Article Title: ARCHIVE | Criteria | Corporates | General: Local and Foreign Currency Ratings Converge for EMU Issuers Data: Standard & Poor's revised its credit ratings for issuers within the European Monetary Union (EMU) on May 7. Local and foreign currency ratings have been equalized for the 11 sovereign governments forming EMU, as well as for other rated issuers—including sovereign-supported entities, regional and local governments, structured finance transactions, and managed funds (see Ratings News for rating and outlook changes affecting EMU sovereigns and other issuers). The rating actions followed the May 2 decision by European heads of state and government that 11 EU sovereigns will join the monetary union as founding members next year. These actions also are consistent with Standard & Poor's EMU ratings criteria outlined in 1996 (see Stronger-Rated Sovereigns Will Lead The Way Into EMU, CreditWeek, Nov. 13, 1996). Two years ago, Standard & Poor's indicated that it would no longer differentiate between local and foreign currency ratings once the timetable for monetary union and EMU's membership were assured. Given the political momentum behind EMU, and progress on economic and financial convergence, Standard & Poor's has adjusted its ratings in line with its expectation that monetary union will start on schedule in 1999. KEY CHANGES Convergence of local and foreign currency credit ratings for all EMU issuers. As before, local and foreign currency ratings of five EMU sovereigns are 'AAA' . Ratings of the six other sovereigns joining EMU in 1999 have converged at, or—in the Republic of Ireland's case—just above, their prior foreign currency ratings in the 'AA' category. Local and foreign currency ratings distinctions also no longer apply for other EMU-based issuers, and the ratings cover debt denominated in the euro, the common currency replacing local currencies issued by EMU member states. The current and previous long-term ratings and outlooks for the 11 sovereigns and other EMU issuers are shown in the table. Revised ratings (for Ireland) and outlooks (for Finland, Spain, and Italy) of some sovereigns reflect improvements in their underlying budgetary positions. The credit standing of the states forming EMU is very strong, but Standard & Poor's believes there still are significant differences among them. Economic and fiscal factors, already important, now are the dominant criteria for differentiating the credit quality of sovereigns inside EMU. Going forward, persistent budget deficits, in particular, could slow improvements in the ratings of some governments and lead to downward rating pressure on others. Ratings of other EMU-based issuers no longer constrained by sovereign credit risk. Because monetary and exchange rate policies will be formulated by the new European Central Bank (ECB), and Standard & Poor's regards the EMU area as a whole to be of secure 'AAA' credit quality, sovereign ratings no longer constrain the ratings of issuers in the region. Some Spanish mortgage-backed securities are rated 'AAA', for example, above the 'AA' rating of the sovereign. The same ratings apply to obligations of each EMU issuer regardless of the currency in which it is denominated. This includes debt denominated in local currencies of each member state, as well as in euro, the new common currency that will replace them, and in foreign currencies. Local and foreign currency rating distinctions no longer are appropriate for EMU issuers because member states are transferring monetary and exchange rate policy responsibilities to the independent ECB. In the past, the 'AAA' local currency ratings assigned to EU sovereigns with foreign currency ratings in the 'AA' category reflected these governments' control over their currencies and monetary systems. National monetary policy could be (and at times was) used as a tool to cushion local economic shocks, an option no longer available to sovereigns joining EMU. As a result, Standard & Poor's believes that the default risks on euro and foreign currency debt will be the same going forward. EMU Sovereign Long-Term Ratings and Outlooks CURRENT PREVIOUS EURO/LOCAL CURRENCY FOREIGN CURRENCY LOCAL CURRENCY FOREIGN CURRENCY Austria AAA/Stable AAA/Stable AAA/Stable AAA/Stable France AAA/Stable AAA/Stable AAA/Stable AAA/Stable Germany AAA/Stable AAA/Stable AAA/Stable AAA/Stable Luxembourg AAA/Stable AAA/Stable AAA/Stable AAA/Stable Netherlands AAA/Stable AAA/Stable AAA/Stable AAA/Stable Belgium AA+/Stable AA+/Stable AAA/Stable AA+/Stable Ireland AA+/Stable AA+/Stable AAA/Stable AA/Stable Finland AA/Positive AA/Positive AAA/Stable AA/Stable Spain AA/Positive AA/Positive AAA/Stable AA/Stable Italy AA/Stable AA/Stable AAA/Stable AA/Negative Portugal AA-/Positive AA-/Positive AAA/Stable AA-/Positive OTHER EMU ISSUERS' LONG-TERM RATINGS AND OUTLOOKS CURRENT PREVIOUS Country/issuer Euro/local currency Foreign currency Local currency Foreign currency Belgium Flanders (Community of) AA+/Stable AA+/Stable AAA/Stable AA+/Stable Societe Nationale des Chemins de Fer Belges AA+/Stable AA+/Stable

AAA/Stable AA+/Stable Finland Local Government Pensions Institution A/Stable A/Stable AAA/Stable AA/Stable Municipality Finance Ltd. A+/Stable A+/Stable AA+/Stable AA/Stable Italy Bologna (City of) AA/Stable AA/Stable AA+/Stable AA/Negative Portugal Metropolitano de Lisboa, E.P. AA-/Positive AA-/Positive AAA/Stable AA-/Positive Spain Autopistas del Atlantico Concesionaria Espanola S.A. (AUDASA) AA/Positive AA/Positive AA+/Stable AA/Stable Basque Country (Autonomous Community of) AA/Positive AA/Positive AA+/Stable AA/Stable Empresa Nacional de Autopistas S.A. (ENAUSA) AA/Positive AA/Positive AA+/Stable AA/Stable Instituto de Credito Oficial AA/Positive AA/Positive AAA/Stable AA/Stable Radio Televison Espanola (RTVE) AA/Positive AA/Positive AAA/Stable AA/Stable EMU POSITIVE FOR CREDITWORTHINESS Overall, Standard & Poor's views EMU, and the stress on fiscal performance and competitiveness it has generated, as being favorable for creditworthiness. Ratings and/or outlooks have improved for each of the 'AA' rated sovereigns, except Belgium, in recent years. As EMU sovereigns work toward sustaining the Maastricht convergence criteria, some of the six 'AA' rated sovereigns, three of which have positive outlooks, could see further improvements in their ratings. However, Standard & Poor's believes that rating all EMU sovereigns at 'AAA' now is not appropriate. Despite the policy commitments of member states, the fiscal and debt pressures they face and the flexibility each enjoys varies. The risk still is that some may falter in their resolve to maintain fiscal discipline, for many of the same economic and political reasons as in the past. The Maastricht targets are more readily achievable for the 'AAA' sovereigns, with their stronger fiscal profiles and generally more diversified economies, than for the 'AA' rated sovereigns. For Belgium and Italy, in particular, the route to sustainable convergence will be a long one. Cutting their public debt burdens to the 60% debt-to-GDP Maastricht criterion requires a decade or more of fiscal austerity. The path will be challenging, given persistent budgetary pressures and stubbornly high unemployment. EMU has no fiscal equalization system, as exists between regions in each member state; no provision for a "bail-out" of a sovereign, either by the ECB or other EMU members; and, at least in EMU's initial stages, little tolerance by the majority of member states for high fiscal deficits in the minority. With national governments no longer having privileged access to credit, the economic and political costs of fiscal slippage within EMU could well be higher than they were before monetary union.