Fitch Ratings 2020 Outlook: Latin American Sovereigns

Persistent Negative Rating Pressure

Fitch's Sector Outlook: Stable

Fitch Ratings expects a mild economic recovery for Latin America in 2020 although growth will remain well below potential for most countries. Material downside risks persist especially in the context of slowing U.S., China and global growth and domestic idiosyncratic risks. Several countries have eased monetary policy against a more accommodative global monetary policy backdrop to support growth amid moderate inflation and anchored expectations.

However, fiscal space to provide stimulus to boost economic activity is quite limited across the region. Fiscal consolidation remains challenging and debt burdens have increased in several countries in recent years, putting downward pressure on credit profiles.

Rating Outlook: Negative

Seven sovereigns in Latin America are on Negative Outlook (compared to five at end-2018, when another was on Negative Watch), which indicates that downward rating pressure persists despite 13 downgrades in the region over 2017-2019. This is the highest number of Negative Outlooks among the different regions of the world. While the largest economies of Mexico, Brazil and Argentina are not on Negative Outlook, Mexico was downgraded in June, while Brazil has suffered multiple downgrades since 2015 (the last in February 2018).

Argentina's foreign- and local-currency Issuer Default Ratings (IDRs) were downgraded to 'RD' in August and its 'CC' ratings highlight the significant financial distress and indicate that default or some form of restructuring is probable.

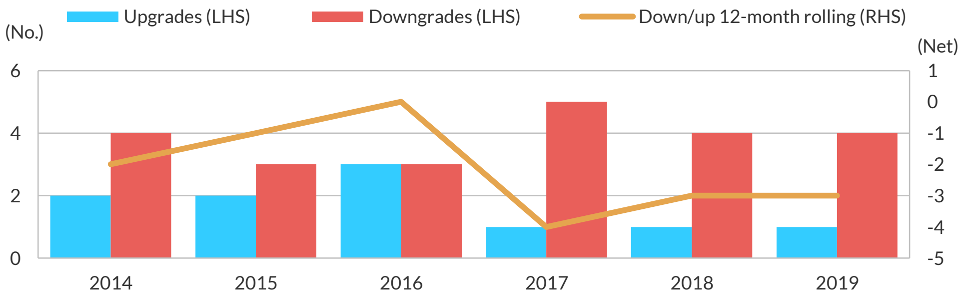
Rating Distribution Weighting

The majority of sovereigns in Latin America are in speculative grade. Only Chile is rated in the 'A' category. Uruguay is the only 'BBB-' rated sovereign with a Negative Outlook.

Shelly Shetty, Senior Director

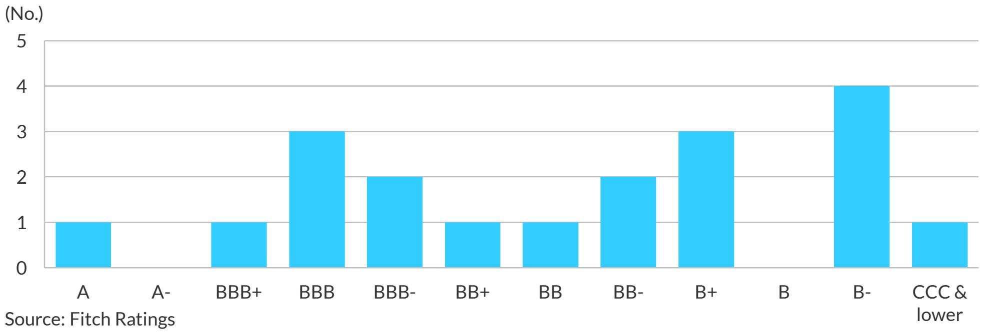
"Fitch expects a mild economic recovery but fiscal, political and governability risks to challenge the region's economic and ratings outlooks in 2020. Despite the more favourable external financing conditions, the global economic slowdown and domestic idiosyncratic issues can increase downside risks. The rise in protest activity in the region reflects long standing institutional weaknesses and high income inequality, posing a risk to the outlook in 2020."

Latin America - Rating Changes



Source: Fitch Ratings

Rating Distribution



Source: Fitch Ratings

What to Watch

- Downside risks to economic growth and fiscal accounts could reduce sovereign creditworthiness in Latin America. The region continues to grapple with the trade-off between fiscal discipline and growth. Structural reforms are needed to help both.
- Sluggish domestic growth and persistent income inequality could increase political and social stability risks. This could add to fiscal pressures and undermine governability.
- Despite the favourable external financing conditions, specific countries could still be vulnerable to shifts in investor confidence. Argentina's likely debt restructuring and the renegotiation with the IMF will be important milestones. Similarly, Ecuador's adherence to its IMF program will be key for it to meet its large financing needs.

Growth and Fiscal Challenges Will Persist in 2020

Fitch forecasts Latin American growth (excluding Venezuela) to recover mildly in 2020, reaching 1.7% from an estimated 0.8% in 2019 with downward risks persisting. Recoveries in Brazil and Mexico, and a shallower contraction in Argentina underpin this scenario. However, most countries are expected to grow below potential and the recovery continues to be weak, especially in the context of weak growth of 1% during 2014-2018. Moreover, growth in Latin America will be the weakest among the different regions of the world. Previously faster-growing economies of Chile and Peru are slowing significantly too. The service-oriented economies of Panama and the Dominican Republic are expected to show the most robust growth.

The global, U.S. and China slowdowns will weigh on Latin America's recovery. Commodity price volatility, global trade uncertainties and the deep economic crisis in Argentina are important headwinds. Political, policy and reform uncertainties, limits to future monetary easing and a narrow fiscal space to provide stimulus makes the recovery vulnerable. The structural reform agenda is largely stalled despite the limited economic diversification (high commodity dependence) and important competitiveness constraints confronting countries. For example, Mexico has shelved its plans to carry out oil auctions to attract private investment. Brazil has started the process of disinvestment and is focused on measures to improve its difficult business environment but progress could be slow with positive spill-overs taking time to materialize.

Sluggish growth, spending pressures, compressed capital expenditure and budgetary rigidities are weighing on the ability of countries to consolidate fiscal accounts and stabilize government debt. Fragmented congresses are also detracting from fiscal and economic reforms. Political unrest in several countries (see below) is leading to additional spending pressures (Chile) and/or preventing the implementation of corrective measures (Ecuador). Countries are facing tough trade-offs between fiscal discipline and growth (Mexico) while competitiveness boosting tax relief measures are also on the agenda in some. Sustained fiscal consolidation could be challenging and test policy credibility in some countries, such as Mexico and Colombia.

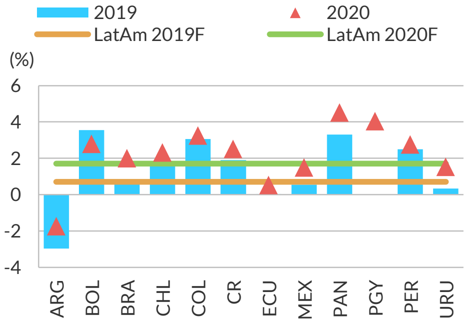
About two-thirds of the countries in Fitch's portfolio are forecast to see a further debt increase in 2020 and there is only one country (Jamaica) where the debt trajectory is on a firm downward path owing to its high primary surpluses. Given the still high share of foreign-currency debt, currency pressures can add to debt escalation (e.g. Argentina).

High fiscal deficit countries like Brazil and Costa Rica have embarked on consolidation although risks remain. Brazil's passage of the social security reform recently was a milestone although it is insufficient for accelerating consolidation. Moreover, the recently submitted fiscal package of constitutional reforms, while auguring well for medium-term compliance with the spending cap, can confront delays and dilution in congress. Costa Rica's initial revenue out-performance from the tax reform is positive but the spending rule may face challenges.

Political and Social Pressures to the Forefront

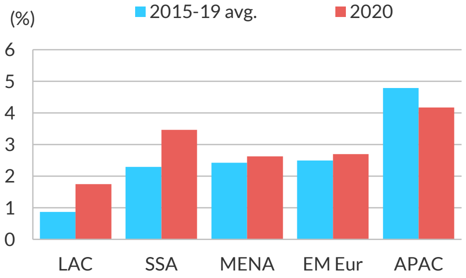
The electoral calendar will ease significantly in 2020 with only the Dominican Republic and Suriname holding elections. Election-related fiscal slippage is a risk for both sovereigns. Peru is expected to hold interim congressional elections in early 2020 pending a court decision. However, the new administrations in Argentina and Uruguay will inherit large fiscal deficits and have yet to

Real GDP Growth



Source: Fitch Ratings

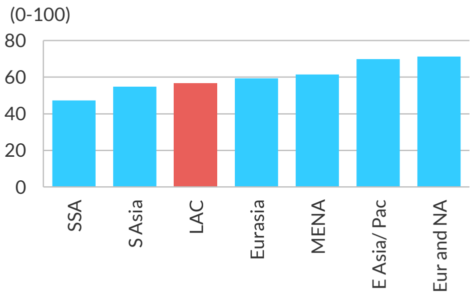
Weighted Average Regional Growth



Source: Fitch Ratings

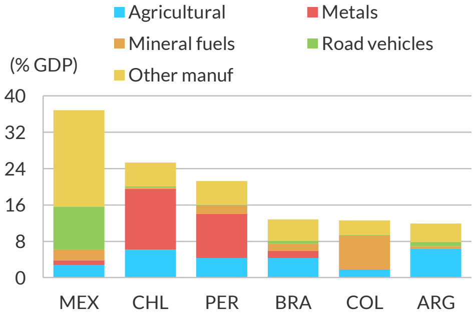
Competitiveness

Average score of 12 pillars



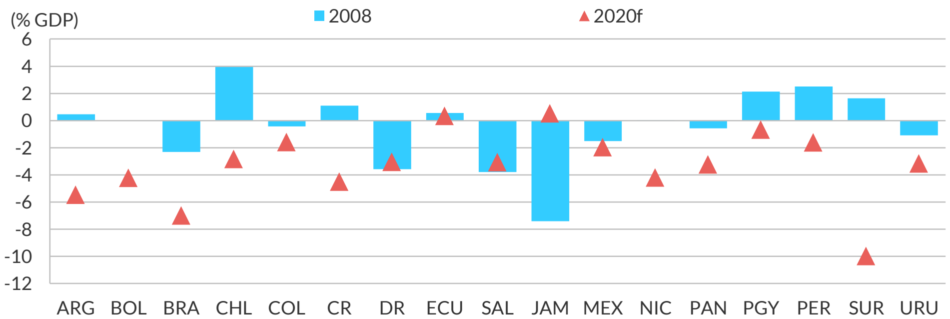
Source: Fitch Ratings, World Economic Forum

Merchandise Exports



Source: Fitch Ratings, UNCTAD

General Government Balance



Source: Fitch Ratings

lay out clear consolidation strategies. Bolivia's political outlook is highly uncertain following resignation of former President Evo Morales after his putative first-round victory in October elections marred by irregularities, which could add to pressures already weighing heavily on international reserves and could complicate efforts needed to avoid a greater balance-of-payments strain. New elections are expected to take place, but political and social dynamics appear likely to remain volatile. These developments have underpinned Fitch's recent downgrade of Bolivia. Brazil's fragmented congress and President Jair Bolsonaro's lack of an allied base could complicate political negotiations for reforms, especially as the October 2020 local elections draw closer.

Social unrest has sprouted up in countries across the ratings spectrum, which reflects the challenging social and economic backdrops, including sluggish growth, limited job creation and high income inequality, as well as perceived lack of policy action by governments to address these issues. The spread of civil unrest into other countries cannot be ruled out. Low governance scores are largely incorporated in ratings and highlight constraints to upward rating potential across the region and challenges to reforms needed to avoid potential negative pressures in some cases. However, higher and sustained protest activity could undermine political stability and further increase governability challenges and limit the appetite for fiscal consolidation or productivity-enhancing (but unpopular) structural reforms. The extent to which such unrest translates into negative rating pressures will depend on country-specific factors, including starting points in terms of growth profile, sovereign balance sheet and the authorities' policy response.

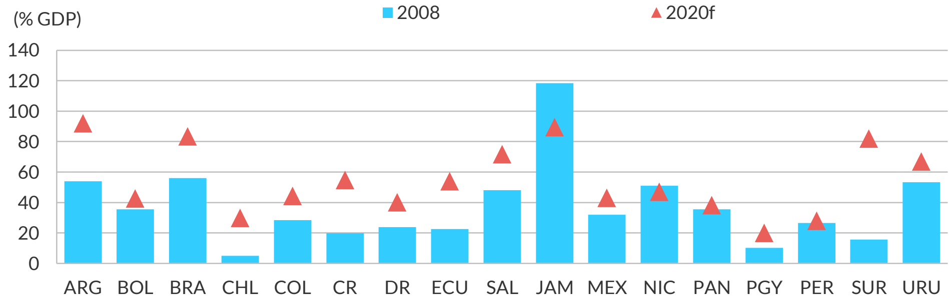
Argentina Restructuring and Key IMF Programs in the Region

Fitch believes that in the context of Argentina's weak debt tolerance and fundamentals, in terms of both liquidity and solvency, a comprehensive debt restructuring (involving maturity extensions and a combination of haircut and coupon reduction) will be needed. The immense fiscal adjustment that would be required to make a debt restructuring that involves only maturity extension is unlikely to be politically feasible or credible. Given the reduced level of international reserves and the ramp-up in debt maturities in early 2020, a sovereign default cannot be ruled out, especially if debt restructuring negotiations are long and difficult.

The two biggest IMF programs in the region (Argentina and Ecuador) are facing difficulties. After lending over USD40 billion to Argentina, the IMF has withheld disbursements since August's PASO primary elections. President-elect Fernandez has yet to offer details around his economic policy agenda and pledges to boost fiscal spending and lower interest rates to support consumption could require relaxation of targets set in the IMF program, thereby challenging the negotiation process. However, investors may need the anchor of a revised IMF program before agreeing to a debt-restructuring proposal.

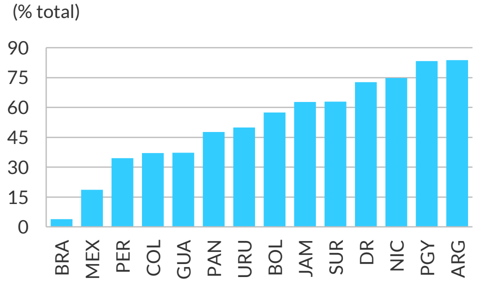
Ecuador's large 2020 financing needs may also be difficult to cover in the absence of continued IMF and other multilateral disbursements. The IMF has not disbursed funds since July as it awaits greater clarity on measures needed to meet fiscal consolidation targets, after the government backtracked on cuts to fuel prices in response to large protests. This highlights the complicated outlook for it to achieve the large fiscal consolidation effort called for under the IMF program to stabilise debt dynamics, build up external buffers, and improve financing access. Ecuador's capital market access remains sensitive to its ability to remain on track with the IMF program.

General Government Debt



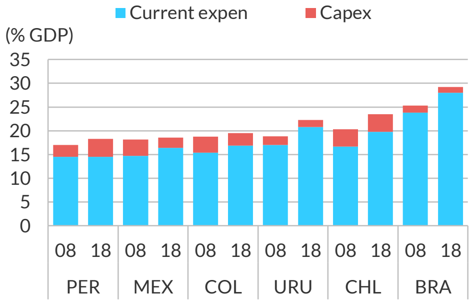
Source: Fitch Ratings

FC Share of GG Debt
2019F



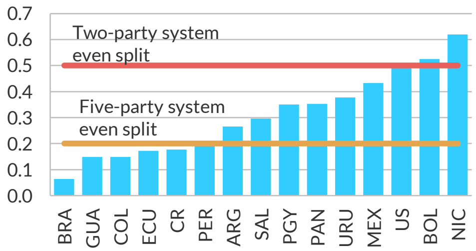
Source: Fitch Ratings

Central Govt Expenditure



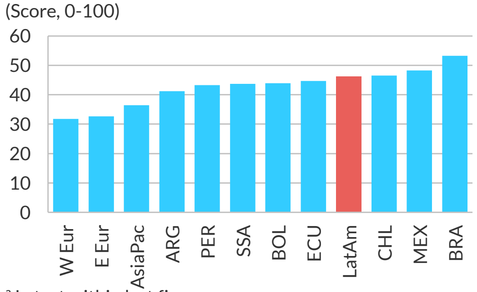
Source: Fitch Ratings

Political Dispersion
Herfindahl-Hirschman Index



Note: A lower number suggests greater fragmentation or higher number of smaller parties
Source: Fitch Ratings

Gini Coefficient[a]



[a] Latest within last five years
Source: Fitch Ratings, World Bank

Appendix

Latin America

Country	LT FC IDR	FC Outlook	ST FC IDR	LT LC IDR	LC Outlook	ST LC IDR	Country Ceiling
Argentina	CC	-	C	CC	-	C	CCC
Aruba	BBB-	Negative	F3	BBB-	Negative	F3	BBB
Bolivia	B+	Negative	B	B+	Negative	B	B+
Brazil	BB-	Stable	B	BB-	Stable	B	BB
Chile	A	Stable	F1	A+	Stable	F1+	AA
Colombia	BBB	Negative	F2	BBB	Negative	F2	BBB+
Costa Rica	B+	Negative	B	B+	Negative	B	BB-
Dominican Republic	BB-	Stable	B	BB-	Stable	B	BB-
Ecuador	B-	Stable	B	B-	Stable	B	B-
El Salvador	B-	Stable	B	B-	Stable	B	B
Guatemala	BB	Negative	B	BB	Negative	B	BB+
Jamaica	B+	Stable	B	B+	Stable	B	BB-
Mexico	BBB	Stable	F2	BBB	Stable	F2	A-
Nicaragua	B-	Stable	B	B-	Stable	B	B-
Panama	BBB	Stable	F2	BBB	Stable	F2	A
Paraguay	BB+	Stable	B	BB+	Stable	B	BB+
Peru	BBB+	Stable	F1	A-	Stable	F1	A-
Suriname	B-	Negative	B	B-	Negative	B	B-
Uruguay	BBB-	Negative	F3	BBB-	Negative	F3	BBB+

Source: Fitch Ratings

Outlooks and Related Research

2020 Outlooks
Global Economic Outlook (September 2019)
Latin American Sovereign Credit Overview 4Q19 (October 2019)

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