

Research Update:

Colombia Long-Term Foreign Currency Rating Lowered To 'BB+' On Persistent Fiscal Weakness; Outlook Stable

May 19, 2021

Overview

- We believe Colombia's fiscal adjustment will prove to be more protracted and gradual than previously expected, diminishing the likelihood of reversing the recent deterioration in public finances.
- We therefore lowered our long-term foreign currency rating on Colombia to 'BB+' from 'BBB-'.
- The outlook is stable, reflecting our view that economic recovery, coupled with certain fiscal measures, will stabilize the government's recently worsening debt burden over the coming two to three years.

Rating Action

On May 19, 2021, S&P Global Ratings lowered its long-term foreign currency sovereign credit rating on Colombia to 'BB+' from 'BBB-' and its long-term local currency rating to 'BBB-' from 'BBB'. The outlook on our long-term ratings is stable. We also lowered our short-term foreign currency rating to 'B' from 'A-3' and our short-term local currency rating to 'A-3' from 'A-2'.

We revised down Colombia's transfer and convertibility assessment to 'BBB'.

Outlook

The stable outlook reflects our expectation of economic recovery in 2021 following the significant contraction last year. The combination of renewed GDP growth and certain fiscal measures is likely to gradually curtail Colombia's fiscal deficits, resulting in net general government debt stabilizing above 60% of GDP. The stable outlook also incorporates our expectation for an institutional solution to recent and significant social unrest, which would result in prospects for political and institutional stability for the medium to long term.

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Downside scenario

We could lower our ratings on Colombia in the next 12 to 18 months if the potential long-term damage caused by the pandemic, other domestic developments, or new external shocks prevent the Colombian economy from recovering in 2021 and result in lower-than-expected GDP growth in subsequent years. Such a scenario would most likely result in consistently higher fiscal deficits than currently projected and a steady increase in the government's debt burden, leading to a downgrade. A perceived deterioration in Colombia's institutional effectiveness, evidenced by an inability to form political and social consensus to sustain growth and its fiscal profile, could also lead to a downgrade.

Upside scenario

We could raise our ratings on Colombia within the next 12 to 18 months if economic growth is faster than expected, coupled with structural fiscal measures that reduce Colombia's fiscal financing gap, lower the debt burden, and strengthen public finances. A larger and more diverse export sector, helping to reduce external vulnerability and strengthen economic resilience, could also lead to an upgrade over the medium to long term.

Rationale

The downgrades follow the withdrawal of a fiscal reform introduced to Congress in a context of high spending pressures, which has resulted in a significantly lower likelihood of Colombia improving its fiscal position following a recent and marked deterioration. Given the country's high external vulnerability and moderate economic profile (balanced by adequate institutions and monetary credibility), in our view Colombia's debt levels, stabilizing at about 60% of GDP during 2021-2024, and relatively large fiscal deficits are no longer consistent with an investment-grade ('BBB-' or higher) foreign currency rating.

An ambitious fiscal reform proposal presented to Congress on April 15, 2021, aimed to finance transitory and structural higher spending--mainly transfers to the most vulnerable segments of the population--while helping to consolidate fiscal deficits. The fiscal reform was expected to be diluted during the Congress debate but to yield some additional and permanent current revenue. Instead, it was met by marked political opposition and protests from some segments of the population. While the larger protests since April 28 have been mostly peaceful, some violence has also occurred. These developments forced the government to withdraw the fiscal reform proposal by May 2, 2021.

The government, under new leadership at the Ministry of Finance, is looking to conciliate with various groups participating in the protests, as well as other social groups, and garner political support across party lines to make an alternate fiscal policy proposal. Prospects for substantial structural reforms are low in the near term, given ongoing protests and the approach of national elections next year. COVID-19 exacerbated the weakness in Colombia's fiscal profile, though the worsening trend was present for most of the past decade. Moreover, as in many other emerging markets, the pandemic showed the substantial weakness of the country's safety nets, which will most likely drive spending growth over the long term.

The COVID-19 pandemic and its related economic contraction significantly widened Colombia's fiscal deficit. Discounting the transitory fiscal impact of the economic contraction and absent structural fiscal improvements, we expect the change in net general government to be 3%-4% of

GDP in 2021-2024. Conversely, renewed economic growth should contribute to stabilizing net general government debt at about 60% of GDP during 2021-2024, compared with 43% in 2019. The general government interest burden is expected at just below 15% of general government revenue for 2021-2024.

Colombia's rating fundamentals remain weaker than those of similarly rated peers. That said, in our opinion, Colombia's flexible credit line with the IMF, our expectation of adequate access to the international debt markets, and a credible and efficient monetary policy continue to mitigate external risks and support Colombia's creditworthiness.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

Key Statistics

Table 1

Colombia Selected Indicators

	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
Economic indicators (%)										
Nominal GDP (bil. LC)	804,692.00	863,782.00	920,471.00	987,791.00	1,061,119.00	1,002,587.20	1,092,499.22	1,169,407.67	1,243,996.99	1,320,653.33
Nominal GDP (bil. \$)	293.48	282.83	311.88	334.20	323.43	271.48	305.59	324.84	343.17	361.82
GDP per capita (000s \$)	6.3	6.0	6.6	6.9	6.5	5.4	6.0	6.3	6.6	6.9
Real GDP growth	3.0	2.1	1.4	2.6	3.3	(6.8)	6.0	3.5	3.3	3.1
Real GDP per capita growth	2.0	1.0	0.1	0.8	0.9	(8.7)	4.6	2.4	2.2	2.0
Real investment growth	(1.2)	(0.2)	(3.2)	1.5	3.8	(21.2)	12.0	4.0	4.0	3.5
Investment/GDP	23.8	23.2	21.6	21.2	21.5	18.8	19.9	20.0	20.1	20.2
Savings/GDP	17.2	18.6	18.2	17.1	17.1	15.5	16.2	15.9	16.2	16.4
Exports/GDP	15.7	14.7	15.1	15.9	15.9	13.7	14.5	14.8	15.0	15.2
Real exports growth	1.7	(0.2)	2.6	0.6	3.1	(17.4)	12.0	6.0	4.5	4.5
Unemployment rate	8.9	9.2	9.4	9.7	10.5	16.1	13.6	12.5	11.6	10.7
External indicators (%)										
Current account balance/GDP	(6.6)	(4.5)	(3.4)	(4.1)	(4.4)	(3.3)	(3.7)	(4.1)	(3.9)	(3.8)
Current account balance/CARs	(33.4)	(23.5)	(17.2)	(19.5)	(20.5)	(17.1)	(18.6)	(19.6)	(18.7)	(18.1)
CARs/GDP	19.7	19.3	20.0	20.9	21.5	19.6	20.1	20.8	21.0	21.1

Table 1

Colombia Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
Trade balance/GDP	(4.6)	(3.2)	(1.4)	(1.5)	(2.6)	(2.9)	(2.5)	(2.4)	(2.5)	(2.5)
Net FDI/GDP	2.6	3.3	3.3	1.9	3.4	2.1	2.7	2.8	2.9	3.0
Net portfolio equity inflow/GDP	0.2	(0.1)	0.2	(0.2)	(0.4)	(0.2)	0.5	0.2	0.4	0.0
Gross external financing needs/CARs plus usable reserves	96.5	89.7	95.4	98.4	99.4	93.0	93.4	90.3	93.0	95.4
Narrow net external debt/CARs	95.9	121.6	115.8	112.2	114.4	169.3	163.4	157.9	154.8	154.4
Narrow net external debt/CAPs	71.8	98.5	98.7	93.9	95.0	144.6	137.8	132.0	130.4	130.7
Net external liabilities/CARs	208.1	249.1	238.6	222.2	244.6	331.0	303.8	295.1	294.7	297.4
Net external liabilities/CAPs	156.0	201.7	203.5	185.8	203.0	282.7	256.1	246.8	248.3	251.8
Short-term external debt by remaining maturity/CARs	41.3	42.3	48.8	45.4	47.3	68.1	63.6	53.5	54.1	52.3
Usable reserves/CAPs (months)	7.3	8.2	7.6	6.8	6.8	10.1	9.6	9.2	8.7	8.0
Usable reserves (mil. \$)	46,223	46,174	47,133	47,888	52,650	58,500	61,973	61,947	60,069	58,803
Fiscal indicators (general government; %)										
Balance/GDP	(3.0)	(2.8)	(2.3)	(2.0)	(1.8)	(6.8)	(6.5)	(4.7)	(3.6)	(3.3)
Change in net debt/GDP	6.7	2.5	3.5	5.9	4.9	11.6	7.1	4.5	3.8	3.2
Primary balance/GDP	(0.4)	0.1	0.6	0.8	1.1	(3.9)	(3.1)	(1.2)	(0.2)	0.2
Revenue/GDP	23.9	22.4	23.3	25.1	26.5	23.9	24.0	24.4	25.3	25.5
Expenditures/GDP	26.9	25.2	25.7	27.0	28.3	30.7	30.4	29.1	28.9	28.8
Interest/revenues	10.7	13.1	12.4	11.1	11.0	11.8	14.0	14.2	13.7	13.5
Debt/GDP	43.7	44.4	45.3	48.2	49.4	64.3	65.1	65.3	65.8	65.4
Debt/revenues	183.1	198.3	194.1	192.2	186.7	268.9	271.4	267.8	259.7	256.1
Net debt/GDP	36.7	36.7	37.9	41.2	43.2	57.4	59.7	60.3	60.5	60.1
Liquid assets/GDP	7.1	7.7	7.4	7.0	6.2	7.0	5.4	5.0	5.3	5.3
Monetary indicators (%)										
CPI growth	5.0	7.5	4.3	3.2	3.5	2.5	2.8	3.4	3.0	3.0

Table 1

Colombia Selected Indicators (cont.)

	2015	2016	2017	2018	2019	2020	2021f	2022f	2023f	2024f
GDP deflator growth	2.4	5.1	5.1	4.6	4.0	1.4	2.8	3.4	3.0	3.0
Exchange rate, year-end (LC/\$)	3,149.47	3,000.71	2,971.63	3,275.01	3,294.05	3,432.00	3,600.00	3,600.00	3,650.00	3,650.00
Banks' claims on resident non-gov't sector growth	17.6	8.9	11.8	4.1	7.9	2.3	7.6	8.5	8.5	8.4
Banks' claims on resident non-gov't sector/GDP	49.5	50.3	52.7	51.1	51.4	55.6	54.9	55.6	56.7	57.9
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(19.7)	(6.2)	3.2	0.5	(9.0)	(3.0)	N/A	N/A	N/A	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 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

Colombia Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	3	Stable democracy with continuity in economic policies across party lines. Policy implementation is strong. Our base case assumes policy pragmatism, backed by a professional and technical trained civil service and ample checks and balances, including an active judiciary.
Economic assessment	4	Based on GDP per capita (\$) trend as per Selected Indicators in table 1.
External assessment	6	Based on narrow net external debt and gross external financing needs as per Selected Indicators in table 1. The country is exposed to significant volatility in terms of trade due to its dependence on hydrocarbons.
Fiscal assessment: flexibility and performance	4	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1. We exclude the transitory shock caused by the COVID-19 pandemic and related lockdowns.

Table 2

Colombia Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Fiscal assessment: debt burden	5	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenue) as per Selected Indicators in table 1.
Monetary assessment	3	Colombia has a floating exchange-rate regime, but its currency is not actively traded. The central bank has a track record of independence and uses market-based monetary instruments. It has the ability to act as a lender of last resort for the financial system.
Indicative rating	bb	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	1	We expect relatively large and growing private pension funds' external assets to provide additional external flexibility. Colombia is one of few countries that has a flexible credit line from the IMF that would improve external liquidity under a stress scenario.
Final rating		
Foreign currency	BB+	
Notches of uplift	1	Reflecting an independent monetary policy with a track record of floating currency. The sovereign has relatively adequate capital markets, as demonstrated by local currency fixed income and money market accounting for about 30% of GDP.
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 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

- 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

- Colombia Ratings Affirmed Following Tax Reform Proposal; Outlook Remains Negative, April 22, 2021
- S&P Global Ratings Revises Oil And AECO Natural Gas Price Assumptions And Introduces Dutch Title Transfer Facility Assumption, March 8, 2021
- Banking Industry Country Risk Assessment: Colombia, Jan. 15, 2021
- Colombia 'BBB-/A-3' Foreign Currency Ratings Affirmed; Outlook Remains Negative, Oct. 28,

2020

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; CreditWatch/Outlook Action

	To	From
Colombia		
Sovereign Credit Rating		
Foreign Currency	BB+/Stable/B	BBB-/Negative/A-3
Local Currency	BBB-/Stable/A-3	BBB/Negative/A-2

Downgraded

	To	From
Colombia		
Transfer & Convertibility Assessment		
Local Currency	BBB	BBB+
Senior Unsecured	BBB-	BBB
Senior Unsecured	BB+	BBB-

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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