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Sovereigns
Latin America

Coronavirus Is Still Pressuring Latin American Sovereign Creditworthiness

Growth and Fiscal Deterioration and Downside Risks Are Evident in Rating Outlooks

LatAm Sovereign Ratings

Sovereign	Rating/Outlook		Rating changes and recent Outlook revisions	
			2015-Feb 2020*	Mar 2020-Present**
Chile	A	Negative	Downgrade (-1)	Stable to Neg.
Peru	BBB+	Stable		
Panama	BBB	Negative		
Colombia	BBB-	Negative		Downgrade (-1)
Mexico	BBB-	Stable	Downgrade (-1)	Downgrade (-1)
Uruguay	BBB-	Negative		
Paraguay	BB+	Stable	Upgrades (+2)	
Aruba	BB	Negative		Downgrade (-2)
Brazil	BB-	Negative	Downgrades (-4)	Stable to Neg.
Dom Rep.	BB-	Negative	Upgrade (+1)	Stable to Neg.
Guatemala	BB-	Stable		Downgrade (-1)
Bolivia	B+	Negative	Downgrades (-2)	
Jamaica	B+	Stable	Upgrades (+2)	Pos. to Stable
Costa Rica	B	Negative	Downgrades (-3)	Downgrade (-1)
El Salvador	B-	Negative	Down (-4), Up (+1)	Stable to Neg.
Nicaragua	B-	Negative	Downgrades (-2)	Stable to Neg.
Suriname	CC	-	Downgrades (-4)	In/out of RD (x1)
Argentina	RD	-	In/out of RD (x2)	In/out of RD (x1)
Ecuador	RD	-	Downgrade (-1)	Downgrades to RD

Note: * Net rating changes only ** Rating changes and Outlook revisions

Source: Fitch Ratings

Related Research

What Investors Want to Know: Colombia's Negative Outlook (July 2020)

Remittances: Transmission of US Economic Shock to Central America and the Caribbean (July 2020)

Coronavirus Shock Highlights Importance of LatAm Sovereign Debt Management (June 2020)

What Investors Want to Know: Brazil's Negative Outlook (June 2020)

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The impact of the coronavirus pandemic on Latin America's economic growth and public finances continues to put pressure on sovereign credit profiles. Fitch Ratings has lowered its growth forecasts again for 15 of the 19 rated Latin America sovereigns since early June, as the region has become the new hotspot for coronavirus. The continuing pressure is reflected in the high proportion of Negative Outlooks on our sovereign ratings, notwithstanding the downgrades of eight sovereigns so far this year.

Downgrades or Outlook changes due to the pandemic, global recession and slump in commodity (especially oil) prices can broadly be divided into four categories:

- Financially distressed countries in the process of restructuring their commercial debt – Argentina, Ecuador, and Suriname, all of which are or have been rated 'RD'.
- Sovereigns experiencing a deteriorating growth outlook along with weakening fiscal and debt metrics relative to their respective rating categories. This includes the region's two largest economies, Brazil and Mexico.
- Aruba, the Dominican Republic and Jamaica face a sharp economic shock due to their dependence on tourism, leading to fiscal, external and growth challenges.
- Some central American sovereigns are exposed to the US economic slowdown, lower remittances, and in some cases lost tourism income and activity. This is leading to wider deficits and higher debt amid constrained financing flexibility, partly reflecting shallow local capital markets and political gridlock that hinders timely approval of external bond and/or multilateral financing.

Several years of sluggish economic growth and difficulty in consolidating fiscal accounts and stabilising public debt were already weighing on Latin American sovereigns at the beginning of 2020, when about one-third of Fitch-rated sovereigns in the region was on Negative Outlook. That proportion has risen to 60% (70% excluding sovereigns rated 'CCC' and below, to which we do not assign Outlooks). No Latin American sovereign is on Positive Outlook.

This highlights how the external shocks stemming from the coronavirus, and its spread within the region, still present risks to Latin American sovereign credit.

Fitch Reduces 2020 GDP Forecasts Further

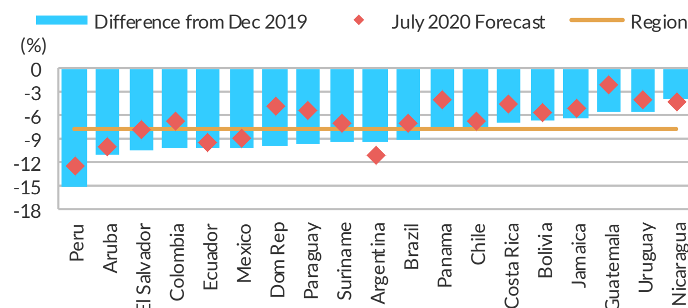
The economic impact of the pandemic initially was felt in Latin America through the worldwide slowdown that reduced activity in the region's major trading partners and through the hit to commodity prices, plus heightened volatility in currencies, stock markets and bond spreads. However, while Latin American

countries initially recorded far fewer cases of coronavirus than many in Asia and Europe, governments still enacted containment measures, which hit economic activity and confidence to varying degrees.

As the pandemic has progressed, however, the number of COVID-19 cases in Latin America had risen to 3.9 million in mid-July, according to John Hopkins University data. Despite some recovery in commodity prices (especially copper), our real GDP forecast revisions reflect weak incoming data, the extension of lockdowns in some countries, difficulty in easing social distancing measures, and the risk of prolonged economic pain where attempts to contain the virus have been least effective.

For the region as a whole, even stringent measures have not always prevented the coronavirus and its economic impact spreading due to uneven compliance, high labour informality and limited social safety nets, challenges in directing transfers to vulnerable segments of the population, and weaker public health systems.

2020 Real GDP Growth Forecast Differential



Source: Fitch Ratings

The possibility of a second wave of infections in advanced economies that hinders the global recovery and rekindles asset and commodity price volatility, and of a more gradual domestic recovery due to the persistence or intensification of the coronavirus spread in the region are risks to our forecasts. We still forecast real GDP growth to resume across the region later in 2020 and pick up moving into 2021 as the US and China recover and disruption from the coronavirus dissipates. However, although we forecast growth in all 19 Fitch-rated Latin American sovereigns next year, this will not be sufficient to return to pre-pandemic GDP levels. There is also uncertainty regarding new potential growth rates and the pace at which output gaps close.

The disinflationary nature of the shock, and easier global monetary policy, has allowed Latin American central banks to lower policy rates. Some central banks have recently acquired, or are in the process of passing legislation to acquire, greater powers to buy private- and public-sector bonds to provide liquidity to local credit markets and prevent the health crisis becoming a financial crisis, So far, most purchase programmes have aimed to reduce volatility and dysfunctionality in local bond markets and not for the traditional Quantitative Easing (QE) target of reducing long-term interest rates.

Some countries, such as Chile, have reached the lower near-zero bound of their policy rates. Others, such as Brazil, have some ability to lower interest rates further from historical lows should conditions require it. QE in Latin America could prove challenging to execute given risks to inflation (and a history of hyperinflation in some countries), currency depreciation, and non-resident portfolio outflows. Countries such as Brazil, whose central bank is not legally independent and with a high and rising debt burden, could reignite fiscal dominance concerns if there were large central bank interventions in the Treasury market (see What Investors Want to Know: Unconventional Monetary Policies in Emerging Markets).

Moreover, it is unclear how effectively monetary stimulus, liquidity provision, and fiscal measures – such as wage subsidy and worker support packages – will limit permanent damage to economies in the region from higher unemployment and corporate bankruptcies. Even if such permanent damage is contained, the recovery may be gradual because of underlying structural weaknesses; uncertain prospects for supply-side reforms to boost confidence, investment and competitiveness; the drag from unwinding of fiscal support packages; uncertainty over fiscal trajectories; and higher public debt burdens.

Fiscal Deterioration Exceeds External Balance-Sheet Impact

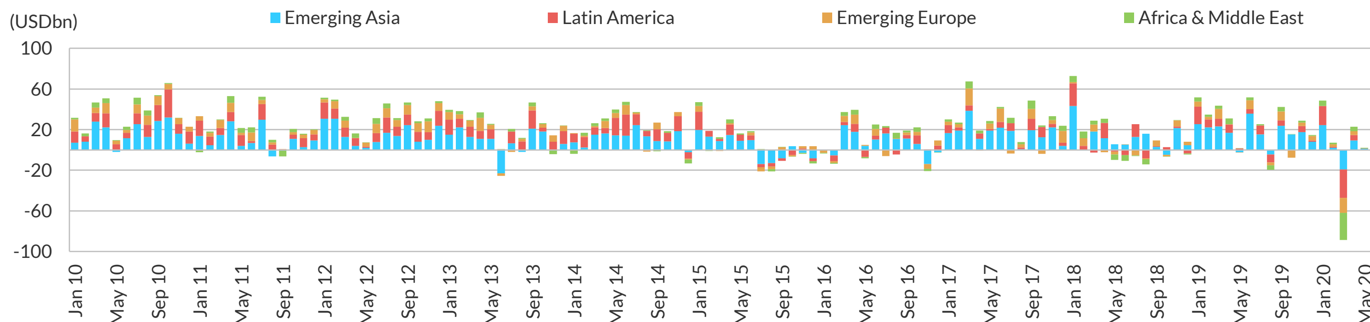
Economic contraction means that import compression is curtailing the deterioration in external accounts. However, tourist-remittance-dependent countries are facing a weakening of their external accounts. We forecast net FDI inflows to the region to fall 30% compared to 2019, reflecting the decline in commodity prices, pandemic-related business disruption, as well as a subdued outlook for domestic demand.

In common with other emerging markets (EMs), Latin America experienced capital outflows at the onset of the crisis, but IIF data show some stabilisation and recovery of flows to the region, as advanced economies have eased monetary policy. This has opened up the external market for Latin American sovereign issuers, with 1H20 external hard-currency bond issuance almost doubling to USD37 billion from USD19 billion in 1H19. Higher market issuance has complemented several countries' efforts to obtain access to multilateral funding at a time of soaring fiscal deficits. However, volatility in capital flows remains a risk, and prudent debt management would remain important for mitigating vulnerabilities.

Several countries have allowed foreign-exchange flexibility to absorb the external shock, although central banks have also been intervening in the derivatives market to smooth FX volatility and provide FX hedges to the private sector. Among the larger Latin American countries, Brazil has intervened in the spot market to support the real by selling about USD19 billion in the year to 17 July. Chile and Peru's central banks have obtained access to the IMF's Flexible Credit Line (FCL), which was already available to Mexico and Colombia. This provides additional firepower to central banks to navigate a period of potentially disruptive capital outflows or tighter external financing conditions.

However, the coronavirus has exposed Latin American sovereigns' persistent fiscal vulnerabilities. The region entered the crisis on a weak fiscal footing, which had already put several of its sovereign ratings under pressure following the 2014-2015 commodity shock. This pressure has been magnified by contracting GDP and

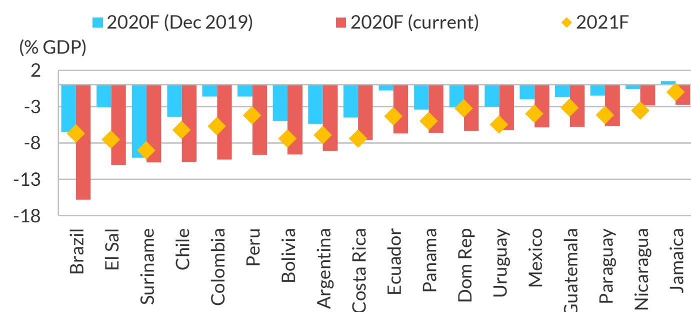
Total EM Portfolio Flows



Source: Fitch Ratings, IIF

sizeable fiscal support. Our forecasts mean that the simple average fiscal deficit in the region will reach nearly 9% of GDP in 2020, which would be nearly triple the average in 2009.

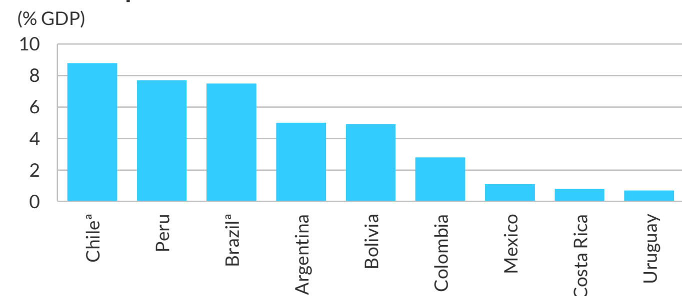
General Government Balance



Source: Fitch Ratings

Several fiscal packages have grown since they were launched, in response to increasing disruption from the pandemic. Mexico is the most notable exception, being engaged in one of the region's smallest fiscal responses. However, economic contraction there means we still forecast the country's deficit to widen by 4pp to 5.9% of GDP. The fact that other governments have increased the size of their packages highlights risks to our current fiscal projections, especially when lockdowns are extended or re-imposed. Brazil and Chile have the largest fiscal support packages, and have progressively increased their sizes during the pandemic.

Fiscal Response to the Pandemic



[a] Refers to measures that have a direct fiscal impact in 2020
Source: Fitch Ratings, Cepal

Fiscal policy anchors, such as fiscal rules or debt ceilings, have been suspended across the board in the region in light of the severity and magnitude of the pandemic-related shock. Some countries, such as Colombia, have suspended the fiscal rule for two years.

Large fiscal deficits, deep recessions and currency depreciations will push debt levels much higher, by around 13pp of GDP on average. Debt will rise in Brazil and El Salvador to more than 90% and 85% of GDP, respectively, in 2020, while Jamaica's debt decline process will be interrupted.

Low interest rates mean interest-to-revenue ratios will not rise as much. But this could change if the erosion of sovereign balance sheets weakened investor appetite for Latin American sovereign debt, pushing up borrowing costs or shortening the duration of the debt, increasing rollover risks. Even holding rates down may be insufficient to reduce debt in the medium term if growth disappoints or if fiscal consolidation process falters.

Gross debt ratios in the region would have risen even more sharply this year were it not for countries, such as Chile, Peru, Panama and Mexico, dipping into stabilisation or sovereign wealth funds or deposits.

Among the low 'B' category sovereign credits – Costa Rica, El Salvador, and Nicaragua – financing constraints of varying degrees are additional sources of risk.

Fiscal Consolidation Will Remain Challenging Post-Pandemic

The capacity and willingness to stabilise debt burdens and rebuild fiscal buffers post-pandemic remains an important element of our sovereign rating assessment. Balancing fiscal consolidation while nurturing nascent economic recoveries will be a key challenge for the authorities.

Some deficit reduction is likely as economic recovery takes hold and fiscal support measures are unwound. But without structural measures it will be hard for governments to accelerate consolidation efforts, anchor investor expectations and stabilise and eventually reduce the growing debt burdens against the backdrop of a slow economic recovery, limited support from rising commodity prices, and prospective election cycles. In this regard, some countries such as Colombia and Peru have acknowledged the need to implement reforms to rebuild their revenue bases in the post-pandemic period.

Re-establishing fiscal anchors would provide greater clarity on the medium-term pace of consolidation and debt

stabilization/reduction. Reactivating economic reform agendas to boost sentiment and private investment would be crucial for fostering a stronger and sustainable recovery as and when public-sector retrenchment begins.

The debate on how to meet the cost of the crisis and over what timeframe will become central to politics and policy making in the region over the coming few years. The political and popular consensus backing the rolling-out of fiscal packages to support Latin American populations amid the pandemic has been reflected in the boost to presidential or government approval ratings in some countries. But there is considerable uncertainty whether congressional approvals for fiscal reforms to pay for the crisis will be achieved, or met with similar enthusiasm.

Reforms may be delayed, diluted or derailed due to fragmented congresses. And elections in Bolivia (September 2020), Peru, Chile, Ecuador, Nicaragua and Mexico (2021) and Brazil, Colombia and Costa Rica (2022) may also discourage governments from pushing through politically difficult or unpopular reforms. Social unrest had already led to fiscal easing before the pandemic in some Latin American countries, and some of the underlying factors, such as inequality and joblessness, could be aggravated by the current crisis.

Debt Restructurings Still Face Difficult Negotiations

Among those sovereigns that have lost financing access, Argentina is still engaged in difficult negotiations to restructure its external bonds. Ecuador's proposed restructuring received an agreement in principle from bondholders said to hold around half of the bonds, but other creditor groups have rejected it. This creates some uncertainty around the country's ability to carry out the operation (and exit default) by its mid-August deadline. The IMF programmes in both countries have been derailed and the renegotiation process for new ones remains challenging.

We downgraded Suriname to 'RD' on 13 July after commercial bondholders agreed to amend the amortisation schedule of Suriname's 2023 notes and the related accounts agreement. We deemed this a material change of terms of the original securities that was agreed to avoid a traditional payment default, and therefore a distressed debt exchange (DDE) and default event.

We upgraded Suriname to 'CC' three days later on completion of the consent solicitation. The very low rating indicates that a broader restructuring of Suriname's foreign-currency debt is probable, reflecting high government debt, an acute shortage of foreign currency, and distressed financing conditions.

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