in a low interest-rate environment[4].

Endnotes

1 The ratings shown in this report are the banks' deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

2 Including Livret A, Livret Jeune, Livret de développement durable et solidaire (LDDS), Livret d'épargne populaire (LEP) and Compte épargne logement (CEL).

3 The ratings shown are CDC's deposit rating and senior unsecured debt rating.

4 The rate was frozen at 0.75% between November 2017 and February 2020 and has since been held at 0.5%.

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Declining loan interest rates challenge Bulgarian banks' profitability

Originally published on 02 February 2022

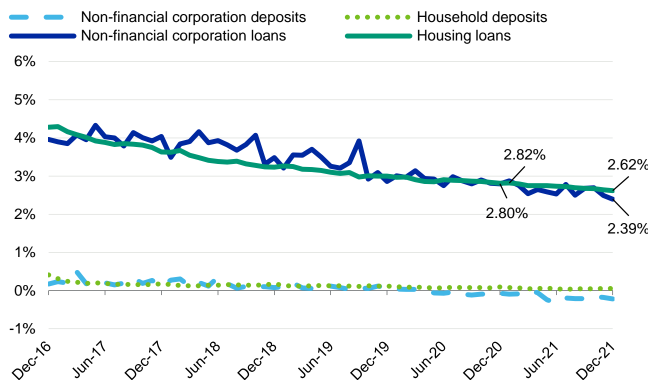
On 28 January, the Bulgarian National Bank (BNB) published interest rate statistics for December 2021 that showed loan rates continued to decline in most categories, while deposit rates remained slightly above or below zero. This ongoing margin compression is credit negative for banks' profitability because it constrains net interest income, their main source of revenue.

Reflecting low benchmark interest rates and intense competition between banks, interest rates on new loans to homebuyers and non-financial corporations fell to record lows in December. Compared with December 2020, the rate on lev-denominated mortgage loans declined 19 basis points to an average of 2.62% and euro-denominated mortgage rates declined 45 basis points to 2.91%; rates on new lev-denominated loans to nonfinancial corporations fell 40 basis points to 2.39% (see Exhibits 1 and 2).

Exhibit 1

Loan rates continue to decline ...

Interest rates on new business in Bulgarian lev

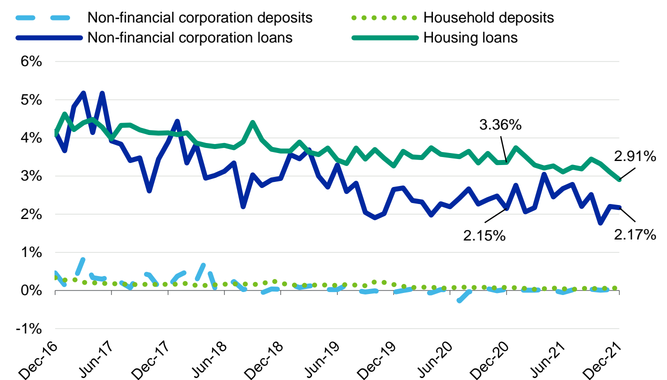


Source: Bulgarian National Bank

Exhibit 2

... while deposit rates remain close to zero

Interest rates on new business in euros



Source: Bulgarian National Bank

We expect this trend to continue even as monetary and financial conditions tighten in 2022 and 2023, driving a shift in the interest rate cycle in other European markets. Convergence with the euro area – the country targets euro adoption in 2024 – will likely continue to push Bulgaria's lending rates lower. We also expect the cost of funds to increase because large banks will need to issue loss-absorbing debt to meet regulatory requirements for bail-inable liabilities.

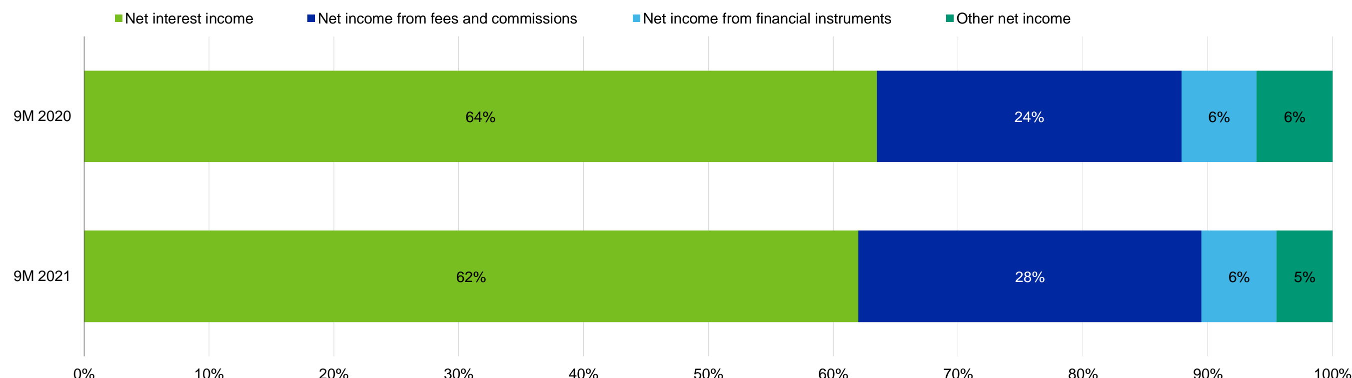
To mitigate these pressures, banks have expanded by 15 bp the negative deposit rate they charge business customers over the past year to an average of minus 0.22% as of December 2021. Banks have also gradually increased their fees and expanded their fee structure over the past year, especially for retail customers given that they cannot charge a negative interest rate on household deposits. We expect these moves to continue, allowing banks to leverage their liabilities more profitably.

Banks' net fee and commission income rose by 19% in the nine months to September 2021 compared with the year-earlier period, according to the BNB. Fees and commissions comprised 28% of banks' net operating income, up from 24% a year earlier (see Exhibit 3). Conversely, net interest income as a percentage of total operating income declined to 62% from 64% a year earlier, with net interest income growing just 3% despite strong lending growth, especially in residential mortgages. Loans to households for the nine-month period grew by an annualised 14%.

Exhibit 3

Fees and commissions make up a larger part of banks' income, as the share of net interest income declines

Breakdown of net operating income



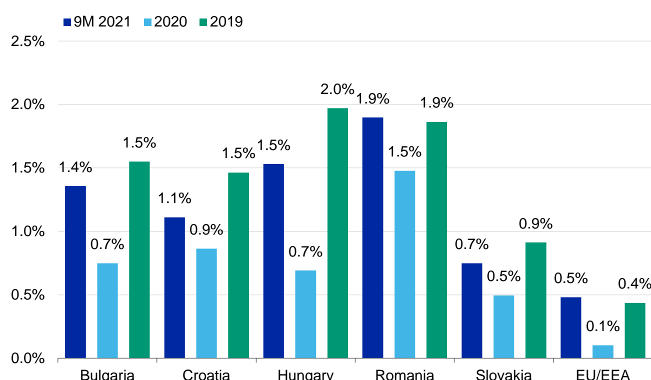
Source: Bulgarian National Bank

Higher fees and commissions and lower loan impairment charges (down 36% in the nine months to September) supported profitability in 2021. According to the European Banking Authority (EBA), Bulgarian banks' return on assets improved to 1.4% by September 2021 from 0.7% in 2020 and was significantly higher than the European average (see Exhibit 4). However, the banks' net interest margin declined to 2.3% by September 2021 from 2.6% in 2020 (see Exhibit 5), continuing a trend that began in 2015.

Exhibit 4

Bulgarian banks' profitability has recovered and remains above the European average

Return on assets



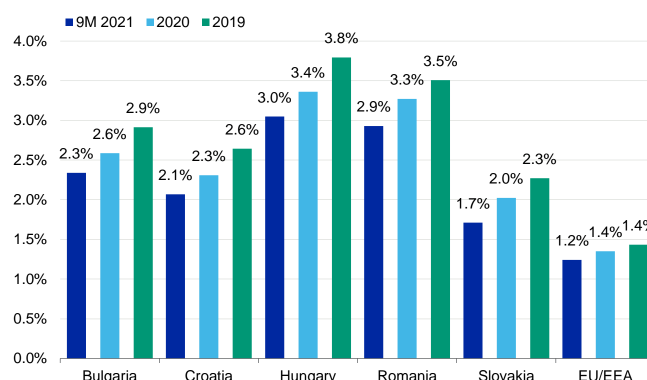
EBA data reflect a limited sample of the largest banks

Source: European Banking Authority

Exhibit 5

But banks' margins have continued to decline

Net interest margin



EBA data reflect a limited sample of the largest banks

Source: European Banking Authority

We also expect mergers and acquisitions to continue among banks in Bulgaria. Economies of scale support efficiency gains, further mitigating revenue headwinds and allowing increased IT investment and the ability to meet rising compliance costs. The five largest Bulgarian banks controlled 67% of banking system assets as of September 2021, up from 60% in September 2019 following the acquisition of smaller banks.

In November 2021, KBC Bank N.V. (KBC, A1 stable, baa1[1]) reached an agreement to acquire Raiffeisenbank (Bulgaria) EAD (RBB, Baa1 review for upgrade, ba1), the sixth-largest bank in Bulgaria by assets. Following closure of the deal, expected by mid-2022, KBC plans to merge RBB into its Bulgarian operations, United Bulgarian Bank AD, the third-largest bank in Bulgaria.

Endnotes

[1] The bank ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment.

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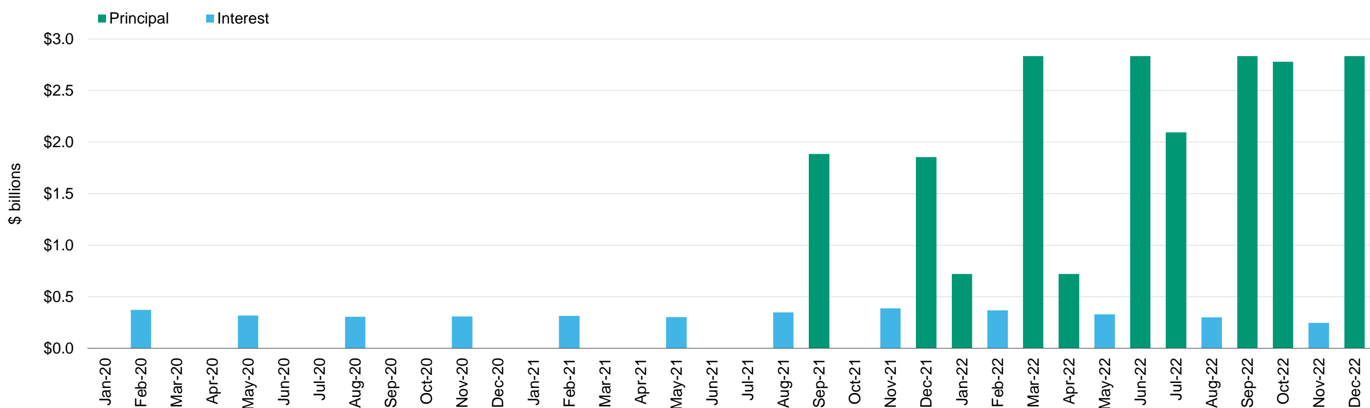
Even with a potential new IMF agreement, Argentina's private-sector debt will likely need restructuring

Originally published on 31 January 2022

On 28 January, the government of Argentina (Ca stable) announced that it had reached an understanding on key policies for a new agreement with the International Monetary Fund (IMF) that, once approved, would allow the government to restructure $45 billion in debt owed to the international financial institution (see exhibit). Any new agreement is likely to face implementation risks and may require further renegotiations of macroeconomic targets. We expect that the IMF agreement will be insufficient to restore international capital market access and that Argentina will still need to restructure debt payments due to private sector creditors that start rising in 2024.

Argentina's principal debt-service payments to the IMF set to rise



Payments pre-2022 are calculated at then-current special drawing rights (SDR) exchange rates. Payments post-2022 are calculated at the current SDR-US dollar exchange rate.
Sources: International Monetary Fund and Moody's Investors Service

Full details of the agreement have yet to be published and negotiations continue on important aspects of the new program. The government announced a gradual fiscal consolidation process with the primary deficit targeted to reach 0.9% of GDP in 2024 from a projected 2.5% of GDP in 2022. We forecast this year's primary deficit at more than 3% of GDP, indicating an even greater fiscal consolidation requirement. The government has also agreed that monetary assistance from the central bank, which reached 3.7% of GDP in 2021, will fall to zero by 2024.

The new program will require the government to commit to a medium-term macroeconomic program, something it had rejected until this past week. Press reports indicate that there remain large differences within the governing coalition on the IMF program, which could lead to limited support for full implementation. And Argentina has a long history of failed programs with the IMF, reflecting limited political will to carry them out to fruition. This cycle of program failures has been showcased by the failure of four of the last five IMF programs (1998, 2000, 2003 and 2018). The final program still requires approval from both the IMF board and the Argentine Congress.

Energy subsidies are among the possible sticking points in the new program. The IMF's chief economist has indicated that a key component of any new agreement will be a progressive reduction in energy subsidies, which represent around 2.5% of GDP in government spending. But the government has so far rejected reducing such subsidies in a significant way and current proposals to raise consumer energy prices are still below the inflation rate, and thus insufficient to reduce the required subsidies.

Our base scenario is that Argentina will sign an agreement and agree to multiyear macroeconomic targets meant to reduce macroeconomic imbalances, but that compliance with the agreement will be spotty at best and require further renegotiations. More

important, a lack of willingness to fully comply with the targets implies that access to the capital markets will not return in time to meet private sector foreign-currency debt payments that start rising in 2024. Therefore, even with an IMF program, the likelihood of a new debt restructuring remains very high.

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Bahamas' fiscal policy report bodes well for administration's commitment to fiscal consolidation

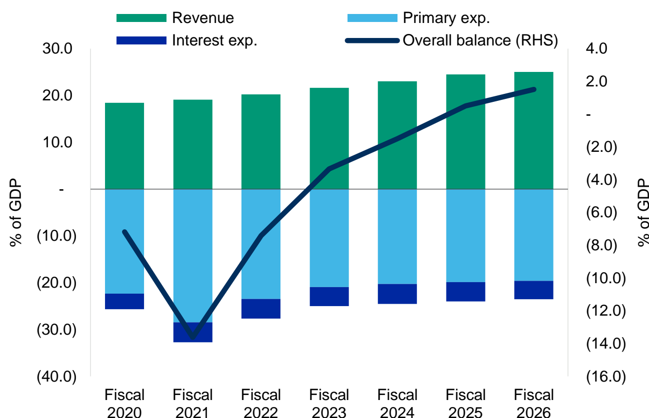
Originally published on 31 January 2022

On 28 January, The Bahamas (Ba3 negative) Ministry of Finance (MoF) released its 2021 fiscal strategy report and medium-term debt management strategy, which project a rapid improvement of the fiscal balance, turning to a 0.5% of GDP surplus by fiscal 2025 (ending 30 June 2025) from a deficit of 7.4% of GDP in fiscal 2022. The MoF expects reduced spending, accelerating economic recovery and recent institutional reforms to boost revenue collection and drive a reduction in the deficit, a credit positive.

The fiscal strategy report is the Progressive Liberal Party (PLP) administration's first such report and bodes well for its commitment to fiscal consolidation. However, there are downside risks to the government's assumptions about how quickly the government is able to narrow the fiscal deficit.

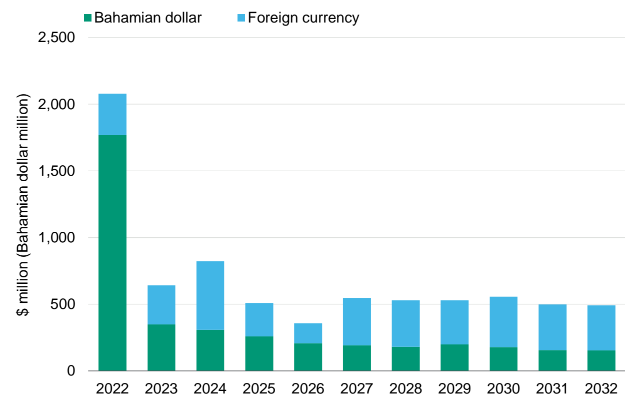
The Bahamas' debt burden likely peaked at 89.4% of GDP at the end of fiscal 2021, while the interest-to-revenue ratio will peak in fiscal 2022 at 24%. The ratios are among the highest for Ba-rated peers. The factors most likely to affect the Bahamas' credit quality are the pace of fiscal consolidation, how quickly the government returns to fiscal deficits consistent with reducing its debt (Exhibit 1), and how the government meets its relatively large financing needs over the next two years without putting downward pressure on debt affordability and increasing liquidity risk (Exhibit 2). Financing needs and liquidity risk will remain elevated over the next two years, with gross financing needs above 20% of GDP in fiscal 2022 and 2023.

Exhibit 1
The Bahamas' government anticipates a relatively rapid pace of fiscal consolidation



Sources: Ministry of Finance and Moody's Investors Service

Exhibit 2
The Bahamas has large external amortizations beginning in 2024 and through 2030
Government debt redemption



Sources: Ministry of Finance and Moody's Investors Service

The government revised up its revenue forecast for fiscal 2022, to 20.2% of GDP from 18.2% of GDP based on the original budget, reflecting a stronger-than-expected economic recovery. The authorities target a 4.8 percentage point of GDP increase in tax revenue between fiscal 2022 and fiscal 2026, bringing total revenue to 25.6% of GDP by fiscal 2026. To meet these targets, the government plans measures to expand the tax base by reducing leakages and strengthening revenue collection capabilities. To that end, the government re-established its Revenue Enhancement Unit and the Revenue Enhancement Policy Committee. The authorities expect the Revenue Enhancement Unit to increase collection by at least $200 million over the next two years; the Revenue Enhancement Policy Committee is tasked with identifying new revenue sources. The government expects efforts to improve collection of the Real Property Tax (RPT) by at least $100 million by fiscal 2024.

However, the government's assumptions about revenue growth may prove overly optimistic, risking a more gradual path to fiscal consolidation. Unexpected shocks along with implementation slippage are two key risks to the projections. Efforts to improve efficiency could fall short and force the government to pursue contentious tax-raising measures.

Similarly, support for state-owned enterprises and the removal of pandemic-related spending are key risks to expenditure assumptions. The authorities expect reduced pandemic-related spending to reduce expenditure as a percentage of GDP to 24% in fiscal 2025 from the fiscal 2021 peak of 32.5%. The authorities assume that Covid-19-related fiscal support measures will be rolled back completely by the end of fiscal 2022, reducing recurrent expenditure to 20% of GDP by fiscal 2026 from 24.9% in fiscal 2022.

Fiscal consolidation and returning the deficit to below 2% of GDP by fiscal 2024 rely on the government's commitment to meeting targets in its Fiscal Responsibility Act (FRA), which limits the deficit to 0.5% of GDP with the goal of reducing government debt to 50% of GDP by fiscal 2031. We assume a more gradual increase in revenue than the government's assumptions, but expect the government to make up for any shortfalls in revenue by reducing spending in order to comply with fiscal targets.

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United Arab Emirates' new corporate income tax is credit positive

On 31 January, the United Arab Emirates (Aa2 stable) Ministry of Finance announced a new federal corporate income tax (CIT) effective 1 June 2023. The new tax will broaden the central government's revenue base, increasing its scope for spending and enhancing its already-strong fiscal metrics and debt-issuing capacity, which is currently capped at around 250% of own stable revenue. And, depending on the extent of revenue sharing with individual emirates, it will be credit positive for them too.

For Abu Dhabi (Aa2 stable) the new tax will diversify government revenue away from hydrocarbons, although modestly. For the other emirates including Sharjah (Baa3 negative) and Dubai, the tax's revenue stream will augment license fees, service fees and volatile land sales. However, free zones in the UAE's non-oil economy will be exempt from the tax, which will limit the fiscal benefits.

The introduction of the corporate income tax is the UAE's most significant fiscal reform since 2018, when it introduced a value added tax (VAT). Oman is the only other GCC country that has a corporate profit tax for foreign- and domestic-owned businesses. Aside from Bahrain, which has no corporate income tax at all, other GCC countries only impose corporate taxes on foreign companies.

We do not expect the UAE's corporate income tax to affect its regional competitiveness or business environment. The UAE's 9% tax is lower than the tax rate in other GCC countries. Oman's corporate income tax is 15% and applies to both domestic and foreign owned companies. Saudi Arabia taxes foreign-owned companies at 20%, in proportion to their foreign ownership; Kuwait's tax is 15% and Qatar's is 10%. All these taxes apply to businesses outside of the oil and gas sector, which is taxed separately.

The UAE currently applies only a 20% tax for foreign-owned banks' UAE sources of income, but no other direct income taxes. Free zone-based companies will be taxed on income generated in the UAE, but not on income from exports. Because most free zone companies are export/re-export oriented and do not conduct commercial activities in the UAE mainland, the competitive attractiveness of UAE's free zones is likely to be unchanged. Furthermore, the new tax could eventually reduce or completely substitute the fees that Dubai imposes on its commercial activities, as indicated by the Director General of Dubai's Department of Finance.

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Final investment decision marks a step toward Uganda's oil production

Originally published on 02 February 2022

On 1 February, Uganda's (B2 stable) state-owned oil company and its partners reached a final investment decision (FID) on the Lake Albert oil development project, marking a step closer to the exploitation and commercialisation of the country's estimated 1.4 billion barrels of recoverable oil reserves.[1] The project's partners aim to start oil production in 2025 and reach output of 230,000 barrels per day (bpd), which would make Uganda the seventh-largest oil producer in Africa. Over the longer term, the ramp-up of oil production would support Uganda's creditworthiness by promoting growth and fiscal revenue, provided the oil wealth is managed prudently.

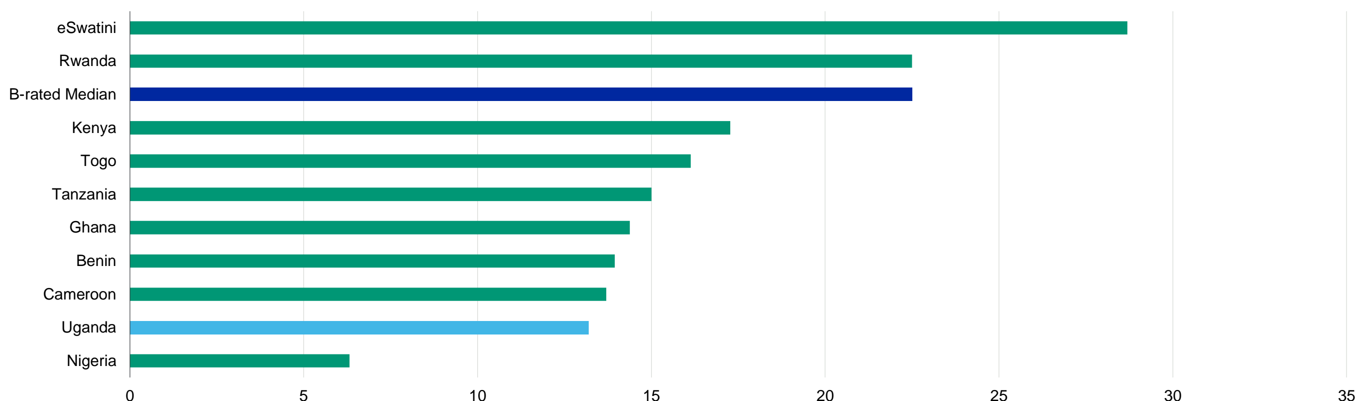
The FID, concluded between TotalEnergies SE (A1 stable), the China National Offshore Oil Corporation (A1 stable), the Uganda National Oil Company, and Tanzania's (B2 stable) state oil company, commits the companies to invest around $10 billion in total (equivalent to nearly 25% of Uganda's GDP) in the project. The agreement encompasses the Tilenga and Kingfisher upstream oil projects as well as an export pipeline through Tanzania (the planned East Africa Crude Petroleum Pipeline, or EACPP) to connect the oil fields in landlocked Uganda with the Tanzanian Indian Ocean seaport of Tanga.

Although commercially viable oil reserves were first discovered in Uganda in 2006, progress on the project and the development of oil infrastructure have been beset by delays, reflecting protracted negotiations with international oil companies, initial disagreements over the export pipeline route and the slow process of land acquisition. However, an agreement between the government and oil companies on a fiscal regime and an intergovernmental agreement reached in 2020 between Uganda and Tanzania on the EACPP project helped to pave the way for the FID.

Oil sector developments will support the medium-term growth outlook. Other large investments include the construction of oil roads, a planned 60,000 bpd oil refinery in the Hoima District in the west of the country and a pipeline connecting the refinery to the capital Kampala, which will increase both foreign direct investment and imports. The onset of oil exports would help to narrow Uganda's large structural current account deficit, which averaged around 6% of GDP between 2016 and 2020.

Oil proceeds could eventually strengthen the government's relatively low revenue. According to IMF projections that assume oil production will start generating revenue in fiscal 2025 (which ends 30 June 2025), oil budget revenue (net of oil-related expenditure) will peak at around 2% of GDP in fiscal 2028 before gradually declining.[2] At present, overall government revenue as a percentage of GDP is among the lowest in Uganda's B-rated peer group, at 13.2% of GDP in 2020 compared with the group median of 22.5% of GDP (see exhibit).

Uganda's revenue base is narrow compared with B-rated peers or other SSA sovereigns
General government revenue, % of GDP (2020)



SSA: Sub-Saharan Africa
Source: Moody's Investors Service

The discovery of hydrocarbon deposits has sparked debate within Uganda over the redistribution of oil wealth, and the government has created an oil fund to direct the proceeds to infrastructure projects. The authorities intend to design, with the support of the IMF, a fiscal rule to manage future oil revenue. Uganda's decision to formally join the Extractive Industries Transparency Initiative in August 2020 is an important step toward promoting transparency in the mining sector and the accountable management of petroleum resources.

Despite progress, the completion of oil infrastructure projects remains liable to implementation risks, as past delays indicate. Further delays in the start of oil production would maintain wider external deficits over the longer term if debt – contracted mainly to finance oil-related projects – were not met by higher foreign exchange receipts and revenue generation capacity. Moreover, Uganda's oil resources are finite: at current levels, recoverable oil reserves would only support production for around 15 years according to World Bank estimates, a lower duration than those of major African producers.[3] Accelerating momentum behind the global transition to a lower-carbon economy also poses a long-term risk for oil and gas-reliant sovereigns, proportional to their economic, fiscal and external sector reliance on hydrocarbons.

Endnotes

1 See Petroleum Authority of Uganda, **Uganda's Petroleum Resources**.

2 See IMF, "**Request for a Three-Year Arrangement Under the Extended Credit Facility-Press Release; Staff Report**".

3 See World Bank, "**Uganda Oil Revenue Management – Closing Gaps in the Fiscal and Savings Frameworks to Maximize Benefits**", March 2020.

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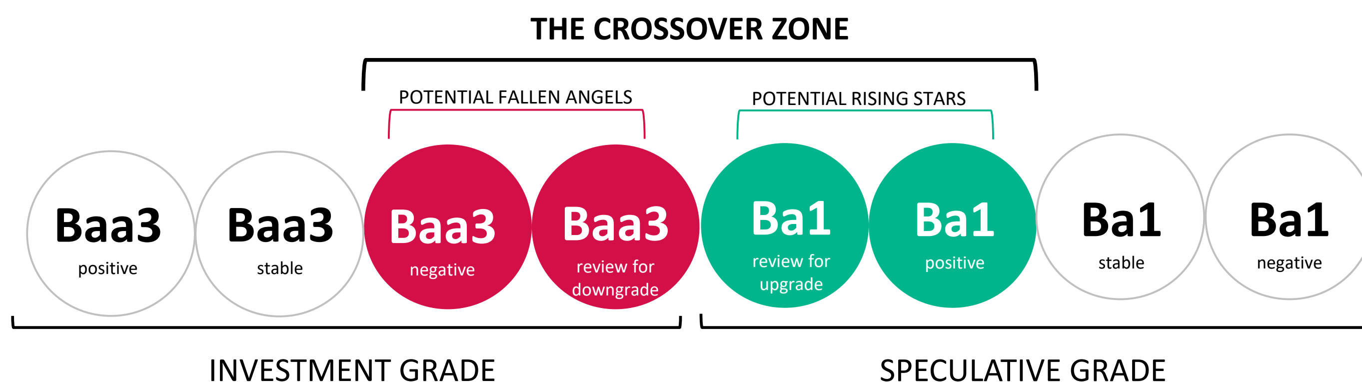
Number of companies in Crossover Zone declines materially on improved fundamentals

Originally published on 27 January 2022

Getting in the zone

The Crossover Zone refers to the ratings closest to the line between speculative grade and investment grade. Companies in the zone are rated Baa3 or Ba1. To be considered in the zone, companies rated Baa3 must be on review for downgrade or have a negative outlook, while companies rated Ba1 must be on review for upgrade or have a positive outlook. (See exhibit.) In this report, nonfinancial companies include utilities, REITs and infrastructure issuers, and all debt totals include Moody's standard adjustments.



- **The number of nonfinancial companies (including utilities) in the Crossover Zone declined to 70 at year-end 2021, from 94 in the third quarter.** The rebound in global growth persists, fueled by vaccination efforts, fewer mobility restrictions and government support in spite of threats from the omicron variant, high inflation and rising interest rates. This momentum reduced the number of potential fallen angels to 50 through December, from 72 the prior quarter. It also supported potential rising stars, although they fell modestly to 20 at year-end from 22 in Q3 after several companies crossed over to investment grade.

- **Six companies crossed over to speculative grade during Q4, up from three in Q3.** Those figures remain subdued versus 2020, when 22 companies crossed over in both the Q1 and Q2.Only two new potential fallen angels entered the zone in Q4, compared with six in Q3, and both were the result of deteriorating credit fundamentals. That number is a stark contrast to the 52 new potential fallen angels that entered the zone in 1Q 2020, and the total number of potential fallen angels declined for the fifth straight quarter with 24 companies leaving the zone in Q4. Four crossed over to speculative grade, while 19 left the zone when their outlooks were changed to stable, and one was put on review for upgrade.

- **Potential fallen angels held $200 billion in debt at end of Q4, significantly less than $352 billion the prior quarter and well below the March 2020 record of $593 billion.** The current debt pile is well below the average of about $335 billion for 2017-20, and continues to decline with positive outlook changes pushing companies out of the zone. Most of the change is attributable to companies with $164 billion of debt leaving the zone, led by Delta Air Lines Inc. (Baa3 stable, $40 billion), NTPC Limited (Baa3 stable, $27 billion) and Power Grid Corporation of India Limited (Baa3 stable, $20 billion). This was vastly more than new potential fallen angels with total debt of $3 billion entering the zone and existing potential fallen angels raising about $9 billion in new debt. Debt of US potential fallen angels fell to $75 billion, from $132 billion, and debt among non-US companies in the category was down $95 billion, to $125 billion.

» **Potential rising stars fell to 20 in Q4, as seven companies entered the zone, while nine exited.** This number is above the quarterly average of 16 in 2020 and is likely to be supported by the ongoing economic recovery. All seven new entrants had improved credit fundamentals. Nine potential rising stars crossed over to investment grade, while just one was downgraded. Potential rising stars held $206 billion in debt at the end of Q4, modestly more than $191 billion in the prior quarter. FirstEnergy Corp. (Ba1 positive), with its $27 billion in borrowings, accounted for the most debt entering the zone. Shimao Group Holdings Limited (B2 review for downgrade), with its $25 billion in debt, was the most indebted to exit.

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REPORT NUMBER 1318036