Research Update:

Balearic Islands Outlook Revised To Positive From Stable; Rating Affirmed At 'A-'

May 9, 2025

Overview

- Our forecasts indicate that the Balearic Islands will achieve further revenue growth, supported by ongoing, but slower, economic growth.
- We expect careful financial management by the Spanish region to contain growth in operating spending and that investments will, essentially, be funded from EU and central government funds in the coming years.
- Therefore, we anticipate that budgetary performance will remain sound and debt will continue to slowly trend down over our three-year forecast horizon.
- As a result, we revised to positive from stable the outlook on our 'A-' long-term foreign and local currency ratings on the Balearic Islands, and affirmed the ratings.

Rating Action

On May 9, 2025, S&P Global Ratings revised to positive from stable its outlook on the Autonomous Community of the Balearic Islands (Baleares). At the same time, we affirmed our 'A-' long-term issuer credit ratings on the Spanish region.

Outlook

The positive outlook reflects the possibility that Baleares could post stronger revenue growth, which would enable it to reduce its debt faster, all else being equal.

Downside scenario

We could revise the outlook back to stable if the region's performance did not exceed our current base-case scenario, and debt continued to reduce only gradually.

PRIMARY CREDIT ANALYST

Mariamena Ruggiero
Milan
+ 390272111262
mariamena.ruggiero
@spglobal.com

SECONDARY CONTACTS

Marta Saenz
Madrid
+ 34 91 788 7231
marta.saenz
@spglobal.com

Alejandro Rodriguez Anglada
Madrid
+ 34 91 788 7233
alejandro.rodriguez.anglada
@spglobal.com

ADDITIONAL CONTACTS

Manuel Becerra
Madrid
+34 914233220
manuel.becerra
@spglobal.com

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Upside scenario

We could consider raising the rating on Baleares if it outperformed our current base-case scenario and so was able to reduce leverage more quickly. We could also raise the rating if Spain's central government implements the debt relief measures it has announced and these help the region to reduce its debt burden by a substantial amount.

Rationale

Although Baleares' debt is still high by international standards, it has clearly been trending downward in recent years. We attribute this positive development to robust growth in operating revenue over the past few years, which we link to the region's robust economic growth and to the availability of funds from the EU's Recovery and Resilience Facility (RRF). RRF funds have benefited Spain and its regions since 2020. Although we predict that revenue growth will slow down from 2025, we expect the region's management to succeed in curtailing operating spending. This will enable Baleares to maintain favorable budgetary metrics and keep reducing its debt, albeit slowly.

Baleares' economy is expected to perform at least in line with that of Spain as it focuses on maintaining balanced budgets, despite slower revenue growth

In our view, the region's economy will continue to match or slightly exceed the national average, bolstered by exceptionally high revenue from tourism. Growing demand for hospitality on the islands has supported and helped to develop Baleares' economy, which is concentrated on the tourist sector. Although we anticipate that this sector will continue to perform well, capacity constraints, combined with the general economic slowdown in Europe, are likely to weigh on growth.

Indeed, there is a risk that international trade tensions could reduce income in the countries that typically generate Baleares' tourism inflows, which could trigger a decline in tourism to the region. Nevertheless, S&P Global Ratings forecasts that Spain's real GDP growth will reach approximately 2.6% by the end of 2025, outperforming the European average of 0.8%. For 2026, we predict economic growth of 1.9% in Spain.

In our view, Baleares has a prudent and experienced management team. Nevertheless, the region saw a sharp rise in operating expenditure over the past two years, with an average annual increase of 10%. Most of this increase comprised one-off costs linked to court judgements, including personnel-related costs. Now that these payments have been honored, we expect the growth in operating expenditure to decelerate in line with the slowdown in revenue growth. This will enable the region to continue to cut its debt.

The RRF will cease in 2026. However, Baleares will continue to benefit from a special fiscal regime that supports certain of its investments between 2023 and 2028. The central government agreed in 2022 to provide a direct transfer (Factor de Insularidad) to compensate Baleares for its investment in transport and infrastructure projects. The regime also includes benefits affecting the corporate tax on foreign direct investments and deductions to personal income tax for nonresidents.

Spanish autonomous communities, including Baleares, operate within a supportive institutional framework that provided them with extraordinary funds to cover increased costs during the

pandemic and has given them access to central government liquidity sources since 2012. That said, most regional revenue is delivered in the form of advances from the regional financing system. Because no central government budget was approved in 2024 and none has yet been approved in 2025, the updating of the advances due to Spanish regions was delayed, making budgeting more difficult for them. Nevertheless, advances were ultimately updated in 2024, and we expect the same to happen in 2025.

The Spanish central government has given details of its proposal to write off part of the debt incurred by normal status regions (see "Bulletin: Spanish State Lays Out Proposal For Regional Debt Absorption," published on Feb. 26, 2025, on RatingsDirect). The reason given for offering to absorb this debt is that the central government provided insufficient funding to these regions during 2010-2013, because of the great financial crisis. The government's proposal will be submitted to the Spanish parliament for approval as an organic law, which requires an absolute majority. Given the current fragmentation in the Spanish parliament, we do not regard this approval as guaranteed. If approved as law, the regions would then individually decide whether to accept the absorption of their debt. Under the current proposal, accepting the measure could enable Baleares to reduce its debt by €1.7 billion, equivalent to about 30% of its 2024 operating revenue, and would also offer interest cost savings, although these have yet to be quantified.

The proposal is proving to be politically controversial. It is therefore unclear whether the measure will ultimately pass, or when each region would feel the impact. We understand that the timing would depend on the debt structure and amortization calendar of each region.

Deficits are mostly being funded from earmarked cash, which will limit debt intake over 2025-2027

Our forecasts indicate that Baleares will preserve operating margins at a sound level, primarily by limiting growth in operating expenditure. Specifically, we anticipate that operating margins will hover at about 7% of operating revenue over 2025-2027. In addition, we forecast that revenue from the financing system will grow by only 0.2% in 2025, after reaching record highs in 2024 (19%) and 2023 (23%). Thereafter, revenue growth is predicted to be roughly in line with nominal GDP growth.

The regional government has enacted several tax reduction measures, including cuts to personal income tax, real estate transaction taxes, and inheritance taxes. That said, we do not consider that these will have a significant impact on revenue growth. Revenue from the financing system has a far greater effect on the growth trajectory and accounts for most of Baleares' revenue.

From 2025 on, as Baleares executes its remaining investments supported by the EU's RFF, we anticipate that it will see some budgetary deficits after capital accounts. The revenue and transfers from the RRF totaled about €1.1 billion and most of these were accrued and collected in previous years, beginning in 2020. We forecast that over the period to end-2027, as the impact of the RRF-funded projects diminishes, the corresponding deficits will narrow. Although debt ratios remain high compared with international peers, we expect they will continue to decrease because most of the deficits for 2025 and 2026 will be funded using earmarked cash--that is, the RRF funds previously collected by the region.

We anticipate a strengthening of Baleares's liquidity position. The region currently benefits from high cash levels, thanks to the earmarked RRF funds it has yet to spend. As expenses related to RRF-supported projects are executed, we expect the region's cash levels to diminish. Nevertheless, we anticipate that the €685 million it has in largely unused credit lines, plus its available cash, will comfortably exceed annual debt service after 2026. Baleares continues to

benefit from access to central government-sponsored credit liquidity facilities to cover its funding needs.

Key Statistics

Table 1

The Autonomous Community of Balearic Islands--Selected Indicators

	--Fiscal year ends Dec. 31--					
(Mil. €)	**2022**	**2023**	**2024**	**2025bc**	**2026bc**	**2027bc**
Operating revenue	4,622	5,268	5,883	5,914	6,119	6,294
Operating expenditure	4,431	4,828	5,323	5,504	5,667	5,827
Operating balance	192	440	560	410	452	466
Operating balance (% of operating revenue)	4	8	10	7	7	7
Capital revenue	701	433	351	322	232	204
Capital expenditure	621	831	890	967	704	673
Balance after capital accounts	271	43	21	(235)	(19)	(3)
Balance after capital accounts (% of total revenue)	5	1	0	(4)	(0)	(0)
Debt repaid	1,180	1,153	923	868	834	845
Gross borrowings	1,102	920	838	890	676	848
Balance after borrowings	193	(190)	(64)	(213)	(178)	(0)
Direct debt (outstanding at year-end)	8,656	8,405	8,295	8,317	8,159	8,162
Direct debt (% of operating revenue)	187	160	141	141	133	130
Tax-supported debt (outstanding at year-end)	9,075	8,755	8,581	8,580	8,398	8,376
Tax-supported debt (% of consolidated operating revenue)	193	164	144	143	135	131
Interest (% of operating revenue)	1	1	2	2	2	2
Local GDP per capita (single units)	30,997	34,381	N/A	N/A	N/A	N/A
National GDP per capita (single units)	28,927	31,160	32,736	33,952	34,974	35,921

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable.

Ratings Score Snapshot

Table 2

The Autonomous Community of Balearic Islands--Ratings Score Snapshot

Key rating factors	**Scores**
Institutional framework	3

Table 2

The Autonomous Community of Balearic Islands--Ratings Score Snapshot (cont.)

Key rating factors	Scores
Economy	2
Financial management	3
Budgetary performance	2
Liquidity	2
Debt burden	4
Stand-alone credit profile	a-
Issuer credit rating	A-

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, April 10, 2025. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Macro Update: Seismic Shift In U.S. Trade Policy Will Slow World Growth, May 1, 2025
- Spanish Regions Brief: After A Strong 2024, Tailwinds Will Fade, April 10, 2025
- "Liberation Day" Tariff Announcements: First Take On What It Means For U.S. And Global Outlook, April 3, 2025
- Economic Outlook Eurozone Q2 2025: A World In Limbo, March 25, 2025
- Bulletin: Spanish State Lays Out Proposal For Regional Debt Absorption, Feb. 26, 2025
- Subnational Government Outlook 2025: Spain--Debt Ratios Are Reducing As Revenue Rises, Jan. 16, 2025
- Local And Regional Government Outlook 2025: For Spanish Regions, Budgetary Improvement Will Need Regional Restraint Or Government Action, Jan. 16, 2025

- Economic Outlook Eurozone Q1 2025: Next Year Will Be A Game Changer, Nov. 26, 2024

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Balearic Islands (Autonomous Community of) (The)		
Issuer Credit Rating	A-/Positive/--	A-/Stable/--
Ratings Affirmed		
Balearic Islands (Autonomous Community of) (The)		
Senior Unsecured	A-	