

Research Update:

Peru Long-Term Foreign Currency Rating Lowered To 'BBB-' On Political Uncertainty Constraining Growth; Outlook Stable

April 25, 2024

Overview

- We expect a moderate economic recovery for Peru in 2024-2025 following the contraction in real GDP last year stemming from various shocks to growth.
- However, a fragmented Congress and limited political capital of the administration weigh on private-sector investment sentiment and pose an opportunity cost to growth, which constrains Peru's capacity to rebuild fiscal space.
- We lowered our long-term foreign currency sovereign credit rating on Peru to 'BBB-' from 'BBB'.
- The stable outlook incorporates our expectation of moderate growth and fiscal deficits that keep net general government debt inching higher, though we expect it to remain below 30% of GDP over the next three years.

Rating Action

On April 25, 2024, S&P Global Ratings lowered its long-term foreign currency sovereign credit rating on Peru to 'BBB-' from 'BBB' and its long-term local currency rating to 'BBB' from 'BBB+'. The outlook on our long-term ratings is stable. At the same time, we lowered the our short-term foreign currency sovereign credit rating to 'A-3' from 'A-2' and affirmed the short-term local currency credit rating at 'A-2'. We also lowered our transfer and convertibility assessment to 'BBB+' from 'A-'.

Outlook

The stable outlook incorporates our expectation of a moderate recovery in real GDP, while net general government debt continues to rise but remains below 30% of GDP over 2024-2027. We assume Peru's monetary policy credibility and strong external position will remain ratings strengths.

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Downside scenario

We could lower the ratings over the next two years if there is a pronounced shift in economic policy that precipitates further deterioration in investor sentiment and growth prospects. Lower growth could, in turn, put additional pressure on fiscal deficits and accelerate an increase in the debt burden.

Upside scenario

We could raise the ratings over the next two years if stable political conditions support effective policy execution that boosts investment and economic growth prospects. Under this scenario, we would also expect a moderately stable debt trajectory.

Rationale

We expect Peru's complex political landscape will persist in the run-up to the next presidential and Congressional elections. This in turn limits the government's capacity to implement more timely policies to boost the investment and economic growth outlook, in our view. Lingering political uncertainties pose an opportunity cost to growth despite favorable copper prices.

Moderate growth, especially in per capita terms, will limit improvement in Peru's socioeconomic conditions. Peru already has lower income levels than many regional and similarly rated peers. Subdued growth also limits the resiliency to weather new shocks.

Our sovereign credit ratings also incorporate Peru's limited fiscal and external imbalances and a still-low government debt burden, albeit with a more vulnerable composition compared to before the pandemic.

Institutional and economic profile: Weak government undermines a more robust growth outlook

- We believe that limited governability and political uncertainty reduce the predictability of policy, constraining investment and potential growth.
- We forecast a recovery with growth of 2.7% in 2024 due to subdued investment.
- Favorable copper prices and demand should contribute to growth in the medium term, but beyond that, growth will depend on sustaining investor confidence.

Very low popular support both for the executive and Congress, along with very high political fragmentation and lack of strong political parties in Peru, underscores the uncertainty of its political institutions. The lack of consensus at the political level continues to prevent policies aiming to rebuild important buffers lost to the pandemic and subsequent economic crises, such as pension savings and the increase on the government's debt burden (despite remaining at relatively low levels).

While still-strong economic institutions have been able to prevent a radical shift in policies despite the numerous presidential changes over the last six years, political uncertainty eroded business confidence and economic growth.

As a result, we expect only a gradual economic recovery following social and weather shocks in

2023 that led to an economic contraction of 0.6%. Our base case assumes growth of 2.7% in 2024 with subdued investment recovery. The dissipation of the El Niño phenomenon will allow for recovery in fishing, agriculture, and primary manufacturing, while lower inflation and interest rates will provide better conditions for consumption and investment.

We expect that metal prices will remain a favorable external factor for Peru, contributing to growth in the medium term. Copper prices remain above their long-term average. Despite swings in demand patterns, we believe current prices are close to minimums considering expected growth in renewables infrastructure, the electric vehicle industry, and cost inflation (see "S&P Global Ratings Makes Modest Changes To Metal Price Assumptions," Feb. 8, 2024).

Of note, the Chancay port, a US\$1.3 billion investment (in the first stage) expected to be concluded at the end of 2024, would be a new Latin American hub that, along with expected industrial developments, could be positive for trade and overall growth in the future. Improved complementary infrastructure will be needed to expand its relevance in the region more broadly, although this could move slowly. We expect GDP growth to trend to 3.1% in 2025-2027, with income per capita increasing to US\$8,700 by 2027, which is below that of similarly rated and regional peers.

Flexibility and performance profile: Some narrowing of the fiscal deficit will contain increases in the debt burden

- Fiscal deficits will gradually narrow as the economy recovers, although we believe spending will remain pressured.
- We expect Peru's external indicators to remain solid.
- Inflation should be back within the central bank's 1%-3% target range in 2024.

We expect the general government deficit will gradually narrow to roughly 2.0% of GDP by 2027, after increasing to 2.8% of GDP in 2023. This reflects a recovery in growth and tax revenues, plus the phasing out of extraordinary support related to the recent El Niño weather phenomenon and economic reactivation programs for around 1.4% of GDP. Moreover, higher copper prices will moderately sustain fiscal revenue above pre-pandemic levels. However, government spending is also likely to remain pressured because of demands for social spending and infrastructure.

S&P Global Ratings does not strictly consider countries' fiscal rules in our ratings. These, however, reflect institutional commitment toward fiscal prudence. Peru has a track record of fiscal responsibility across successive administrations. Nonetheless, we consider that lower-than-expected economic growth is a key risk for fiscal performance and the debt trend because contracting spending in such scenario could be hard to achieve.

To cover projected deficits, Peru will likely continue to rely on available liquid assets (estimated at 10% of GDP in 2023) as well as market issuance and loans from multilateral lending institutions. We expect net general government debt to increase to a still moderately low 25% of GDP by 2027, which is in line with our forecast for deficits and a moderate exchange rate depreciation (net general government debt was 11.6% before the pandemic). Interest payments are likely to hover at around 7% of revenue. About 87% of Peru's debt is at fixed rates and has an average maturity of 12 years, which limits the impact from tighter financing conditions.

High reliance on external markets during the early pandemic years raised the vulnerability of Peru's sovereign debt to negative shocks. The government is likely to continue to perform liability management operations to gradually revert the deterioration of its currency profile. Moreover, high U.S. interest rates and a gradual recovery in local pension funds' assets under management

have contributed to recent decreasing nonresident holdings. The most recently approved pension fund withdrawal, however, will be negative for local market financing.

Because of the magnitude of Peru's net general government debt and potential level of combined debt, contingent liability risks for Peru's fiscal and debt position we consider are limited. These include:

- The government's exposure to public-private partnership projects (estimated at about 1.6% of GDP);
- Reactiva Peru guarantees (with expected losses estimated at 0.7% of GDP by the government);
- International disputes regarding investment issues (2.2% of GDP), recently lowered after an international tribunal settled the amount to be paid by the Peruvian government for certain agrarian bonds (issued in the 1970s during a land expropriation program) at US\$100 million; and
- Potential additional support to state-owned oil company Petroperú following support measures for 0.7% of GDP in 2022, including a US\$1 billion capital injection and a loan from the Treasury for US\$750 million that has been rolled over. The government has also extended guarantees for US\$1.3 billion in short-term facilities with Banco de la Nacion.

We expect continued resiliency in Peru's external indicators, although the recent approval of a new pension withdrawal could marginally erode external indicators. External indicators recently improved, in part because of the slowdown in economic activity and favorable terms of trade (export prices decrease was lower than that of imports). We expect deficits of 1.0% of GDP on average, after narrowing to a 0.6% surplus in 2023.

Imports will recover along with increased demand and potentially higher freight costs, while dividend payouts should also pick up. This explains the widening in the current account deficits, but these will be fully covered by foreign direct investment inflows (that include reinvestment). We expect terms of trade to remain more favorable compared with the past decade, albeit below the 2021 peak, thanks to supportive copper prices.

We expect narrow net external debt to average 34% of current account receipts (CAR) from 2024 to 2027. We expect the government (which explains two-thirds of external debt) will rely on but not significantly expand external financing to cover its deficits. At the same time, CARs are set to continue increasing as metal prices and production contribute to goods exports, while services exports recover at a gradual pace. Gross external financing needs are likely to stay around 75% of CAR plus usable reserves in 2024-2027.

Peru has a successful track record of monetary policy credibility and effectiveness. We expect inflation to return to the central bank's target range of 1%-3% in 2024. Annual inflation has been decreasing after peaking at 8.8% in June 2022, and it was 3.0% in March 2024. Energy-related price shocks have largely dissipated, while higher food prices--partly due to weather events and social conflicts--have also moderated, albeit at a slower pace. Excluding energy and food, inflation was 3.1% in March. The central bank has been normalizing monetary policy, currently at 6.0%, cautiously considering effects from the El Niño phenomenon that have now dissipated.

Key Statistics

Table 1

Peru--Selected Indicators

	2017	2018	2019	2020	2021	2022	2023	2024f	2025f	2026f
Economic indicators (%)										
Nominal GDP (bil. LC)	703.50	745.71	775.57	720.78	877.82	939.44	1,001.71	1,067.84	1,125.54	1,184.07
Nominal GDP (bil. \$)	215.72	226.95	232.44	206.39	226.38	245.29	271.47	284.76	296.39	303.61
GDP per capita (000s \$)	6.9	7.2	7.3	6.4	6.9	7.4	8.0	8.3	8.6	8.7
Real GDP growth	2.5	4.0	2.2	(10.9)	13.4	2.7	(0.6)	2.7	3.0	3.1
Real GDP per capita growth	1.5	2.6	0.9	(12.0)	12.0	1.4	(1.8)	1.4	1.7	1.8
Real investment growth	(0.3)	4.4	3.3	(16.2)	34.6	1.0	(5.6)	3.8	2.1	3.1
Investment/GDP	21.4	22.4	21.8	19.9	21.7	22.1	19.2	19.6	19.6	19.7
Savings/GDP	20.6	21.2	21.3	21.0	19.5	18.1	19.8	18.7	18.6	18.7
Exports/GDP	23.9	24.4	23.5	22.2	29.3	29.0	27.3	27.1	27.2	27.3
Real exports growth	7.8	2.1	1.1	(19.7)	13.2	6.1	3.7	3.6	3.4	3.3
Unemployment rate	6.9	6.7	6.6	13.0	10.7	7.8	6.4	6.4	6.4	6.4
External indicators (%)										
Current account balance/GDP	(0.8)	(1.2)	(0.6)	1.1	(2.2)	(4.0)	0.6	(0.9)	(0.9)	(1.0)
Current account balance/CARs	(2.9)	(4.2)	(2.0)	4.2	(6.9)	(12.5)	2.0	(2.8)	(3.1)	(3.2)
CARs/GDP	27.2	27.5	27.0	25.5	32.3	32.4	31.2	30.1	29.9	29.9
Trade balance/GDP	3.1	3.2	3.0	3.9	6.6	4.2	6.4	6.1	6.2	6.3
Net FDI/GDP	2.8	2.9	2.2	(0.4)	2.5	4.6	1.0	2.2	2.5	2.5
Net portfolio equity inflow/GDP	(2.1)	(2.6)	(0.7)	(0.0)	(2.8)	(0.8)	(1.4)	(1.4)	(1.4)	(1.4)
Gross external financing needs/CARs plus usable reserves	80.0	73.9	73.9	62.0	68.5	73.0	68.8	74.1	74.8	74.8
Narrow net external debt/CARs	15.4	22.2	13.7	18.6	30.1	34.1	37.0	36.9	34.7	32.8
Narrow net external debt/CAPs	14.9	21.3	13.4	19.4	28.1	30.3	37.8	35.9	33.6	31.8
Net external liabilities/CARs	133.3	132.7	130.3	144.8	119.4	133.0	126.7	127.9	127.0	126.6
Net external liabilities/CAPs	129.5	127.3	127.7	151.2	111.6	118.3	129.3	124.3	123.1	122.7
Short-term external debt by remaining maturity/CARs	34.0	24.5	27.7	25.9	18.7	17.0	17.8	20.3	19.4	18.7
Usable reserves/CAPs (months)	8.3	8.5	8.9	12.1	9.4	8.3	8.3	7.7	7.4	7.3
Usable reserves (mil. \$)	46,386	47,340	50,712	61,012	61,483	57,729	56,802	56,638	57,113	57,561

Table 1

Peru--Selected Indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023	2024f	2025f	2026f
Fiscal indicators (general government; %)										
Balance/GDP	(2.8)	(2.0)	(1.4)	(8.3)	(2.5)	(1.4)	(2.8)	(2.6)	(2.3)	(2.0)
Change in net debt/GDP	2.4	2.2	1.8	8.3	3.4	0.9	2.4	2.4	2.4	2.3
Primary balance/GDP	(1.7)	(0.7)	(0.1)	(6.8)	(1.1)	0.0	(1.2)	(1.1)	(0.8)	(0.5)
Revenue/GDP	18.1	19.3	19.8	17.8	21.0	22.0	19.6	20.5	20.5	20.6
Expenditures/GDP	21.0	21.2	21.2	26.1	23.5	23.4	22.4	23.1	22.8	22.6
Interest/revenues	6.1	6.4	6.4	8.4	6.7	6.6	7.9	7.3	7.2	7.4
Debt/GDP	21.6	22.2	23.5	31.1	32.7	31.1	30.1	30.8	31.9	32.7
Debt/revenues	119.3	115.4	118.8	174.5	156.1	141.5	153.1	150.4	155.7	158.7
Net debt/GDP	8.4	10.1	11.6	20.7	20.4	20.0	21.2	22.3	23.6	24.7
Liquid assets/GDP	13.3	12.1	12.0	10.3	12.3	11.1	8.8	8.5	8.4	8.0
Monetary indicators (%)										
CPI growth	2.8	1.3	2.1	1.8	4.0	7.9	6.3	2.3	2.3	2.1
GDP deflator growth	3.9	2.0	1.7	4.3	7.4	4.2	7.2	3.8	2.3	2.1
Exchange rate, year-end (LC/\$)	3.24	3.37	3.31	3.62	3.98	3.81	3.74	3.75	3.85	3.95
Banks' claims on resident non-gov't sector growth	5.4	9.9	5.8	14.2	5.9	4.0	0.7	6.6	6.0	6.0
Banks' claims on resident non-gov't sector/GDP	42.1	43.6	44.4	54.6	47.4	46.1	43.5	43.5	43.8	44.1
Foreign currency share of claims by banks on residents	29.6	27.7	26.3	21.9	22.2	23.3	0.0	0.0	0.0	0.0
Foreign currency share of residents' bank deposits	37.2	33.1	34.3	36.8	37.8	34.9	27.3	0.0	0.0	0.0
Real effective exchange rate growth	(3.9)	2.5	(1.9)	2.7	13.3	(8.3)	(6.8)	0.0	0.0	0.0

Sources: N/A.

Adjustments: N/A.

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. f--Forecast. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result 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.

Ratings Score Snapshot

Table 2

Peru--Ratings Score Snapshot

Key rating factors	Score	Explanations
Institutional assessment	4	We expect continued prudent fiscal and monetary policy management. However, recent persistent political tension between the executive and legislative branches coupled with fragmentation across the political spectrum, in our view, have hurt investor sentiment and weigh on Peru's growth and investment prospects.
Economic assessment	4	Based on GDP per capita (US\$) and growth trends as per Selected Indicators in table 1.
External assessment	3	Based on narrow net external debt and gross external financing needs/(CAR plus usable reserves) as per Selected Indicators in table 1. The net external liability position is substantially worse than the narrow net external debt position (generally by over 100% of CAR), signaling a risk of a potential shift in foreign direct investments or portfolio equity investments.
Fiscal assessment: flexibility and performance	2	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in table 1. Debt denominated in foreign currency currently represents over 40% of the total stock. Nonresidents hold generally more than 60% of the government commercial debt.
Monetary assessment	3	The central bank conducts a managed floating exchange rate regime. The independent central bank has a solid track record of maintaining low single-digit inflation under its inflation targeting regime for two decades that has contributed to lower dollarization in the financial system.
Indicative rating	bbb-	
Notches of supplemental adjustments and flexibility		
Final rating		
Foreign currency	BBB-	
Notches of uplift	1	Independent monetary policy with a track record of free floating currency, but the Peruvian sol is not actively traded. Active local currency fixed-income market with capitalization above 10% of GDP with some secondary trading.
Local currency	BBB	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings List, April 10, 2024
- Sovereign Ratings History, April 10, 2024
- Banking Industry Country Risk Assessment Quarterly Monitor: Q1 2024, April 3, 2024
- Credit Conditions Emerging Markets Q2 2024: Unmet Expectations Could Heighten Risks, March 27, 2024
- Sovereign Debt 2024: The Americas See A Continued Rise In Sovereign Borrowing, Especially In The U.S., Feb. 27, 2024
- S&P Global Ratings Makes Modest Changes To Metal Price Assumptions, Feb. 08, 2024
- Pension Reforms In Latin America: Balancing Act To Improve Benefits And Contain Fiscal Pressure, February 06, 2024
- Peru's Banking Industry Country Risk Assessment Remains At Group '5', Despite Rising Economic Risks, November 30, 2023
- Petroleos del Peru Petroperu S.A. Downgraded To 'B+' From 'BB' On Weaker Capital Structure; Outlook Stable, October 12, 2023
- Peru, Aug. 2, 2023

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

Downgraded

	To	From
Peru		
Transfer & Convertibility Assessment	BBB+	A-

Peru

Senior Unsecured Foreign Currency	BBB-	BBB
Senior Unsecured Local Currency	BBB	BBB+

Downgraded; CreditWatch/Outlook Action

	To	From
Peru		
Sovereign Credit Rating		
Foreign Currency	BBB-/Stable/A-3	BBB/Negative/A-2

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Peru		
Sovereign Credit Rating		
Local Currency	BBB/Stable/A-2	BBB+/Negative/A-2

Ratings Affirmed

Peru		
Certificate Of Deposit	A-2	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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