

Credit Opinion: Victoria (State of) Australia

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Australia

Ratings

Category	Moody's Rating
Treasury Corporation of Victoria	
Outlook	Stable
Bkd Issuer Rating	Aaa
Bkd Senior Secured -Dom Curr	Aaa
Bkd Bonds -Dom Curr	Aaa
Commercial Paper	P-1

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Key Indicators

Victoria (State of) Australia (As at June 30)	2001	2002	2003	2004	2005	2006
Net Direct and Guaranteed Debt/Total Revenue (%)	45.0	36.8	38.5	39.5	42.4	41.6
Net Direct and Guaranteed Debt/GDP (%)	6.2	5.1	5.3	5.3	5.7	5.7
Cash Financing Surplus (Requirement)/Total Revenue (%)	2.8	5.4	0.2	0.8	1.9	0.4
Gross Operating Balance/Total Revenue (%)	8.7	10.1	9.7	7.2	6.5	6.6
Interest Payments/Total Revenue (%)	2.0	1.7	1.8	1.9	1.4	1.4
Intergovernmental Transfers/Total Revenue (%)	41.4	44.1	42.5	44.3	45.1	45.7
Real Gross State Product growth (% change)	1.5	4.0	2.6	5.2	2.4	2.7

Opinion

Credit Strengths

Victoria's credit strengths include:

- Sound operating environment
- Well-established institutional framework, providing fiscal flexibility
- Low debt burden
- Strong financial performance supported by prudent fiscal management and revenue growth
- Diverse economic base

Credit Challenges

Victoria's credit challenges include:

- Potential for slower revenue growth

--Higher capital spending levels likely to lead to increased borrowing

Rating Rationale

The ratings assigned to Victoria reflect the application of Moody's Joint Default Analysis rating methodology for regional and local governments, including these inputs: (1) Baseline Credit Assessment (BCA) of 1 on a scale of 1 to 21, where 1 represents the lowest credit risk; (2) Aaa local currency rating of the Commonwealth of Australia; (3) 70% default dependence (degree to which Victoria's and Australia's default risks are correlated); (4) 80% likelihood that the commonwealth government would act to prevent a default by the state.

The BCA of 1 reflects the following factors:

Typical of advanced industrial economies, Australia's operating environment is characterized by high GDP per capita, low GDP volatility and a high ranking on the World Bank's Government Effectiveness Index, suggesting a low level of systemic risk. This, combined with a well-established institutional framework that provides the Australian states and territories with policy flexibility over own source revenues and discretion over expenditure decisions, supports the BCA.

Victoria's BCA is also supported by a sound record of fiscal performance underpinned by the state's prudent fiscal practices and strength in tax revenues. Over the past seven years the general government sector has produced surpluses in most years which have averaged about 2% of revenues. A minor deficit emerged in 2005/06 to reflect increased capital spending. Less favorable results for the consolidated government sector--average surpluses of just below 1% of revenues and a deficit of -3.4% of revenues in 2005/06--reflect greater capital investments by public corporations.

The state's modest debt burden reflects positive cash operations and the application to debt reduction of proceeds from a vast privatization of state electricity corporations in the 1990s. Substantial financial assets held in liquid investments provide an ample cushion for debt obligations.

Victoria's sizable and diversified economic base amply supports its financial obligations. Over the past decade the state has grown at a pace similar to Australia's. Population gains spurred by international migration contribute to growth. This year a serious drought will likely detract from expansion, but is expected to be partially offset by a strengthening in consumer demand supported by strong labor force trends and recovery in exports.

The strong financial support provided by the Commonwealth government through fiscal transfers to all states is also a key factor in Victoria's ratings

Default dependence of 70% reflects the joint exposure of the economies of the state and commonwealth governments to national economic trends, as well as a medium level of fiscal transfers from the commonwealth government.

A likelihood of extraordinary support of 80% from the commonwealth government to enable the state to avoid a default reflects Moody's assessment of the incentive provided by the risk to the federal government's reputation if Victoria were to default, as well as indications of support stemming from the strong system of commonwealth-state transfers.

Rating Outlook

The stable outlook reflects Moody's assessment that the state's strong financial profile and low debt burden position it well to absorb financing deficits (net borrowing result) expected as the state increases capital spending, and an associated increase in the debt burden anticipated over the medium term. The 2006/07 budget indicates that the state's general government sector is expected to incur moderate average deficits of -2.5% over the medium term, while the non-financial public sector is projected to register average deficits equal to -5.6% of revenues. The recent budget update indicates that the state is generally in line to meet these targets as a significant portion of the increased capital spending commitments made during last year's election campaign are expected to be absorbed by unallocated capital spending.

What Could Change the Rating - Down

An unlikely scenario combining a severe decline in the housing market and economic recession along with a significant change in the government's prudent fiscal policies that would lead to a rapid accumulation of debt, could have an adverse impact on the rating.

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