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Research Update:

Victoria 'AAA' Rating Affirmed; Outlook Stable

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Rationale

On Sept. 5, 2007, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' ratings on the Australian state of Victoria. The outlook is stable. The ratings on the state's central financing authority, Treasury Corp. of Victoria (TCV), which operates with the benefit of a state guarantee, have also been affirmed at 'AAA/A-1+' (see separate report on TCV, published on RatingsDirect, on Oct. 25, 2006).

Located in the southeast, Victoria is the second largest state in Australia. The state accounts for nearly 25% of Australia's output and, with about 5.2 million people, represents 25% of Australia's total population. The ratings on Victoria are supported by the state's strong balance sheet, diversified economy, ongoing fiscal discipline and strong system support.

Victoria's balance sheet is strong. This provides it with the flexibility to increase debt without jeopardizing the rating. While the state's current policy favors partial debt-funding of its capital program, Victoria's debt levels are expected to remain consistent with the rating. Even after factoring in the state's increased debt, Victoria's balance sheet, including its unfunded superannuation liabilities, is expected to remain strong.

The government's strong financial management is a credit strength as it is likely to provide ongoing financial stability. Victoria's good governance--including its adequate fiscal strategy and good financial transparency--is a credit strength. The government has consistently exceeded its fiscal commitment to an operating surplus of at least A\$100 million.

The state governs in a supportive financial environment. Australia's system support and the predictability of Commonwealth-state relations are among the strongest in the world, and are expected to remain so. In particular, Australia adopts a supportive system of fiscal equalization, which is administered by an independent commission, and which provides a buffer for the state against specific fiscal shocks. Similar to New South Wales and Western Australia, under this system Victoria receives less than its average per capita share of the goods and services tax (GST) pool.

The state has a well diversified economy, which means it is more resilient to any downturn in a particular sector. While the economy has not seen the large growth rates experienced by the resource states of Queensland (AAA/Stable/A-1+) and Western Australia (AAA/Stable/A-1+), its performance is largely in line with the national average. The state's forecast economic growth is expected to remain robust, and will be strengthened by the state's ongoing economic reform program, population growth, and high participation rates.

Limited fiscal flexibility is a credit weakness of the Australian states, including Victoria, but this has not impeded strong fiscal outcomes. Under the current institutional environment, the Commonwealth of Australia has control over most taxes, whereas the states assume most of the responsibilities for delivering services. Victoria relies on about 46% of its operating revenues

from the Commonwealth.

Short-term credit factors

Victoria's short-term rating is 'A-1+' and is supported by the state's strong liquidity. Victoria's short-term debt is more than offset by its liquid assets. At June 30, 2007, liquid assets were A\$4.7 billion and short-term liabilities were A\$2.1 billion.

Outlook

The stable outlook reflects the government's commitment to fiscal prudence. This includes a fiscal strategy which seeks to maintain an adequate operating performance and strong balance sheet.

Downward pressure may be placed on the rating in the event that the state ramps up its debt funded capital program beyond expectations or there is an appreciable deterioration in its operating performance. However, the state doesn't have the same infrastructure needs as some of the other states that have forecast larger capital programs. Furthermore, we believe that any fiscal weakening due to exogenous shocks would be transitory and that the government is likely to take the necessary actions to correct finances.

Ratings List

Ratings Affirmed

Victoria (State of)

Issuer Credit Rating	AAA/Stable/A-1+
Senior Secured	
Foreign Currency	AAA
Senior Unsecured	AAA
Commercial Paper	
Local Currency	A-1+

Victoria (Treasury Corp. of)

Issuer Credit Rating	AAA/Stable/A-1+
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