CreditOutlook

Credit Implications of Current Events

9 APRIL 2018

NEWS & ANALYSIS

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Corporates

Stephen Sohn
Senior Vice President
+1.212.553.2965
stephen.sohn@moodys.com

Walmart's new global money transfer service is credit negative for Western Union and MoneyGram

Last Tuesday, Walmart Inc. (Aa2 stable) and MoneyGram International, Inc. (B1 stable) announced the launch of Walmart2World, a new money transfer service. MoneyGram will operate the service, which will allow customers to send money from any of Walmart's 4,700 US stores to any MoneyGram location in 200 countries. The companies also renewed for two more years their long-term contract to offer all MoneyGram products and services at Walmart. The new Walmart2World partnership, which will charge significantly lower fees than competing services, is credit negative for The Western Union Company (Baa2 stable), the industry leader, and MoneyGram, the No. 2 player. The partnership has the potential to capture transaction volume from Western Union for US outbound transfers, cannibalize MoneyGram's own higher-margin money transfer service and trigger a pricing battle that could weaken revenue and profit at both companies.

Walmart2World will charge $4 to send up to $50, $8 to send $51-$1,000 and $16 to send $1,001-$2,500. These fees are lower than what MoneyGram and Western Union typically charge for similar amounts, depending on the origin and destination of the money transfer. Walmart's entry into the global money transfer market will exacerbate pricing pressures in the industry in much the same way that its Walmart2Walmart white-label domestic money transfer service triggered price cuts among its rivals following its launch in 2014.

Walmart2Walmart hurt MoneyGram far more than Western Union because of the latter's lack of a contractual relationship with the retail giant and the fact that domestic money transfers contribute less than 10% of Western Union's total revenue. But Walmart2World is likely to have a greater effect on Western Union than Walmart2Walmart did because US outbound activity is a sizable portion of its total revenue. In 2017, Western Union's revenue from money transfers originating in the US and Canada (including domestic transactions) accounted for 37% of revenue in its consumer-to-consumer segment (which contributed 79% of total company revenue) and about 90% of the segment's operating profit.

During the same period, MoneyGram's US outbound transactions constituted 44% of total money transfer transactions, with global-money-transfer revenue comprising 89% of total revenue. Walmart is MoneyGram's largest agent, accounting for 17% of its total revenue in 2017, down from 27% in 2013 owing to the sizable revenue loss following the launch of Walmart's domestic offering.

Walmart's entry into the global money transfer market will challenge MoneyGram and Western Union's fees for the US outbound corridors. The potential effect on MoneyGram is less certain because the company has the potential to realize an increase in transaction volume and profit from the Walmart partnership. But these gains could be more than offset by a shift away from higher-margin MoneyGram money transfers to the less profitable Walmart transactions.

To fend off competition from Walmart2World and to protect its leading global market position, Western Union may cut prices, pay higher agent commissions and increase customer acquisition costs. A pricing war on US outbound activity risks jeopardizing Western Union's recent stable operating performance, which included a return to revenue and profit growth during a period of relatively stable pricing.

With the entrance of a new competitor, we expect flat to low single-digit revenue and profit growth for Western Union in 2018. The company's core business will still be supported by international money transfers, which account for most of its revenue, and global remittances to developing countries that we expect will grow by low- to mid-single-digit percentage rates on a constant currency basis over the next two years.

Vincent Gusdorf, CFA
Vice President - Senior Analyst
+33.1.5330.1056
vincent.gusdorf@moodys.com

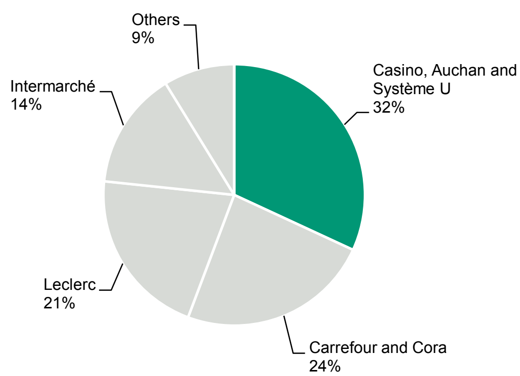
Casino's partnership with Auchan will reduce purchasing costs, a credit positive

Last Tuesday, French food retailer Casino Guichard-Perrachon SA (Ba1 stable) said that it had entered exclusive talks with competitor Auchan Holding to create a purchasing partnership. The proposed alliance is credit positive for both Casino and Auchan because it will give them more clout with suppliers and will result in procurement synergies. Although the groups have not publicly quantified any savings yet, we expect that small positive effects on profitability will materialize after the next round of negotiations with suppliers, scheduled for the beginning of 2019 in France.

A partnership will also have positive knock-on effects on the credit quality of Casino and Auchan's current partners overseas, Spain's Distribuidora Internacional de Alimentacion (DIA, Baa3 stable) and Germany's Metro AG (Ba1 stable). However, the magnitude will not result in a substantial decrease in DIA's and Metro's Moody's-adjusted debt/EBITDA, which for DIA was 3.7x in December 2017 and for Metro was 4.7x in September 2017.

Casino will combine its purchases of consumer goods with those of Auchan and its existing partner, Système U, a French retail co-operative, to create the largest procurement alliance by market share in French food retail, as Exhibit 1 shows. Casino's former partner Intermarché will not be part of the partnership.

EXHIBIT 1
Casino's alliance with Auchan and Système U will be the largest in the French grocery market
French food retailers' 2017 market shares



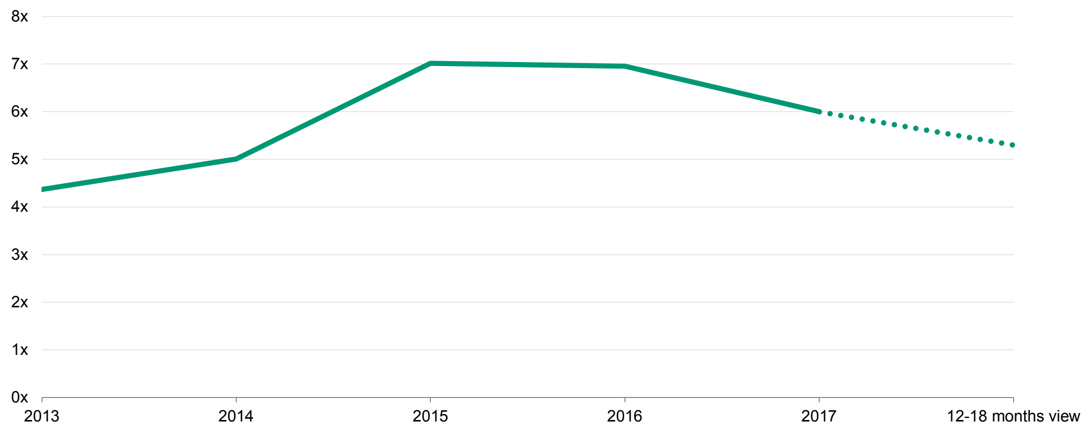
Source: Kantar Worldpanel

In the non-food segment, Casino, its online subsidiary CDiscount and existing partner Conforama will join Auchan and Boulanger. For international purchases, Casino and DIA will join forces with Auchan, Metro and Système U. Casino estimates that all these groups' combined revenue will total nearly €200 billion. This procurement alliance will cover purchases from national or international manufacturers, but will not include farmers or small and midsize enterprises.

This latest alliance follows Casino's announcement on 26 March that its subsidiary Monoprix will sell food products on Amazon.com, Inc.'s (Baa1 positive) Prime Now service, providing express delivery service to customers in Paris. This will supplement Casino's November 2017 agreement with Ocado Group plc (Ba3 stable), which will manage next-day delivery. These agreements will improve Casino's profitability because sales made through Amazon Prime Now or in partnership with Ocado are more profitable than those made on Monoprix's existing website.

Our stable outlook on Casino's Ba1 long-term rating assumes that the company will lower its Moody's-adjusted gross debt/EBITDA to 5.0x-5.5x from 6.0x at year-end 2017, mostly from EBITDA growth. We also expect Casino to maintain a stable dividend policy and to deleverage its French operations at a pace similar to the rest of the group. Our view of Casino's credit quality also assumes that the credit quality of Casino's parent company, Rallye, will not deteriorate, and that Casino will lower its leverage, as shown in Exhibit 2.

EXHIBIT 2
We assume that Casino will lower its leverage to the middle of the 5.0x-5.5x range
Casino's Moody's-adjusted debt/EBITDA



Sources: Company data and Moody's Investors Service estimates

However, competition remains strong in France: research firm Kantar Worldpanel calculates that Casino's market share fell 0.2 percentage point year on year over the 12-week period that ended 6 March 2018. Moreover, in late March, independent cooperative E. Leclerc launched an online delivery service in the Paris area, a region that contributes significantly to Casino's earnings. Although we do not expect this to have much effect on Casino's profitability over the next 18 months, notably because it is beefing up its online capabilities, Leclerc's initiative could have a more significant effect in two to three years if Leclerc delivers on its promise to sell cheaper products to Parisians.

NEWS & ANALYSIS

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Hui Ting Sim
Associate Analyst
+65.6311.2643
huiting.sim@moodys.com

Maisam Hasnain, CFA
Analyst
+65.6398.8325
maisam.hasnain@moodys.com

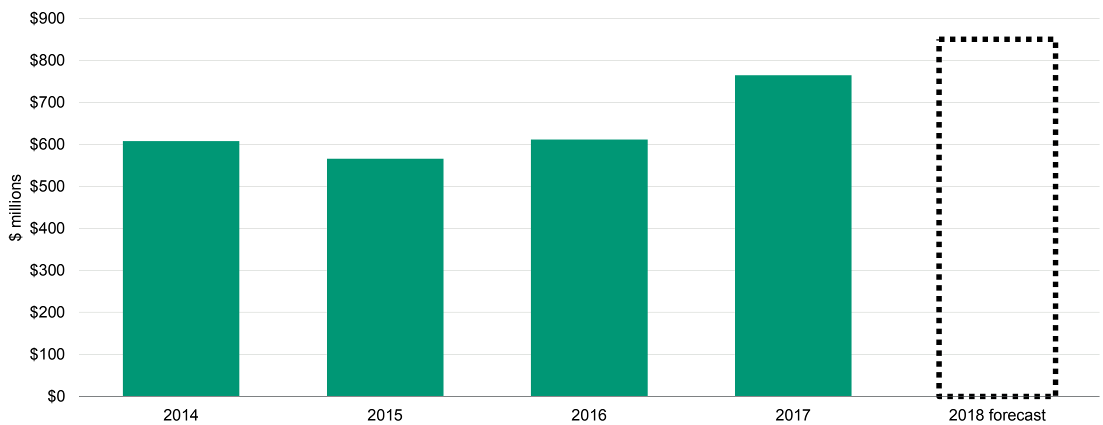
BUMA's new mining service contract increases scale and is credit positive

Last Wednesday, Bukit Makmur Mandiri Utama (P.T.) (BUMA, Ba3 stable) entered a mining services contract with PT Insani Baraperkasa, a subsidiary of mining company PT Resource Alam Indonesia Tbk, for topsoil removal and coal extraction until 2025. BUMA estimates the contract is worth IDR4.5 trillion ($340 million) in incremental revenue over the eight-year period. The new contract is credit positive for BUMA because it increases the company's scale and provides visibility on cash flow owing to the contract's long-term nature. BUMA's total order book will increase to around $6.0 billion from $5.6 billion before this transaction, or 7.8x its total revenue in 2017. This contract is the latest of three contracts that BUMA has secured this year, totaling around $980 million.

We expect BUMA's revenue to grow around 11% year on year to $850 million in 2018, supported by the recent new contract wins and increased coal production for existing customers, as shown in Exhibit 1. The company's revenue increased 25% to $765 million in 2017, driven by higher topsoil removal and coal production volume, and higher thermal coal prices.

EXHIBIT 1

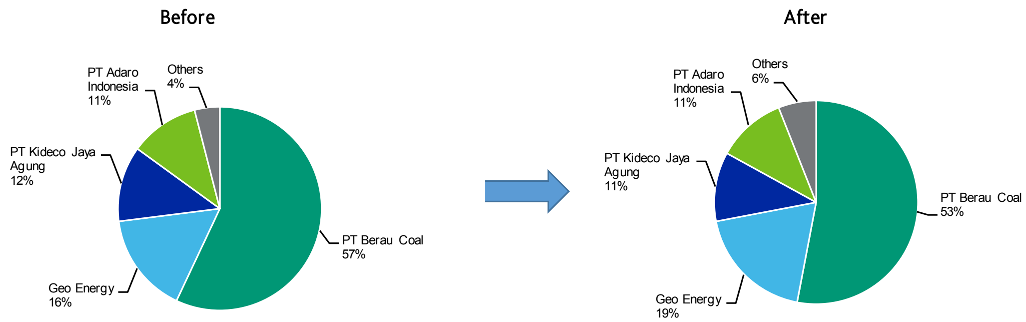
BUMA's revenue growth will increase further in 2018, helped by new contracts



Sources: BUMA, Moody's Financial Metrics and Moody's Investors Service 2018 estimate

The new contracts this year reduce BUMA's customer concentration risk because the pro forma revenue contribution from its largest customer, PT Berau Coal, will decline to around 53% from 57% in 2017, as shown in Exhibit 2. Berau Coal is 90%-owned by PT Berau Coal Energy Tbk, which is currently restructuring its debt.

EXHIBIT 2
BUMA's 2018 revenue contribution from PT Berau Coal will shrink versus 2017



Sources: BUMA and Moody's Investors Service estimates

Established in 1998, BUMA is a coal-mining services contractor in Indonesia, providing mining services to some of the country's largest coal producers. The company's operations are located in Kalimantan, where the majority of Indonesia's coal reserves are located.

Infrastructure

Cliff Wang
Associate Analyst
+1.212.553.6905
cliff.wang@moodys.com

Michael Haggarty
Associate Managing Director
+1.212.553.7172
michael.haggarty@moodys.com

Jeffrey F. Cassella
Vice President - Senior Credit Officer
+1.212.553.1665
jeffrey.cassella@moodys.com

For Georgia Power, state regulators' approval of tax reform settlement is credit positive

Last Monday, the Georgia Public Service Commission (GPSC) approved a 6 March tax reform settlement agreement between Georgia Power Company (A3 negative) and the GPSC staff. The settlement agreement addresses the effects of US tax reform legislation enacted at the end of last year, outlining customer refunds because of the lower tax rate as well as the treatment of deferred liabilities associated with Georgia Power's excess accumulated deferred income taxes.

Importantly, the agreement allows Georgia Power to increase its authorized retail equity ratio, which is currently around 51%, to the lower of the utility's actual common equity layer or 55%, until its next rate case filing, a credit positive. Georgia Power's settlement agreement and the increased authorized equity ratio also signal the continued credit-supportive regulatory environment in Georgia and the constructive relationship the utility has with the GPSC.

The tax reform legislation is overall credit negative for US regulated utilities because the lower 21% statutory tax rate reduces cash collected from customers, while the loss of bonus depreciation reduces tax deferrals, all else being equal. As a result, many utilities face a revenue reduction stemming from potential customer refunds and have been working with their state regulators to pursue regulatory offsets to mitigate the negative cash flow, including changes to their authorized equity layer.

Under Georgia Power's settlement agreement, the utility will issue customer refunds totaling $330 million, including $131 million in October 2018, $96 million in June 2019 and $103 million in February 2020. Furthermore, Georgia Power will defer as a regulatory liability a reduction in revenue related to the lower state tax rate in Georgia, as well as the full benefit of approximately $700 million in federal and state excess accumulated deferred income taxes. The amortization of these regulatory liabilities is likely to be addressed in the utility's next base rate case, which is currently scheduled to be filed by 1 July 2019. In the event that there is no rate case filing in 2019, Georgia Power's customers will be given an additional $185 million in annual bill credits, with any incremental federal income tax savings deferred as a regulatory liability until the next eventual rate case.

Georgia Power is a regulated vertically integrated utility and the largest subsidiary of The Southern Company (Baa2 negative), providing electricity to retail customers in Georgia and to wholesale customers in the Southeast. Georgia Power serves more than 2.4 million customers and has approximately 15,274 megawatts of generating capacity.

Gidon Eydelnant
Associate Analyst
+1.212.553.1775
gidon.eydelnant@moodys.com

Jeffrey F. Cassella
Vice President - Senior Credit Officer
+1.212.553.1665
jeffrey.cassella@moodys.com

NextEra Energy Partners' sale of Canadian renewable assets is credit positive

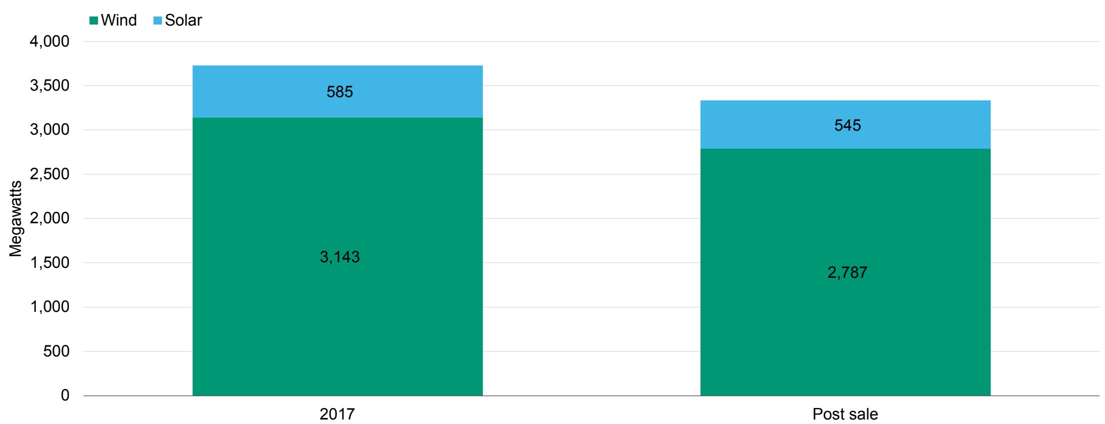
On Monday, NextEra Energy Partners, LP (NEP, Ba1 stable), the yieldco subsidiary of NextEra Energy, Inc. (NEE, Baa1 stable), announced that it had agreed to sell its 396-megawatt Canadian portfolio of renewable generating facilities to the Canada Pension Plan Investment Board (CPPIB) for $582.3 million. As part of the transaction, CPPIB will also assume $689 million of existing debt. NEP plans to use the sale proceeds to recycle capital and acquire higher-yielding generation assets in the US, where the company will benefit from a lower corporate tax rate and a longer federal income tax shield.

The assets being sold consist of the 59.9-megawatt Bluewater, 22.9-megawatt Conestogo, 149-megawatt Jericho and 124.4-megawatt Summerhaven wind generating facilities, and the 20-megawatt Moore and 20-megawtt Sombra solar generating facilities. Together, these assets have an average contract life of 16 years and a 10-year average cash available for distribution (CAFD) of $38.4 million, giving the deal a purchase price, excluding assumed debt, of about 15x CAFD.

NEP plans to retain the proceeds until it identifies renewable energy projects to purchase from either third parties or from NextEra Energy Resources LLC, from which NEP had previously acquired its renewable asset portfolio. NextEra Energy Resources is the principal subsidiary of NextEra Energy Capital Holdings, Inc. (Baa1 stable), an intermediate holding company of NEE and the principal debt financing vehicle for NEE's non-utility-related businesses. NextEra Energy Resources holds one of the largest private portfolios of renewable power projects in North America.

Following the deal's close, NEP's generation portfolio will consist of approximately 2.8 gigawatts of wind generation and approximately 545 megawatts of solar generation (see exhibit). NEP also owns seven natural gas pipelines in Texas with a total capacity of about 4 billion cubic feet per day. NEP expects the transaction to close in second-quarter 2018, subject to regulatory approvals and other conditions. After the asset sale, the remainder of NEP's US portfolio will reside on the West Coast, the southern Great Plains and the upper Midwest US.

NEP's generation portfolio as of year-end 2017 and pro forma for the Canadian renewable assets sale
Capacity in megawatts



Source: NextEra Energy Partners, LP

As of year-end 2017, NEP's adjusted debt/EBITDA was 6.2x, and we do not expect this sale to have a material effect on its financial metrics. The company's liquidity profile will be temporarily bolstered by retaining the cash proceeds once the asset sale is completed. Beginning in January 2018, NEE deconsolidated NEP from its balance sheet following changes to NEP's governance structure, which, among other things, enhanced NEP unitholder governance rights. NEE will now reflect its ownership interest in NEP as an investment under the equity method of accounting.

Banks

Warren Kornfeld
Senior Vice President
+1.212.553.1932
warren.kornfeld@moodys.com

Lan Wang
Associate Analyst
+1.212.553.7761
lan.wang@moodys.com

Federal Farm Credit Banks would be negatively affected by China's proposed tariffs

Last Wednesday, China's State Council announced that it would impose additional 25% tariffs on a list of US goods of up to approximately $50 billion annually, raising the ante on a previous round of tit-for-tat tariff hikes both countries threatened in the past several days. China's proposed tariffs target multiple US agricultural products including soybeans, the biggest US agricultural export to China. China's tariff hikes on US agricultural products – should they become effective – would be credit negative for the Federal Farm Credit Banks (FFCB, Aaa stable[1]) because they would negatively affect FFCB member banks' and associations' asset quality.

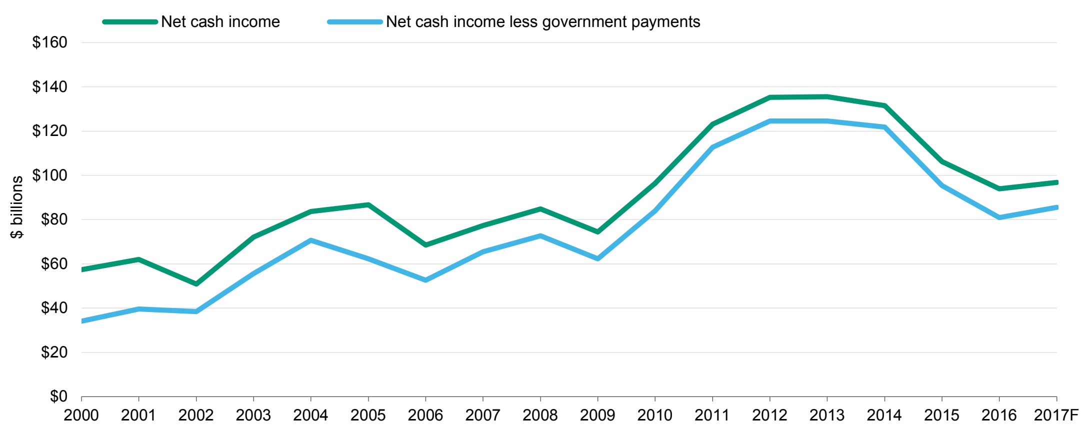
The Federal Farm Credit System (FCS), a group of four banks (AgriBank, FCB (Aa3 stable), The Farm Credit Bank of Texas (Aa3 stable), AgFirst Farm Credit Bank (Aa3 stable) and CoBank, ACB) and 69 lending associations, provide loans and other financial services to US agricultural producers and cooperatives, and rural communities. As of 2017, the system provided approximately 40% of all US farm business credit. The four banks provide loans to associations located in different states with some overlapping coverage. If China's increased tariff on US soybean exports (60% of which are sold to China) were to become effective, we would expect it to have a relatively larger effect on AgriBank than the other three FCS banks because AgriBank has a proportionately larger loan portfolio in the top soybean-producing states of Illinois, Iowa and Minnesota.

The banks' asset quality relies on US farmers' profitability, which has declined since 2014 (see Exhibit 1) in large part because of low crop prices.

EXHIBIT 1

US farm income has declined since 2014

US farm net cash income (including and excluding government payments), 2000-17

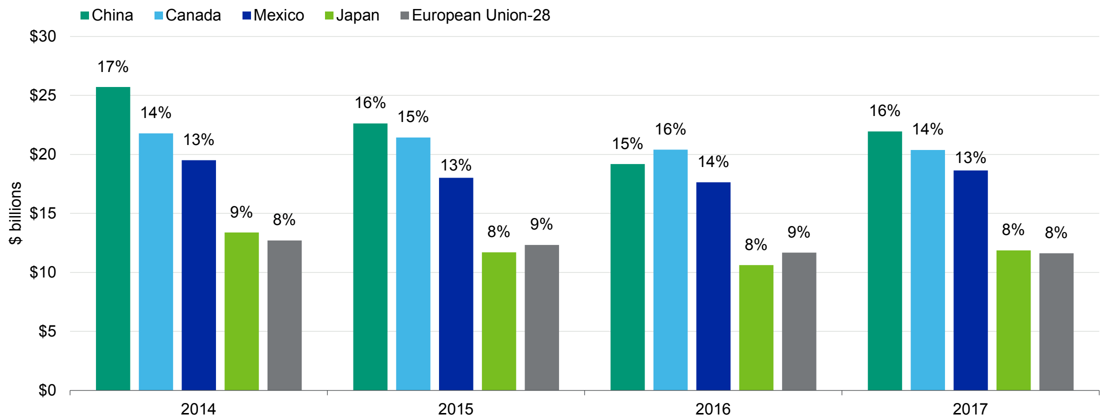


Data for 2017 is US Department of Agriculture – Economic Research Service's forecast value as of 7 February 2018.
Source: US Department of Agriculture – Economic Research Service

[1] The Federal Farm Credit System's Aaa long-term senior unsecured rating reflects its a1 standalone Baseline Credit Assessment, very high support from the US government (Aaa stable), and very high dependence between the FCS and the US government.

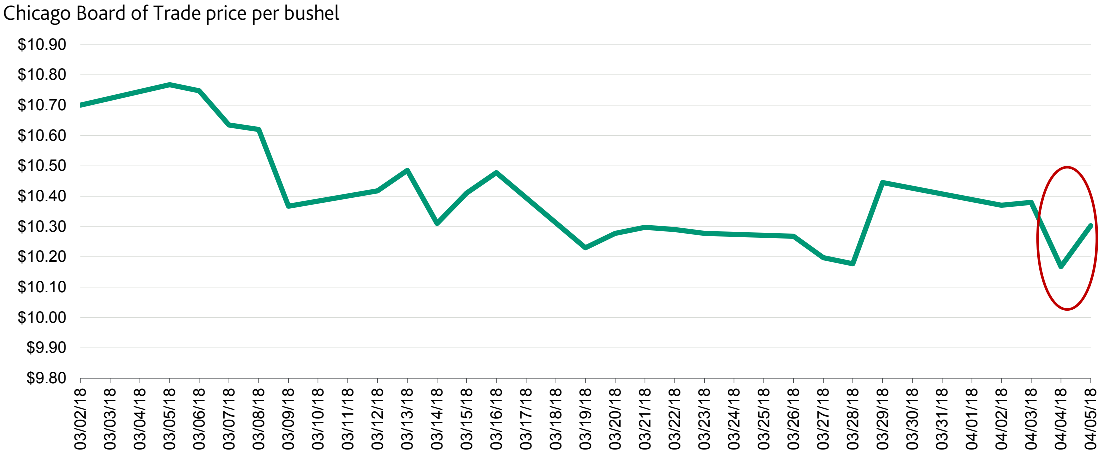
With exports accounting for more than 30% of gross agricultural cash income and China the largest agricultural export destination (see Exhibit 2), China's proposed tariff hikes on the US agricultural products would negatively pressure already-low crop prices and farmers' net income. However, after an initial drop immediately after Wednesday's announcement, agricultural commodity prices, including soybeans (see Exhibit 3) quickly recovered.

EXHIBIT 2
China is the top export destination for US agricultural products
Top US agricultural export destinations, fiscal 2014-17



Data labels above the bars are the ratio of exports to each country or region to total US agricultural exports.
Source: US Department of Agriculture – Economic Research Service

EXHIBIT 3
Soybean prices
Chicago Board of Trade price per bushel



Source: Factset

Although many crop farmers' profitability is strained, system asset quality is strong, with the ratio of problem loans to gross loans at 0.76% as of year-end 2017 and net charge-offs of just three basis points of gross loans in 2017. We expect commodity prices to remain low for the next several years, which would negatively pressure currently strong asset quality performance. Nonetheless, we expect the asset quality deterioration to be well below that during the recession, when the problem loan ratio peaked at 2.1% in 2009 and charge-offs rose to a high of 0.35% in 2010. However, rising commodity prices at the time generally limited the effect of the deterioration. A further decline in commodity prices would accelerate and worsen the already downward pressure on the FCS' asset quality.

Felipe Carvallo
Vice President - Senior Credit Officer
+52.55.1253.5738
felipe.carvallo@moodys.com

Georges Hatcherian, CFA
Assistant Vice President - Analyst
+52.55.1555.5301
georges.hatcherian@moodys.com

Mexico's proposed norms for payroll-linked loans are credit positive for banks

Last Monday, Banxico, Mexico's central bank, proposed clearer and stricter norms for banks' payroll-linked loans. The proposed norms are credit positive for Mexico's banks because they will reduce the risk of certain consumer loans by more effectively securing them with salaries and reducing the risk of borrowers shifting accounts between banks. This should lead to fewer nonperforming loans and lower credit costs, allowing banks to reduce the rates they charge for these products. The proposal includes a request for comment that ends 30 April.

The enhanced norms will boost payroll-linked loan growth, which dropped to just 3% in 2017 from an average of 17% in the prior three years. The 2017 loan growth was the lowest growth rate of any loan class and reflected banks' perception of higher risk. The enhanced norms will allow banks other than those administering individuals' payrolls to offer secured consumer loans by establishing a framework for banks to automatically receive payments from payrolls deposited in other financial institutions.

The proposed norms cap the portion of an individuals' payroll that can be pledged for loan installments at 35% on an aggregate basis. Additionally, banks would be required to communicate with other lenders when they open a payroll account or originate a payroll loan. This requirement will ensure that borrowers do not breach the cap, reducing the risk that borrowers become overleveraged, and will enable banks to track individuals who change their payroll account to another bank. The limit is based on effective average monthly deposits into the borrower's account during the previous 12 consecutive months, rather than their reported salaries, ensuring that the loan amount is based on the borrower's actual disposable income.

Borrowers also will have to determine which bank's payroll-linked loan will be prioritized. Prioritization will ensure that a bank's claims are not diluted by subsequent loans issued by other banks, and that they retain their security even if the individual's payroll is transferred to another bank. Currently, banks lose their security when a borrower moves his or her payroll to another bank, and there are no restrictions on borrowers' ability to do so.

Because of the historical ineffectiveness of security of payroll loans in Mexico, delinquencies have been considerably higher than in other countries. In Mexico, 3% of payroll loans are nonperforming. Although this is just half the delinquency rate of unsecured personal loans, it is well above the 1% rate in Colombia, where payroll-linked loan installments are withheld by public-sector employers and pension providers before the balance of the salaries or pensions are deposited into borrowers' bank accounts. Even in Brazil, which is just emerging from a deep and protracted recession, the delinquency rate on payroll loans is 2.4%, below the overall system average of 3.8%. As a result, interest rates for payroll loans in Mexico remain prohibitive for many potential borrowers, averaging more than 20%.

Because banks other than those handling an individual's payroll will be able to offer that individual a payroll loan, small and midsize banks with limited branch networks and deposit- taking franchises but substantial consumer lending would benefit most from the new regulations. Those banks include Banco Azteca, S.A. (Ba1 stable, ba3[2]), Banco del Bajío, S.A. (Baa3 positive, ba1), BanCoppel, S.A. and Banco Ahorro Famsa, S.A. The new norms will not affect non-bank financial institutions focused on payroll-linked lending, such as Crédito Real, S.A.B. de C.V. or Alpha Holding, S.A. de C.V. (B1 stable), which have established arrangements with public-sector employers that allow them to receive loan installments before salaries are deposited into a borrower's bank account.

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

Maksim Maliutin
Associate Analyst
+7.495.228.6117
maksim.maliutin@moodys.com

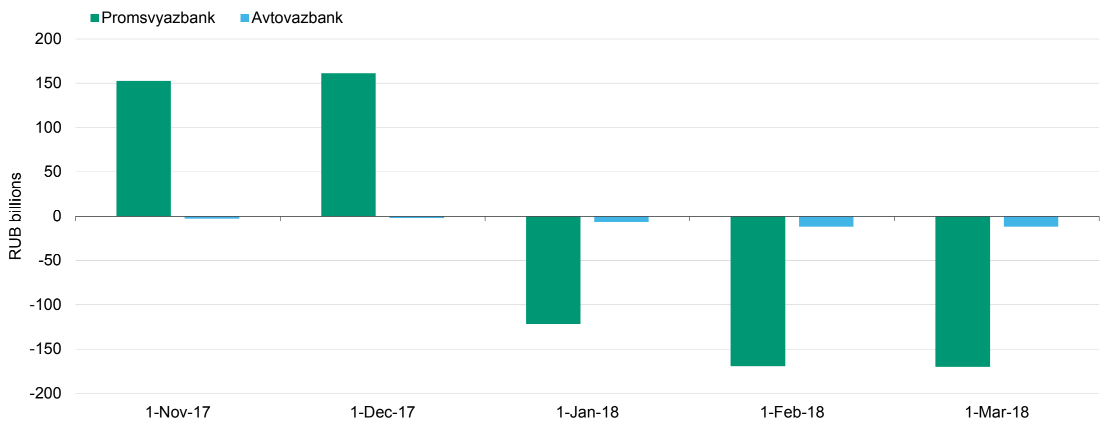
Petr Paklin
Assistant Vice President - Analyst
+7.495.228.6051
petr.paklin@moodys.com

Promsvyazbank will benefit from Russian central bank's capital injections

Last Monday, Central Bank of Russia (CBR) First Deputy Chairman Vasily Pozdyshev announced that the regulator would provide RUB130 billion of financial support to Promsvyazbank (PSB, B2/B2 developing, ca[3]) via Russia's Deposit Insurance Agency (DIA), which will contribute Russian sovereign bonds to PSB's capital. The CBR and DIA's actions are credit positive because they will replenish PSB's capital cushion, which is negative. Additionally, the aid illustrates the state's commitment to support systemically important banks (SIBs), thereby preserving banking sector stability. The assistance is broadly in line with the CBR's earlier intention to recapitalize PSB by the end of first-quarter 2018, and will follow a recent Tier 1 equity injection made on 28 March. The DIA has contributed RUB113.4 billion in cash and is PSB's controlling shareholder.

PSB needs additional capital to comply with the minimum total capital adequacy ratio of 10.5% for SIBs once the bank completes financial rehabilitation. The capital shortage emerged in mid-December last year, when the CBR's provisional administration took operational control of the bank. As a result, PSB recognized additional impaired assets and incurred significant provisioning charges against them. As of 1 March 2018, the bank's negative capital under Basel III requirements totaled RUB170.1 billion, versus positive total capital of RUB161.4 billion just four months earlier (see Exhibit 1).

EXHIBIT 1
Promsvyazbank's and subsidiary bank Avtovazbank's Basel III regulatory capital



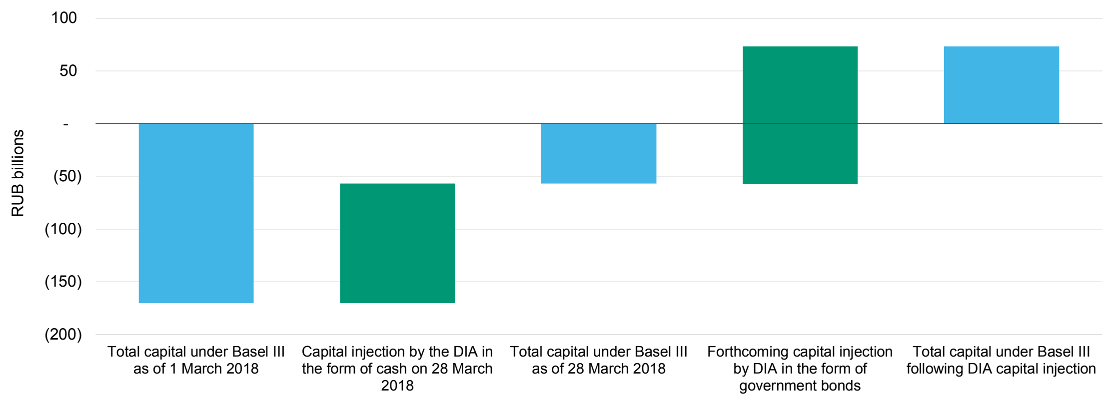
Source: The Central Bank of Russia

As part of the recapitalization, the CBR will contribute Russian sovereign bonds to the DIA, which in turn will make the capital injection into PSB, bringing the total amount of financial support provided to PSB to RUB243.4 billion. This amount is in line with our previous estimate of PSB's likely rescue package of more than RUB200 billion, but we believe that amount may not be sufficient to comply with minimum regulatory capital requirements. As per our estimates, PSB's regulatory capital would total RUB73.3 billion (see Exhibit 2), while its total capital adequacy ratio would fall below the regulatory minimum of 10.5% for SIBs to reach 7.6%, taking into account completed capital contributions and unchanged risk-weighted assets.

[3] The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

EXHIBIT 2

PSB's regulatory capital waterfall as of 1 March 2018, including recent and forthcoming capital injections



Sources: The Central Bank of Russia, Russian Deposit Insurance Agency and Moody's Investors Service estimates

The CBR also intends to split PSB's and subsidiary bank Avtovazbank's assets into good and bad banks. Consequently, PSB group's toxic and non-core assets will be transferred to a distressed asset fund that the CBR is about to set up for troubled Bank Trust, a subsidiary of Bank Otkritie Financial Corporation PJSC (B2/B2 review for upgrade, caa3 review for upgrade). To meet the minimal regulatory levels, PSB would need to release at least RUB28 billion of RUB275 billion in total loan-loss reserves after the toxic asset disposal. Given the CBR's intention to complete PSB's financial rehabilitation, we believe that the cleanup of its balance sheet, together with the state contributions, will restore its capital cushion to minimal regulatory thresholds.

Mik Kabeya
Assistant Vice President - Analyst
+971.4.237.9590
mik.kabeya@moodys.com

Francesca Paolino
Associate Analyst
+971.4.237.9568
francesca.paolino@moodys.com

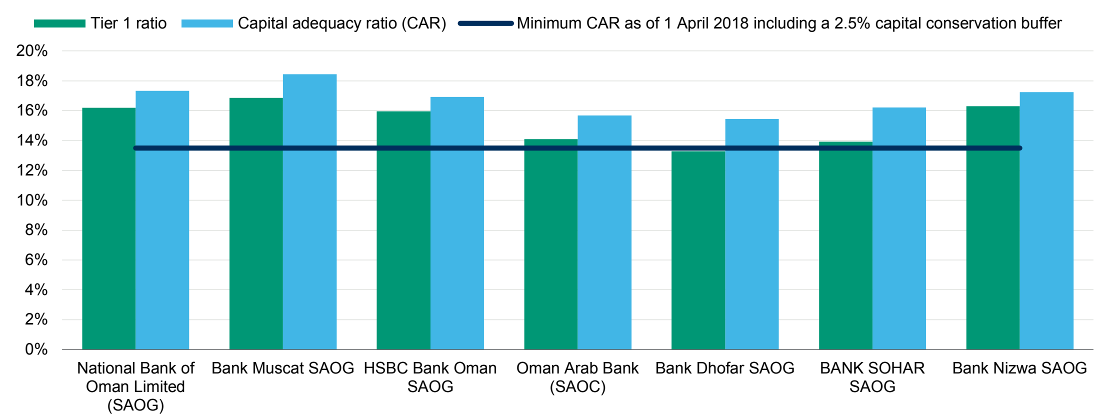
Oman's regulatory changes to improve its business environment will moderately weaken banks' credit profiles

Last Tuesday, the Central Bank of Oman (CBO) disclosed five regulatory amendments that took effect 1 April and will moderately weaken banks' credit profiles, a credit negative. The amendments aim to strengthen banks' capacity to grant credit and provide liquidity to the economy by reducing the minimum total capital adequacy ratio (CAR), including net local inter-bank transactions in the funding base for lending ratio purposes and relaxing regulatory limits on maturity mismatches. Additionally, the changes withdraw the minimum 100% risk-weighting requirement for exposures to debt from other sovereigns and central banks and increase the limit on credit exposure to non-residents and to the placement of bank funds abroad.

The amendments will raise banks' interest income by increasing lending volume and lowering funding costs by diversifying funding sources, but banks' capitalisation buffers will decline. Furthermore, banks' asset quality will erode because of increased lending in a weakening environment and their funding will be hurt by an increased reliance on market funding and by increased maturity mismatches.

The reduction in the minimum CAR (excluding a 2.5% capital conservation buffer) to 11% from 12% will encourage banks to gradually increase private-sector lending, reducing their capital ratios over the next 12 to 18 months, when we expect borrowers' creditworthiness to weaken. However, the new minimum CAR remains relatively high by global standards.

Moody's-rated Omani banks' reported capital adequacy ratios as of 31 December 2017



Sources: Central Bank of Oman and banks' financial statements

The inclusion of net local inter-bank transactions (total inter-bank borrowing minus total inter-bank lending) in the funding base computation for lending ratio purposes[4] will negatively affect banks' funding profiles given our expectation that Omani banks will increase their reliance on inter-bank funding because it is now eligible for the regulatory lending ratio. This is credit negative despite our expectation that banks' interest income will increase from additional lending and lower funding costs because inter-bank funding reduces banks' need to pay up for customer deposits.

4 Since 1 January 2009, Omani banks have been subject to an 87.5% regulatory lending ratio cap computed as net lending (excluding eligible government soft loans) as a proportion of the funding base (including customer deposits, net balances due to banks abroad and capital funds).

Relaxing the regulatory limits on maturity mismatches will negatively affect banks' funding profiles if, as we expect, banks increase the proportion of long-term assets funded with liabilities with shorter tenors. We consider this relaxation credit negative, despite our expectation that banks will benefit from lower funding costs.

Withdrawing the minimum 100% risk-weighting requirement on banks' exposures to foreign sovereign debt, however, will positively affect banks' capital buffers. This is because we expect lower reported risk-weighted assets on selected foreign debt securities, including US Treasury bills, to constitute a measurement of counterparty risk more in line with the Basel III standardised framework. Additionally, this change will allow banks to more easily diversify their asset risk by holding debt securities issued by foreign sovereigns with a stronger credit profile.

The increased limit on credit exposures to non-residents and to the placement of bank funds abroad to 75% of the local net worth from 50% previously will positively affect banks' interest income. This is because we expect that banks will be able to place a larger portion of their extra foreign-currency liquidity with international counterparties that offer higher rates than the CBO.

Francesca Paolino
Associate Analyst
+971.4.237.9568
francesca.paolino@moodys.com

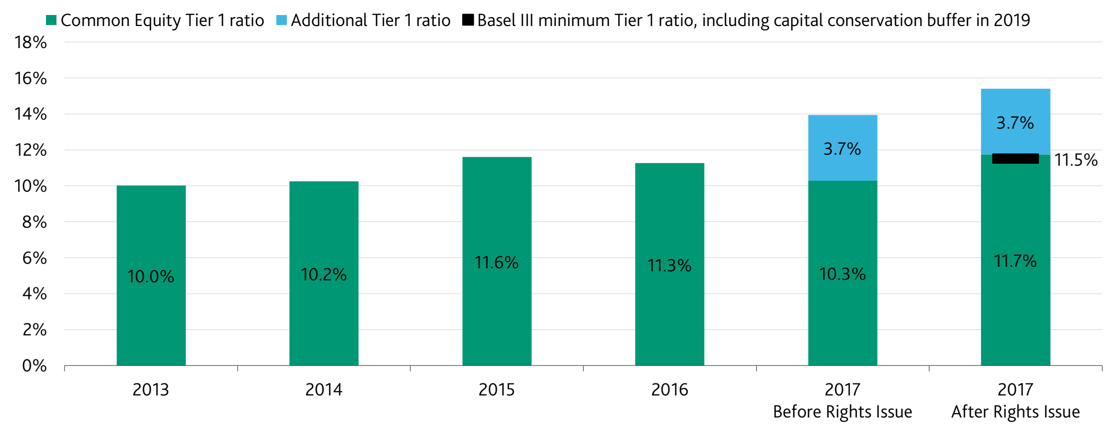
Mik Kabeya
Assistant Vice President - Analyst
+971.4.237.9590
mik.kabeya@moodys.com

Bank Sohar's rights issuance will be credit positive

On 1 April, Oman-based Bank Sohar SAOG (Ba1 negative, ba3[5]) announced that its shareholders had approved an increase in the bank's authorised capital to OMR400 million ($1.0 billion) from OMR200 million ($519 million) at an extraordinary general meeting. The higher authorised capital will allow the bank this year to complete an OMR40 million ($104 million) rights issue that will increase its capital buffer by around 150 basis points, a credit positive. The rights issuance also will support the bank's liquid resources amid a relatively tight funding environment in Oman.

We estimate that the issuance will strengthen Bank Sohar's regulatory Tier 1 capital ratio to around 15.4% on a pro forma basis, from 13.9% as of year-end 2017. The 15.4% Tier 1 capital ratio would exceed the 11.5% minimum (including a capital conservation buffer[6]) that the Central Bank of Oman will impose at the beginning of next year as part of its gradual implementation of Basel III capital requirements (see exhibit). The rights issuance supports the capitalisation given the bank's relatively low earnings retention, with a 42% cash dividend payout ratio for 2016 and proposed to be 35% for 2017. The additional capital also will support the bank's loan growth, which we expect will be around 7% in 2018, lower than in previous years (14% on a compound aggregate basis during 2013-17) owing to slower economic growth in Oman. The issuance increases the bank's loss-absorption buffers amid a weakening operating environment as subdued economic growth and fiscal consolidation affect the creditworthiness of corporate and retail borrowers.

Bank Sohar's reported Tier 1 capital ratio



Minimum regulatory capital is as of 31 December.
Sources: Bank Sohar and the Central Bank of Oman

The rights issuance also will support Bank Sohar's modest liquidity buffers in the tight domestic funding environment. Funding conditions eased somewhat during 2017 owing to higher oil prices, the Omani government's large international debt issuance and slower credit growth. However, credit as a percent of sector-wide deposits in the Omani banking system remained among the highest in the Gulf Cooperation Council region at 109% in January 2018.

The bank's liquidity buffers are relatively modest, especially considering its high reliance on market funding and its funding concentration. As of December 2017, Bank Sohar's liquid assets were 21.5% of tangible banking assets, in line with local peers, and market funds/tangible banking assets were a high 26.3%, versus 11.5% for local peers. Bank Sohar's total assets of OMR2.8 billion ($7.4 billion) as of December 2017 constituted a 9% market share in Oman by assets. The bank issued a OMR100 million Additional Tier 1 perpetual bond in September 2017 and completed a rights issue of around OMR40 million ($104 million) in April 2015.

5 The bank ratings shown in this report are Bank Sohar's deposit rating and Baseline Credit Assessment.
6 As of 1 January 2019, Omani banks must comply with a capital adequacy ratio of 13.5%, which includes a 11.5% Tier 1 capital ratio and a 2.5% capital conservation buffer.

Alka Anbarasu
Vice President - Senior Credit Officer
+65.6398.3712
alka.anbarasu@moodys.com

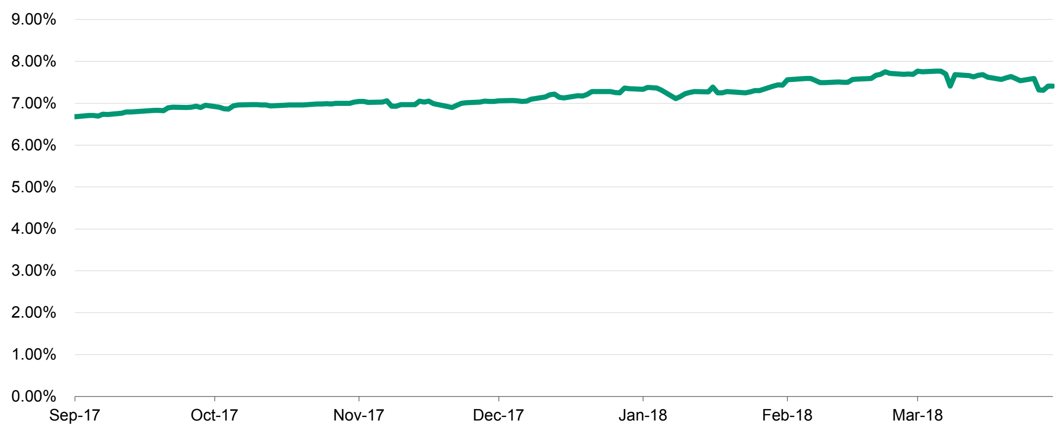
India's creation of an investment-fluctuation reserve will benefit banks

Last Monday, the Reserve Bank of India (RBI) issued guidelines requiring banks to create an investment-fluctuation reserve (IFR) constituting a minimum of 2% of their combined held-for-trading and available-for-sale investment portfolios. The IFR's creation will be credit positive for India's banks because it will help protect them from increases in bond yields, cushioning the negative effect on profitability.

Under the new guidelines, banks over the next three fiscal years will be required to set aside for the IFR either profits from the sale of investments made during the year or their net profit less mandatory appropriations until the reserve equals at least 2% of their held-for-trading and available-for-sale portfolios. The IFR will be eligible for inclusion in banks' Tier 2 capital.

The RBI created the IFR requirement in the response to a sharp increase in the Indian government 10-year bond yield over the past six months to 7.41% on 31 March 2018 from 6.95% on 30 September 2017 (see Exhibit 1). This resulted in significant mark-to-market losses for Indian banks owing to their substantial holdings of government securities.

EXHIBIT 1
India's 10-year government bond yield



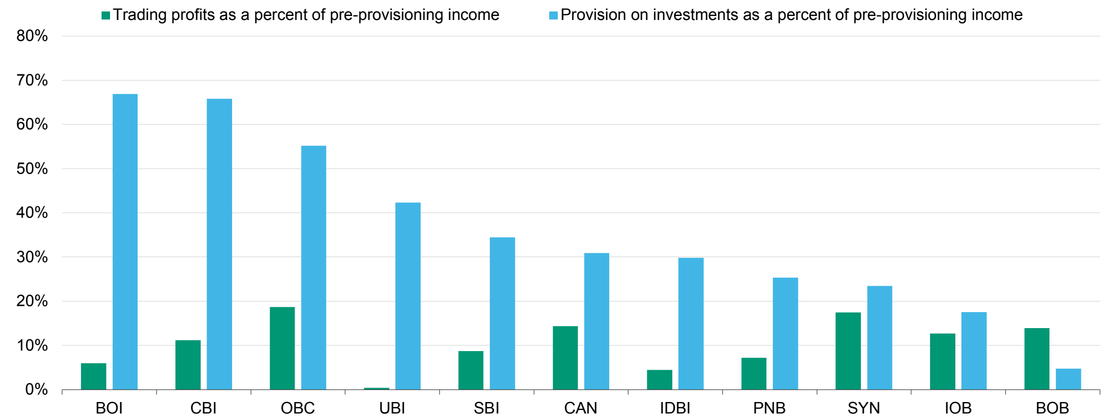
Source: Factset

For the quarter that ended December 2017, provisions on investment portfolios consumed about 32% of rated public-sector banks' operating profits largely because of the sharp increase in bond yields, with banks such as Bank of India (Baa3 stable, ba3[7]) and Central Bank of India (Ba3 positive, b3) experiencing the most severe effects. At these banks, the provisions on investments consumed more than 65% of operating profits (see Exhibit 2), while the effect on private-sector banks was smaller.

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

EXHIBIT 2

Rated Indian public-sector banks' trading gains and provisions on investments for the quarter that ended December 2017



BOI = Bank of India; CBI = Central Bank of India; OBC = Oriental Bank of Commerce; UBI = Union Bank of India; SBI=State Bank of India; CAN = Canara Bank; IDBI = IDBI Bank Limited; PNB = Punjab National Bank; SYN = Syndicate Bank; IOB = Indian Overseas Bank; and BOB = Bank of Baroda

Sources: The banks

In response to banks' significant mark-to-market losses banks, the RBI also provided a onetime dispensation to spread the recognition of investment portfolio losses for the quarters that ended in December 2017 and March 2018 over the next four quarters. The regulatory forbearance allowing banks to spread those losses over the next four quarters will help reduce the immediate negative effects on their profitability, which are already depressed because of high credit costs.

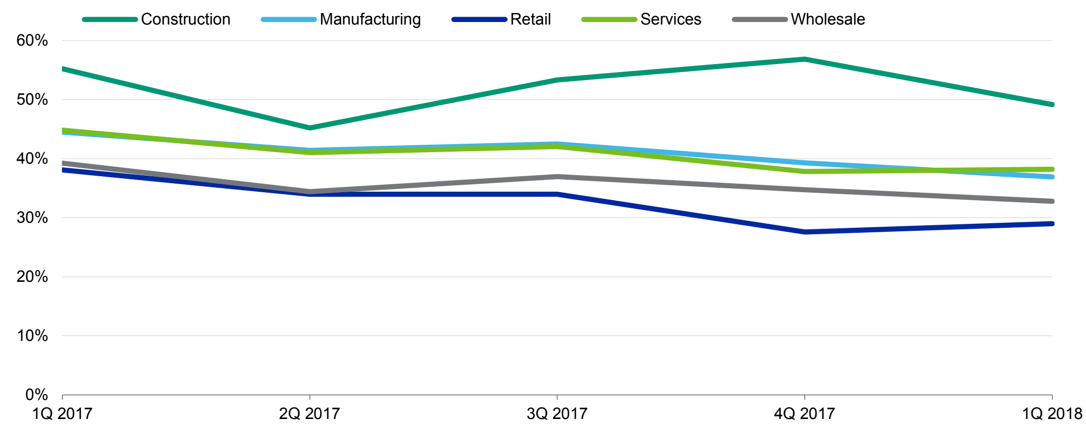
Simon Chen, CFA
Vice President - Senior Analyst
+65.6398.8305
simon.chen@moodys.com

For Singapore's banks, a decline in slow payments by corporations is credit positive

Last Tuesday, the Singapore Commercial Credit Bureau (SCCB) released its latest update on the payment performance of Singaporean companies for first-quarter 2018, which showed an overall improvement in payment indicators from fourth-quarter 2017, including a decline in the percentage of companies with slow payments. Slow payments are payments of less than 50% of total bill amount within the agreed payment terms. The improved payment performance is positive for Singapore's banks because it reflects a broad improvement in corporate cash flow and debt serviceability that will support banks' asset quality this year.

Compared with a year ago, payment indicators generally improved during 2017 and first-quarter 2018, reflected by a decline in companies with slow payments across the five industry sectors covered by the SCCB (see Exhibit 1), particularly in the construction sector, which has the poorest record of prompt payments among all industry sectors. The first-quarter 2018 improvement followed deterioration in the second half of 2017, and occurred among special trade contractors and building and heavy construction companies.

EXHIBIT 1
Percentage of Singaporean companies by sector making slow payments

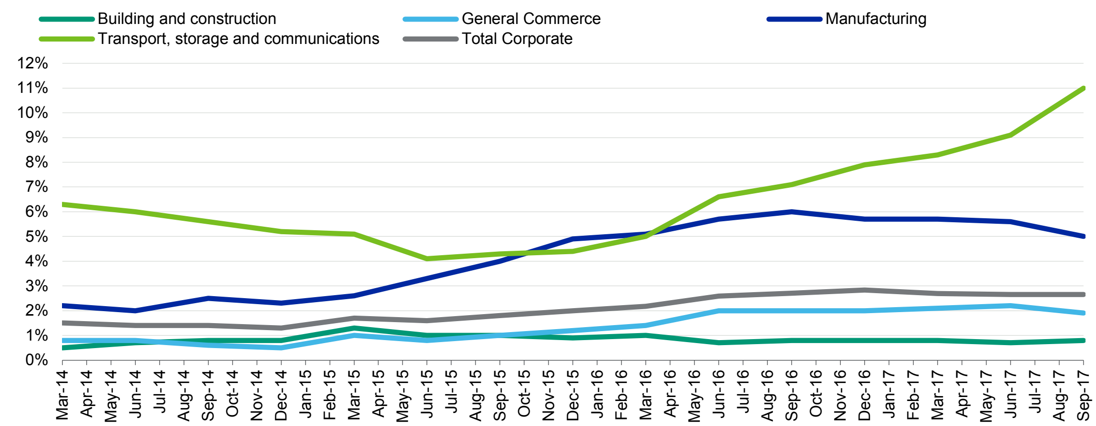


Source: Singapore Commercial Credit Bureau

Operating conditions for Singapore's construction sector have been challenging over the past two years amid subdued economic activity, a slowdown in project development and rising operational costs. We expect the construction sector's gradual improvement this year because of Singapore's recovering economy and the government's plan to accelerate public infrastructure development, which will support banks' stable asset quality in this sector (see Exhibit 2).

EXHIBIT 2

Singapore banks' gross nonperforming loan ratio by industry sector



Source: Monetary Authority of Singapore

For DBS Bank Ltd. (Aa1/Aa1 stable, a1[8]), Oversea-Chinese Banking Corp. Ltd. (Aa1/Aa1 stable, a1) and United Overseas Bank Limited (Aa1/Aa1 stable, a1), nonperforming loan (NPL) ratios tied to the construction sector were 0.2%-0.8% at year-end 2017, much lower than overall NPL ratios of 1.5%-1.8% as of the same date.

The manufacturing, retail, services and wholesale sectors collectively account for around 23% of total loans, and continued to show a lower percentage of companies with slow payments in first-quarter 2018 compared with a year ago. This trend will support these sectors' stable asset quality performance.

Most corporate-related asset quality issues at Singapore banks over the past three years were tied to the marine and offshore engineering sector (which in Exhibit 2 is reflected in the transportation, storage and communications sector). We expect global oil prices to remain at $45-$65 a barrel in 2018-19, which leads us to believe that the marine and offshore industry has passed its trough and that further spillover for Singapore banks will be manageable because many weak companies in the sector have either already defaulted or restructured their liabilities. Nonetheless, NPL ratios in this sector will remain elevated while banks work out their loans with troubled borrowers.

[8] The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

Insurers

Ken Mayeri
Associate Analyst
+1.212.553.9385
kenneth.mayeri@moodys.com

Dean Ungar
Vice President - Senior Analyst
+1.212.553.6968
dean.ungar@moodys.com

Humana and UnitedHealth team up in blockchain pilot to tackle $2.1 billion annual healthcare data problem

Last Monday, Humana Inc. (Baa3 stable) and UnitedHealth Group Incorporated (A3 stable) announced the launch of a pilot blockchain program aimed at reducing administrative costs associated with the longtime industry challenge of separate and redundant provider databases. Although the commercialization of this pilot is likely years away, the promise of eliminating the need to reconcile multiple databases would be credit positive for health insurers.

The companies will launch the pilot with laboratory company Quest Diagnostics Incorporated (Baa2 stable) and technology-based healthcare cost management service provider MultiPlan, Inc., with the goal of developing an industry-wide resource for healthcare provider data. If successful, which we believe is likely but could take years, there will be significant cost savings to health insurers, a credit positive.

According to a report published by CAQH, a non-profit alliance of health plans and trade associations, hospitals, doctors and health insurers spend $2.1 billion per year on redundant provider data maintenance tasks. Approximately two-thirds of these costs ultimately fall on insurers. CAQH estimates that 75% of the total costs dedicated to redundant data reconciliation tasks would be eliminated if industry participants all had access to the same ledger. Assuming that these savings are split pro rata between hospitals, doctors and health insurers, health insurers would realize more than $1 billion in annual savings. For context, the eight large publicly traded health insurers that we rate generated approximately $77 billion of selling, general and administrative expenses last year.

Healthcare stakeholders including insurers, managed care organizations, health systems, physicians and diagnostics information service providers all internally collect and maintain provider data. Some provider data, such as a doctor's name or the school the doctor attended, are relatively static, while other provider data require more maintenance, such as the location of the doctor's practice or if the doctor is currently accepting new patients. Since such data are currently tracked internally by many different industry participants, those efforts are redundant and require time and resources.

The collaboration between Humana, UnitedHealth, Quest Diagnostics and MultiPlan aims to create a single source of data by sharing data each has on the blockchain's distributed ledger. This will allow all participants to see changes to provider data simultaneously and in real-time, simplifying reconciliation and improving data quality.

This pilot is not the first time competing insurance companies have worked together to develop blockchain solutions designed to save costs and increase efficiencies. The Blockchain Insurance Industry Initiative (B3i), a consortium of several of the world's largest property and casualty insurers and reinsurers, on 24 March announced that it had become its own company, B3i Services AG. B3i has already completed its first blockchain prototype application that streamlines the property catastrophe excess of loss reinsurance contract process. Under its new corporate structure, B3i expects the first live trades of reinsurance contracts on its platform by the end of this year.

Asset Managers

Tiziano Oliva
Associate Analyst
+44.20.7772.8663
tiziano.oliva@moodys.com

Rules to reshape UK asset management are credit negative for active managers

Last Thursday, the UK Financial Conduct Authority (FCA) published a series of rules applicable to the £8 trillion UK asset management sector, requesting asset managers to act in the best interests of the investors in their funds. Although the new rules enhance transparency and protection for investors, active asset managers' operating and compliance costs will increase and their fees will decline, reducing profit margins and accelerating the shift toward passive investment management, a credit negative. The FCA's final rules on governance will take effect on 30 September 2019, with the rules for risk-free profits (box profits) taking effect on 1 April 2019.

Active managers that have been experiencing an increase in operating and compliance costs following a number of local and global regulatory initiatives[9] will have to overhaul their cost structures and product lineup or merge to offset the pressure on revenue and generate economies of scale.

The additional rules on delivering value to investors will reduce the fees charged by active managers that will have to adapt their business models and product offerings to an even more competitive pricing environment. Asset managers that provide the best value-for-money proposition likely will consolidate their market share. Bigger players with solid governance standards and diverse solutions in both active and passive management, such as FIL Limited (Baa1 stable) and BlackRock, Inc. (A1 positive), will be best positioned to absorb the additional regulatory pressures.

The FCA requires asset managers to assess their funds' value-for-money proposition against a non-exhaustive list of prescribed elements. Asset managers will have to take corrective action if the assessment does not meet minimum requirements, providing explanations in a publicly available annual report. Other rules to protect investors are the mandatory repayment to the fund or to the end investors of box profits made by the fund manager when buying and selling funds with a dual pricing structure, and the launch of a facilitated process to move investors to cheaper, but otherwise identical, share classes of the same fund. To further bolster fund governance, the FCA also requires asset managers to appoint at least two independent directors[10] that account for at least 25% of the total board membership.

The introduction of these rules will increase fee and cost transparency, making the pricing of active funds more competitive and accelerating the shift to passive products (see Exhibit 1). Consequently, active asset managers' fees and profit margins will decline (see Exhibit 2).

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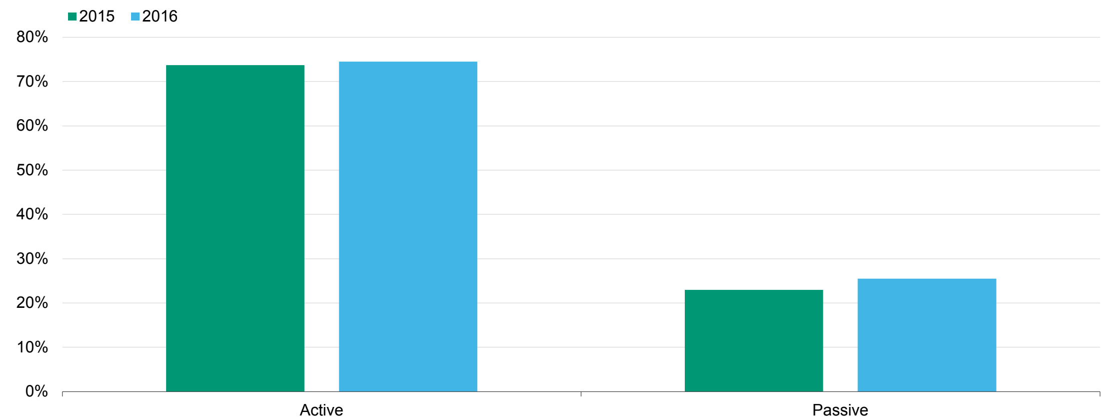
9 See MiFID II is credit negative, intensifying fee competition, shift to passive funds, 15 January 2018.
10 The FCA estimates a cost of around £40,000 a year per independent board member.

EXHIBIT 1
Active and Passive UK Funds' Market Shares, 2015-16



Source: The Investment Association

EXHIBIT 2
FCA's new rules and their credit implications for UK asset managers

Rule	Items affected	Credit implication
Value for money assessment and reporting	Fees and profit margins	Negative
Independent directors comprise 25% of total and a minimum of two board members	Administrative expenses	Negative
Box profits repayment	Profit margins	Negative
Switch to cheaper share classes	Fees and profit margins	Negative

Sources: UK Financial Conduct Authority and Moody's Investors Service

In addition to the rules on governance, the FCA put forward a set of proposals, including the disclosure to investors of a single fee inclusive of all costs, to address the lack of transparency of cost and performance information that makes comparisons between products difficult. Asset managers that are currently not used to operating under a single-fee framework likely will have to streamline their reporting processes into a single format, highlighting all costs incurred in their fund dealing activities and standardising the reporting of funds' performance. This will increase operational costs and price competition.

Sovereigns

Aurelien Mali
Vice President - Senior Credit Officer
+971.4.237.9537
aurelien.mali@moodys.com

Chris Cho
Associate Analyst
+44.20.7772.5354
chris.cho@moodys.com

Ethiopia swears in its first Oromian prime minister, a credit positive

Last Monday, Ethiopia (B1 stable) swore in Prime Minister Abiy Ahmed Ali, its first Oromian prime minister, following the unexpected resignation of Hailemariam Desalegn in February. Mr. Ali's appointment is credit positive for Ethiopia because it is likely to calm social unrest that began three years ago and allow the country to continue attracting investments from abroad.

Sustained foreign investment is critical for Ethiopia's sovereign credit profile because GDP growth depends on public and foreign investments to complete a range of large infrastructure projects that will help diversify national exports. Stabilising the domestic political environment will reduce the risk of a halt in foreign direct investment inflows, which we estimate will exceed $5 billion in fiscal 2018 (which ends in June 2018).

Recent political demonstrations by the Oromian and Amharic people, the two largest racial groups in Ethiopia, stem from their political underrepresentation and perceived mistreatment by the authorities, particularly at the municipal level. Additionally, there has been a recent escalation of violence and humanitarian issues, the imposition of a four-month state of emergency in February, the second in a year, and the re-arrest of opposition reporters and politicians. There is also a widespread perception that the Ethiopian People's Revolutionary Democratic Front (EPRDF), the ruling coalition, is dominated entirely by the Tigrayan elites, who account for just 6% of the population. However, with an Oromian prime minister now leading the country, we believe the justification for social unrest has diminished, which we expect will stabilize the nation's economic environment.

Mr. Ali leads the Oromo Peoples' Democratic Organization, a constituent member of the EPRDF, and has overwhelming support from the country's youth, who have been prominent among social protesters. The shift in leadership does not signal a change in regime, but instead is a response by the four-party coalition to the population's growing discontent and social unrest.

For the most part, the selection of Mr. Ali suggests policy continuity, particularly for economic policies, including Ethiopia's Growth and Transformation Plan 2 (GTP II). GTP II is the government's five-year plan, set to conclude in 2020, to achieve growth by transforming key sectors including agriculture, infrastructure and electricity generation. The plan also targets increasing the government's revenue-generation capacity.

Although it is too early to determine if the leadership change means more political space for the opposition, the new government is likely to be more open to discussion with the population, and we expect that it will act in a more inclusive manner than previously. Additionally, we expect that Mr. Ali will be able to reach out to address key economic and social issues among Ethiopia's youth, including unemployment.

Mr. Ali's appointment also is likely to appease international organisations critical of the government's violent responses to mass protests during states of emergency. Although it is too early to provide a definitive assessment, we expect an improvement in relations between Ethiopia and various agencies, multilateral institutions and international donors that may lead to further development aid and disbursements by entities such as the World Bank.

NEWS & ANALYSIS

Credit implications of current events

Serena Wang
Associate Analyst
+65.6398.8334
serena.cc.wang@moodys.com

Anushka Shah
Vice President - Senior Analyst
+65.6398.3710
anushka.shah@moodys.com

Mongolia's delays and reversals on some structural reforms, if prolonged, are credit negative

Last Wednesday, the International Monetary Fund (IMF) completed its third review of the Government of Mongolia's (B3 stable) performance under its Extended Fund Facility (EFF) and approved a $30.6 million tranche disbursement. The review pointed to strong program performance, but also delays and reversals of some structural reforms mandated by the program. The slippages, if prolonged, pose a risk to the continuity of donor assistance, and leave Mongolia's credit profile vulnerable to commodity price boom-bust cycles, a credit negative.

The review noted Mongolia's strong macro performance, as reflected in stronger growth, narrower deficits, and a healthier foreign reserve position than the IMF expected at the program's start in May 2017. An asset quality review of Mongolian banks, stipulated by the program and conducted by an independent consultant, also points to a much smaller capital adequacy shortfall than the IMF previously forecast, resulting in lower potential recapitalization costs to the government.

However, progress on structural benchmarks is mixed at best. Of 10 structural benchmarks, three are delayed and the IMF expects that two – the establishment of an independent fiscal council and the creation of a credit line for the deposit insurance agency DICOM – will unlikely be met (see Exhibit 1). Reforms subject to delays and reversals were those primarily designed to prevent a return to pro-cyclical fiscal policies and to strengthen and empower institutions to support adherence to fiscal rules. In particular, we expect the establishment of a fiscal council in line with international best practices to improve accountability and effectiveness in restraining budgetary spending. In the past, a lack of independence in the budgetary process and weak enforcement of regulations have often involved increased spending when commodity prices are favorable, or a spike in election-related expenditures, leading to fiscal deficits breaching budgetary targets.

EXHIBIT 1

Mongolia's structural benchmarks under its IMF EFF program

	Due Date	Status
Fiscal		
Establishment of a fiscal council in line with international best practice	End of December 2017	Not Met[1]
Submission of the tax-working group's report to the Ministry of Finance	End of December 2017	Met
Start Implementation of the 2018 tax compliance improvement strategies	End of January 2018	Met
Submission of revised general taxation law	End of February 2018	Not met[2]
Submission of legislation to create a simplified regime for micro/small businesses	End of February 2018	Not met[2]
Social Protection		
Target child money program in the 2018 budget to the poorest 60%	End of December 2017	Met
Banking		
Completion of an asset quality review	End of December 2017	Met
Enact/amend a law on use of public funds (recapitalization law)	End of January 2018	Not met[3]
Set up backup funding for DICOM	End of February 2018	Not met[4]
Amendment of DICOM law to bring in line with IADI core principles	End of February 2019	Met

[1] Parliament approved a regulation for a fiscal council, but did not guarantee political independence in line with advice.

[2] Expected passage in April. Delays related in part to recently joined tax groups.

[3] Expected passage in May.

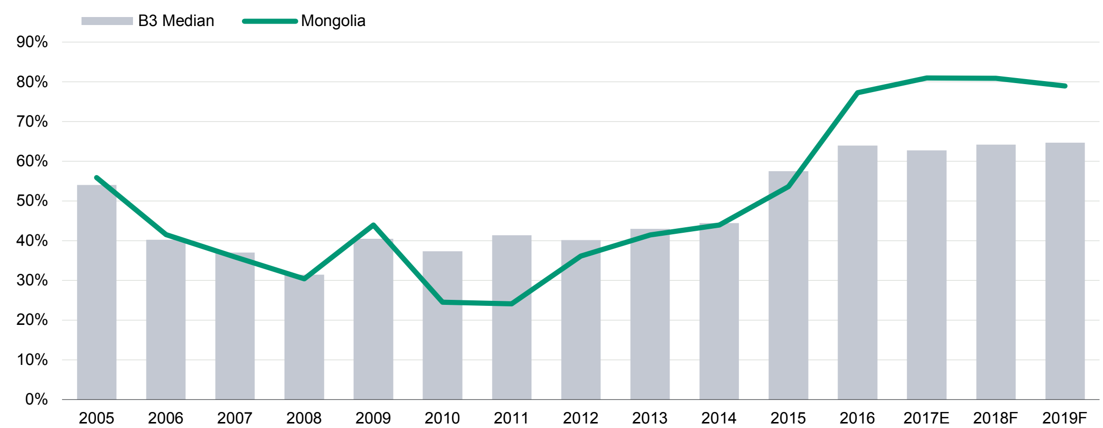
[4] Can be accommodated, particularly if there is a recapitalization law to address systemic banks.

Source: International Monetary Fund

In addition, three fiscal measures that aim to enhance Mongolia's fiscal sustainability were reversed during the third review: the programmed introduction of progressivity in the personal income tax, eliminating an excise tax on two popular fuel types, and rejecting a call for a gradual increase in the minimum retirement age.

These reversals reflect the political challenges associated with pushing through difficult reforms, and will come at a fiscal cost. The reversal of the former two fiscal measures would come at a loss of government revenue worth 0.4% of GDP, according to the IMF, while the withdrawal of the planned increase in retirement age would leave less revenue for other priorities or require more fiscal borrowing in the future to meet the obligations in the pension system. Although deficit reduction in 2017 was substantial, backtracking on these measures undermines fiscal sustainability and debt consolidation. At 81% of GDP in 2017, Mongolia's government debt is higher than the 62.7% median for B3-rated sovereigns (see Exhibit 2). Such potential limits to further deficit reduction suggest that it will continue to pose a credit challenge.

EXHIBIT 2
Mongolia's government debt-to-GDP ratio is higher than the median for B3-rated sovereigns



Sources: Mongolian Ministry of Finance and Moody's Investors Service estimates

In addition, a less favorable macroeconomic environment would likely challenge adherence to such reforms. Coal exports accounted for 36.6% of Mongolia's total exports in 2017 and weakening support from higher coal prices, coupled with falling volume owing to a high base effect and ongoing bottlenecks at the border with China present risks to gains made on the external position last year. Mineral export growth turned negative at the start of this year, led by coal exports, which slumped by 25% year on year in January and February combined.

Over the next five years, Mongolia's growth outlook rests critically on the continuation of the Oyu Tolgoi copper mine and the expansion of the Tavan Tolgoi coal project. Recent tax disputes, corruption investigations and the cancellation of a power sector agreement between the government and Oyu Tolgoi will weigh on growth if they weaken investor confidence or affect scheduled production from the second phase of Oyu Tolgoi mine in 2022.

William Foster
Vice President - Senior Credit Officer
+1.212.553.4741
william.foster@moodys.com

Amelia Tan
Associate Analyst
+65.6398.8323
amelia.tan@moodys.com

Matthew Circosta
Analyst
+65.6398.8324
matthew.circosta@moodys.com

Sri Lanka's new Inland Revenue Act supports government revenue generation, a credit positive

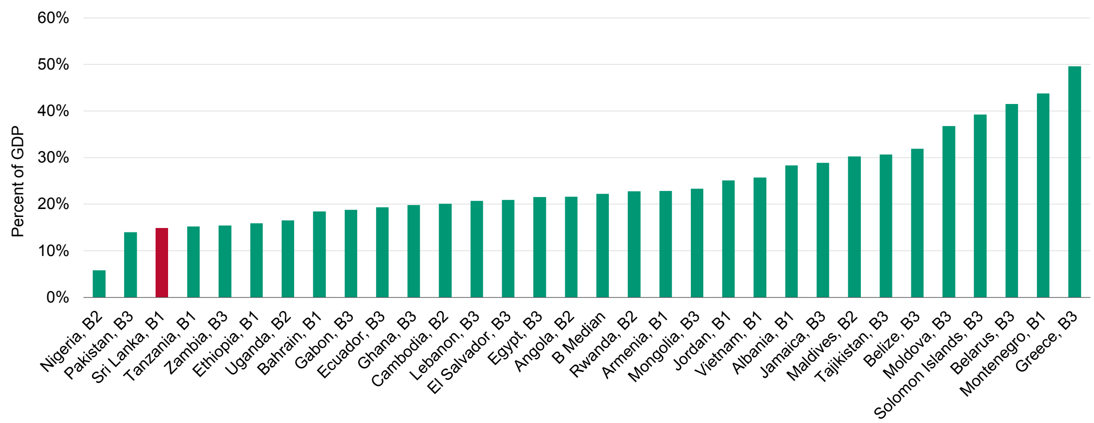
On 1 April, the Government of Sri Lanka's (B1 negative) new Inland Revenue Act took effect. The new act, which builds on international best practices, will rationalize the existing income tax structure and help broaden the income tax base by removing exemptions, a credit positive.

With a very large debt burden and weak debt affordability weighing on its credit profile, successful implementation of revenue reforms will help foster fiscal consolidation. Sri Lanka is currently in an International Monetary Fund (IMF) program in which reforms that contribute to fiscal consolidation are central to meeting IMF program targets.

The government expects the removal of tax exemptions and the introduction of new taxes, including a capital gains tax, to increase government revenue by 0.5% of GDP in 2019 following its first full year of implementation. We consider this target to be achievable. In addition, tax revenue will be strengthened by improved administration through the rollout of Sri Lanka's new technology systems and value-added tax compliance strategies.

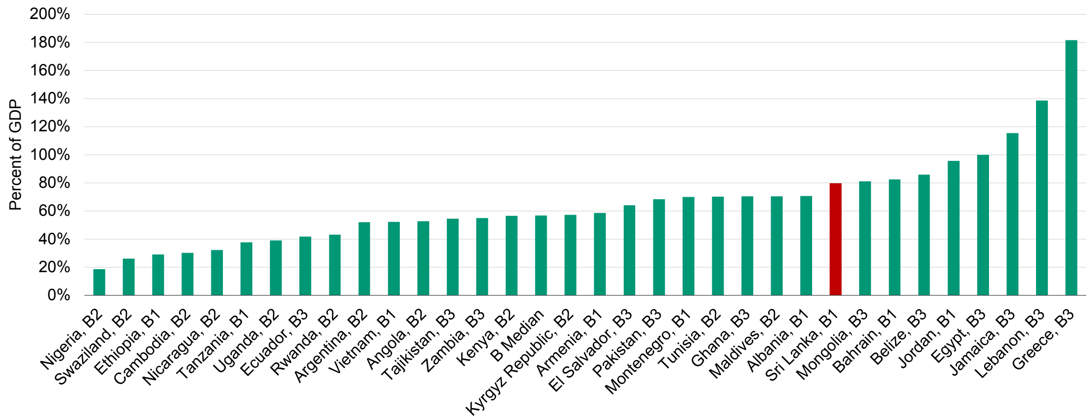
We expect that these measures will strengthen Sri Lanka's fiscal metrics, which are weak compared with many similarly rated sovereigns. In particular, Sri Lanka's government revenue as a share of GDP is lower than many peers, while the government debt-to-GDP ratio is much higher, weighing on its sovereign credit profile (see Exhibits 1 and 2).

EXHIBIT 1
Sri Lanka's government revenue is lower than its peers
General government revenue-to-GDP ratio for 2017



Source: Moody's Investors Service

EXHIBIT 2
Sri Lanka's debt burden is higher than its peers
General government debt-to-GDP ratio for 2017



Source: Moody's Investors Service

We expect government revenue to rise 0.4 percentage point to 15.2% of GDP in 2018 and increase a further 0.8 percentage point to 16% of GDP in 2019. Meanwhile, we expect government expenditures to remain flat at 20% of GDP. As a result, we forecast the fiscal deficit to narrow to 4.8% of GDP this year and shrink to 4.0% of GDP in 2019, from 5.2% in 2017.

Along with the Inland Revenue Act, Sri Lanka will introduce a new Taxpayer Identification Number system. In conjunction with an automation of tax administrative efforts, such initiatives will help to raise tax compliance, broaden the current narrow tax base and improve the composition of the revenue base by raising the share of direct taxes. The government aims to raise the proportion of direct taxes to 40% of total revenue over what the government describes as the medium term from 20% currently.

We expect the cumulative revenue gains from the Inland Revenue Act and other revenue-enhancing measures, along with improved tax administration, to gradually reduce Sri Lanka's debt burden to about 74% by 2021 from 79.3% of GDP in 2017. Still, government debt will remain well above the median of about 55% of GDP for B-rated sovereigns and will remain high for an economy of Sri Lanka's size and income level.

A sustainable rebound in real GDP growth will be essential to help support future revenue gains. We expect real GDP to grow about 4.7% in 2018, up from 3.1% in 2017, which was one of the weakest years on record because bad weather hindered agricultural output. As weather conditions normalize, a rebound in agriculture production and exports will boost growth this year. Stronger growth and higher revenue are key for Sri Lanka to sustainably reduce its government deficit to its target of 3.5% of GDP by 2020.

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EDITORS

Jay Sherman and Elisa Herr

SENIOR PRODUCTION ASSOCIATE

Amanda Kissoon

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