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Puerto Rico gets good marks from S&P for fiscal and economic progress

Standard & Poor's gives Island's credit its first upgrade in 28 years;
Business Monitor International improves its economic forecast for Puerto Rico

San Juan, P.R. – In what constitutes yet another endorsement of the Government of Puerto Rico's management of its fiscal and economic agenda during the last two years, credit rating agency Standard & Poor's just upped its rating for Puerto Rico's general obligation debt improving it from BBB- to BBB, Governor Luis Fortuño and his economic and fiscal team announced today.

This is the first upgrade S&P gives Puerto Rico's credit in 28 years.

"In our opinion, Puerto Rico continues to face significant fiscal and economic challenges. However, in the two years since his inauguration, the administration of Gov. Fortuño has made fiscal stability a priority...The fiscal measures adopted by the Fortuño administration, represent, in our opinion, a factor that lends near-term stability to the credit of the commonwealth, and that could yield the projected results by fiscal 2013 if the economy stabilizes and expenditure discipline is maintained," states S&P in its report issued today.

"Good news and good marks. That's what we continue to receive. First it was Moody's, then S&P who changed its perspective to "positive" last November—although it didn't give us an upgrade at the time—then Fitch, and now, again, S&P, but this time it gives us the upgrade. These are independent firms of expert financial analysts. They have nothing to do with each other and do not respond to the Government of Puerto Rico...and the three have said essentially the same thing: Puerto Rico has accomplished great progress straightening its finances and has a concrete and reliable plan to complete the work ahead, and it deserves the recognition for the improvement we've achieved in the way we're managing our finances and the economy. This is important for all Puerto Ricans because having a better credit rating allows us to save money—$150 million over the life of the bonds—that we can then put into other priorities such as health, education, and fighting crime. It's that simple," explained the Governor.

Fortuño remarked on the fact that the decision of the important rating agency was the result of a meeting it held last Thursday with the government's fiscal team, led by Chief of Staff Marcos Rodríguez-Ema, outgoing Government Development Bank president Carlos García and new GDB president Juan Carlos Batlle and which included the outgoing GDB Executive Vice President for Finance and Treasury Fernando Batlle, the new Executive Vice President for Finance José Otero Freiría, the new Treasury Secretary Jesús Méndez and the new Director of the Office of Management and Budget Juan Carlos Pavía, and in which Fortuño himself participated by phone.

"For those who evaluate our credit, just the same as for all Puerto Ricans, the stability of our fiscal policy is very important. So we went to deliver a very clear message: we are about to complete a very orderly transition of some of the members of our team, but the team itself has not changed, because it continues to be led by the Governor of Puerto Rico and the fiscal and economic initiatives that he has established. And those initiatives not only have cleared Puerto Rico of all but certain bankruptcy—thus protecting tens of thousands of jobs, as well as the value of the homes, IRA accounts and other savings of every Puerto Rican—but it has restored Puerto Rico's trustworthiness before the rest of the world. That was the message we delivered, and here's their answer: a strong pat in the back in recognition of the progress made by this Administration and a credit upgrade," García said.

Between 2001 and 2007, due to the foul management and the continued erosion of the government's fiscal situation during those years, S&P took 6 negative actions against Puerto Rico's credit: from A which Puerto Rico enjoyed in 2000 to BBB- in 2007, the lowest level before being rated as "junk", the industry term given to credit obligations considered non-investment grade.

However, last November, S&P changed now to "positive" its outlook on the island's credit in the wake of 22 months of efforts on the part of the current Administration to stabilize and restructure its fiscal situation threatened by an inherited budget deficit of $3.3 billion—or 43% of the state's revenues—that pushed Puerto Rico's credit to the brink of bankruptcy. As a result of the Administration's fiscal stabilization and restructuring plan, that deficit has been reduced to only 11% of revenues and will be completely wiped out by 2013.

In its report, S&P states that the three main factors that support its rating of Puerto Rico's credit are (1) the island's economy's strong ties to the U.S. economy; (2) the support from the GDB "which in our view provides a stabilizing financial and management influence;" and (3) "[t]he current administration's commitment to restore fiscal balance and economic growth and the progress made to date, which has required the passage and implementation of what we view as difficult and sometimes politically unpopular measures," the report states verbatim.

In its report, S&P specifically endorsed the measures adopted by the government to rein in expenses and enhance revenue. "The rating action is based on the commonwealth's recent revenue performance and continued efforts to achieve fiscal and budgetary balance. We believe that the collections from the recently enacted excise tax...will provide the commonwealth with additional flexibility to continue to narrow the budget gap and achieve structurally balanced budgets in the next two years," states the S&P report.

In its report, S&P also gives the current Administration's fiscal team a pat in the back stating that "[i]n our opinion, the commonwealth's budget management framework has improved over the past two years," and raising the score given for performance under its "the "fiscal management" criterion.

"It is very telling that, in its report, S&P admits that the objective criteria they use for evaluating the credit yield an A- rating for Puerto Rico. However, their methodology contains a series of overriding factors that may result in knocking the rating down one or more notches. In our case, they don't give us the rating that we could have due to two main overriding factors: one is the level of unfunded pension liabilities and the other one the fact that Puerto Rico does not have the tools that the other states do," Batlle explained.

"Based on our criteria, an overall score of 3.0 [which Puerto Rico gets] is associated with an indicative credit level of 'A-'... In the case of the Commonwealth of Puerto Rico we view its system support score and level of unfunded pension liabilities as overriding factors that result in a rating of two notches below its indicative credit level," reads the S&P report.

In explaining the meaning of "system support", the report states verbatim "[i]n our view, Puerto Rico shares many of the attributes that govern the fiscal and policy relationship of the 50 U.S. States and the federal government. However, we believe that Puerto Rico's relatively limited ability to influence federal legislation through the means available to all U.S. states results in a system support framework slightly weaker than the one governing the 50 U.S. states."

In the report, S&P establishes that the outlook on Puerto Rico's credit is stable and enumerates the factors that could result in another credit upgrade in the near future, as well as the factors that could result in downgrade.

"The stable outlook is based on our view of the commonwealth's recent implementation of significant expenditure controls and revenue enhancement measures that we believe could help restore structural budget balance within the next two years. Standard & Poor's could raise the rating if over the upcoming two years in conjunction with an improvement in the commonwealth's economic performance, budget controls remain in place and we believe there is continued progress toward achieving balance between ongoing revenues and expenditures as well as in addressing its unfunded retirement benefit obligations. The rating's upward mobility will be limited if the effectiveness of the recently approved tax and budget measures is impeded by either continued economic deterioration or a loosening of the expenditure discipline exhibited to date, and the commonwealth fails to make progress toward addressing its unfunded retirement obligations in the next two years," states S&P in its report.

"The message couldn't be clearer," Batlle concluded.

In April 2010, rating agency Moody's had acknowledged the progress of the Administration's fiscal stabilization plan when it upgraded Puerto Rico's credit rating from Baa3—the level right before junk—to A3. Although one notch in the upgrade was the result of an overall recalibration of Moody's rating scales, the rating agency upped Puerto Rico 3 notches in recognition of the progress being made in managing the island fiscal situation.

Last January, Fitch Ratings—which previously did not rate Puerto Rico's GOs—gave them a BBB+ rating, very close to Moody's.

Improved economic forecast

Fortuño also welcomed the most recent report on Puerto Rico by Business Monitor International ("BMI"), an independent economic forecast and analysis organization that evaluates parameters of competitiveness and performance of some 175 economies around the world.

In its report issued February 22, BMI reviewed its forecast for average annual economic growth for Puerto Rico for the next 5 years from 0.9% to 1.7%.

"We are turning cautiously optimistic about the future for island's economy, which has been mired in recession for over four years. Drastic measures designed to improve the territory's business environment could attract considerable amounts of FDI (foreign direct investment), providing a much-needed boost to economic growth over the long term, although the territory still faces considerable challenges," states BMI in its report.

"In its report, BMI highlights our Public-Private Partnership initiative, our Permits Reform, our Tax Reform and the improvements to infrastructure financed under the Local Economic Stimulus Plan as the initiatives that will have greater impact in improving our economy's competitiveness in order to attract foreign direct investment in the areas of manufacturing, tourism and construction," said Secretary of Economic Development and Commerce José R. Pérez-Riera who recently held a meeting with BMI's technical team to brief them on the initiatives implemented by the Administration under its Strategic Model for a New Economy to improve the competitiveness of Puerto Rico's economy.

"The administration's ambitious plans combined with more positive economic data in recent months have encouraged us to revise up our real GNP growth forecasts modestly, and we are now penicillin in average real GNP growth of 1.7% over the next five years, from 0.9% previously," states the BMI report.

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