

Rating Action: Moody's upgrades issuer rating of Belgrade to Ba3; outlook stable

Global Credit Research - 20 Mar 2017

London, 20 March 2017 -- Moody's Public Sector Europe (MPSE) has today upgraded the City of Belgrade's long-term issuer rating to Ba3 from B1; the rating's outlook has been changed to stable from positive.

The rating upgrade and the change in outlook follow similar actions on Serbia's government bond rating on 17 March 2017. For full details, please refer to the sovereign press release:

https://www.moodys.com/research/Moodys-upgrades-Serbias-issuer-rating-to-Ba3-stable-outlook--PR_363440.

RATINGS RATIONALE

Today's rating action reflects the improving operating environment of Serbia, as reflected by the upgrade on the sovereign rating. The rating action also reflects Moody's view that the creditworthiness of the City of Belgrade is closely linked to that of the sovereign, as Serbian local governments depend on revenues that are linked to the sovereign's macroeconomic and fiscal performance.

Institutional framework makes the local governments co-dependent on the condition of the central budget. In Serbia, half of local governments' operating revenue is derived from shared taxes (mostly personal income tax) collected within their jurisdiction, but is administratively controlled by the central government.

The rating of Belgrade is underpinned by its sound fiscal performances, with double-digit operating surpluses averaging at 15% of operating revenue over the last five years. Moody's expects that the resilient national economic growth and favourable medium-term prospects will translate into rising receipts from shared taxes and own-source revenues and thus contribute to an improved credit profile. Thus far Belgrade has the greatest capacity among Serbian cities to generate own-source revenues, accounting for additional 45% of its operating revenue.

Belgrade's rating also takes into account the city's strategic role in the national economy. The larger and more dynamic economic base of Belgrade gives it a budgetary advantage over its peers. Belgrade is the country's largest economic hub, accounting for about 39% of national GDP and the city's relative affluence is evident in its GDP per capita, which is 70% above the national average.

The City of Belgrade's rating remains constrained by relatively higher debt than that of the peers, although the city's net direct and indirect debt levels declined to 64% of operating revenue at year-end 2016 from 85% in 2015. However, Moody's regards Belgrade's debt burden as manageable and expects its debt service to remain at below 10% of total revenue in 2017-18. Moody's assumption reflects the city's favourable direct debt maturity profile, which comprises long-term amortising loans.

RATIONALE FOR STABLE OUTLOOK

The stable outlook on the rating reflects the stable outlook on the sovereign rating. It also takes into account Moody's expectations of continued improvement of financial performances of the City of Belgrade, its adequate liquidity position, and declining and manageable debt burden.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Any upgrade in the sovereign rating would lead to upward pressure on Belgrade's rating. Moreover, any improvement in the local governments' expenditure flexibility and ability to raise additional own source revenues would be considered positively.

Any deterioration in Serbia's rating would likely lead to a downgrade of Belgrade's rating, as well as any sustained and significant financial deterioration driven by systemic or individual factors or unexpected sharp increase in debt.

The sovereign action required the publication of this credit rating actions on a date that deviates from the previously scheduled release date in the sovereign release calendar, published on www.moodys.com.

The specific economic indicators, as required by EU regulation, are not available for this entity. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: Serbia, Government of

GDP per capita (PPP basis, US\$): 13,699 (2015 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 2.8% (2016 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 1.5% (2016 Actual)

Gen. Gov. Financial Balance/GDP: -1.4% (2016 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -4% (2016 Actual) (also known as External Balance)

External debt/GDP: 78.4% (2015 Actual)

Level of economic development: Moderate level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

SUMMARY OF MINUTES FROM RATING COMMITTEE

On 16 March 2017, a rating committee was called to discuss the rating of the Belgrade, City of. The main points raised during the discussion were: The systemic risk in which the issuer operates has materially decreased.

The principal methodology used in these ratings was Regional and Local Governments published in January 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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