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OUTLOOK

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Sovereigns – Latin America & Caribbean

2019 outlook stable as growth, debt structures still favorable; political risks rising

Our outlook for Latin American (LatAm) and Caribbean sovereign creditworthiness in 2019 is stable overall, reflecting our expectations for the fundamental credit conditions that will drive sovereign credit over the next 12-18 months. The stable outlook reflects still supportive economic growth, improved debt structures that mitigate liquidity risks, and moderate balance-of-payments risks. The biggest downside risks to the stable outlook stem from domestic challenges related to changes in political dynamics following presidential elections in 2018. Slower global growth in 2019 and elevated government debt burdens will limit upward rating pressures. Ultimately, the policies that the region's governments adopt will be key in determining sovereign credit trajectories.

Exhibit 1

Nearly three-quarters of Moody's-rated LatAm and Caribbean sovereigns have a stable outlook as of 9 January 2019

Source: Moody's Investors Service

Ratings overview

Going into 2019, 21 (72%) of the 29 sovereigns we rate in the LatAm and Caribbean region have a stable outlook. Two (7%) hold a positive outlook and six (21%) have a negative outlook (see Exhibit 1).

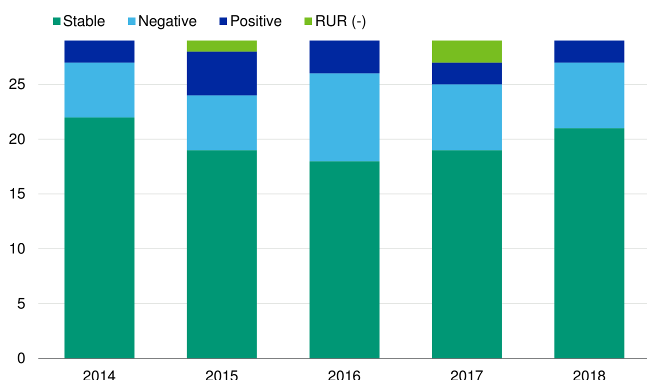
» **2018 saw a limited number of rating changes (5) compared to 2017 (8).** In 2018, we only upgraded El Salvador (B3 stable), which reflected reduced government liquidity risks after political agreements unlocked long-term government financing. The other four rating changes were downgrades primarily involving sovereigns at the lower end of the rating scale, with Chile (A1 stable) as the exception. Chile's downgrade reflected a gradual but broad-based deterioration in its credit profile. Costa Rica's (B1 negative) multi-notch downgrade reflected funding challenges and a continued deterioration in debt metrics due to insufficient fiscal consolidation efforts. Venezuela's (C stable) downgrade reflected our expectation that the ongoing erosion of the sovereign's payment capacity would lead to heavy losses to bondholders. The downgrade of Suriname (B2 negative) was informed by deteriorating fiscal and debt affordability metrics.

» **Negative outlooks on Mexico's and Brazil's ratings were moved back to stable.** The change in outlook for Mexico (A3 stable) reflected receding risks to growth stemming from NAFTA renegotiations as well as continued improvements in fiscal performance. Brazil's (Ba2 stable) outlook change was driven by reduced downside risks to growth and our expectations of renewed reform momentum starting in 2019. Given that new administrations have recently taken office in both countries, their willingness and ability to preserve fiscal rectitude, sustain GDP growth and maintain policy credibility will be key for their credit trajectories going forward.

» **By year-end 2018, the region had the highest number of stable outlooks since 2014**. During the 2014-18 period, 11 countries maintained their ratings, while another 11 were downgraded and 7 were upgraded (see Exhibits 2 and 3). In several instances, we assigned stable outlooks following upgrades or downgrades, including in Honduras (B1 stable), El Salvador, Chile, Trinidad & Tobago (Ba1 stable) and Barbados (Caa3 stable).

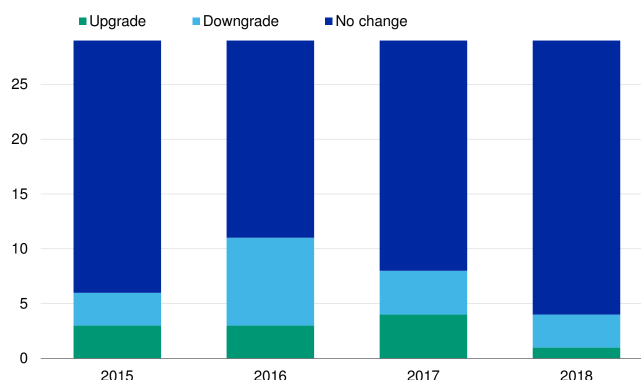
» **The average rating for the region has remained at Ba2 in the last four years**, despite the commodity shock of 2014, uncertainty generated by a shift in US trade and immigration policy and other idiosyncratic issues affecting the region's investment and growth prospects, such as Odebrecht-related corruption scandals.

Exhibit 2
2018 had the highest number of stable outlooks since 2014
End-of-year outlooks for LatAm and Caribbean sovereigns



Source: Moody's Investors Service

Exhibit 3
Most ratings did not change in 2018
Rating changes per year, 2015-18



Source: Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Regional growth momentum to persist and remain supportive at the aggregate level – but it masks mixed performance across countries

In 2019, domestic country-specific factors will prove more significant for LatAm credit prospects than fading global growth. We expect domestic growth conditions to remain credit supportive, with higher economic growth in 2019 compared to 2018, given the preservation of low inflation and only gradual increases in global interest rates. Exchange-rate adjustments that took place in 2015-17 should help contain external imbalances. While not our base case, the risk of a sustained decline in GDP growth would be a risk to debt sustainability and would weaken governments' ability to attain political support to undertake unpopular but necessary reforms.

» **On average, we expect moderately higher economic growth in 2019 (2.0%) compared to 2018 (1.5%).** Growth rates in a handful of countries will come above those estimated for 2018. In Colombia (Baa2 negative), a broad-based recovery, including in mining and construction, will underpin GDP growth, which we project will be 0.7 percentage points higher in 2019 compared to 2018. We expect Panama's economy to grow 5.5% in 2019, making it the region's fastest-growing economy, although average annual growth was 6.7% in 2010-18E. We anticipate better conditions in Brazil and Guatemala (Ba1 stable) to support the region's economic strength. At the same time, we project smaller GDP contractions in Argentina (B2 stable), Nicaragua (B2 stable) and St. Maarten (Baa2 negative) given indications that their economic crises have bottomed out. For the rest, this year's growth will be similar to 2018 with some deceleration in Mexico, the Dominican Republic (Ba3 stable) and Costa Rica (see Exhibits 4 and 5).

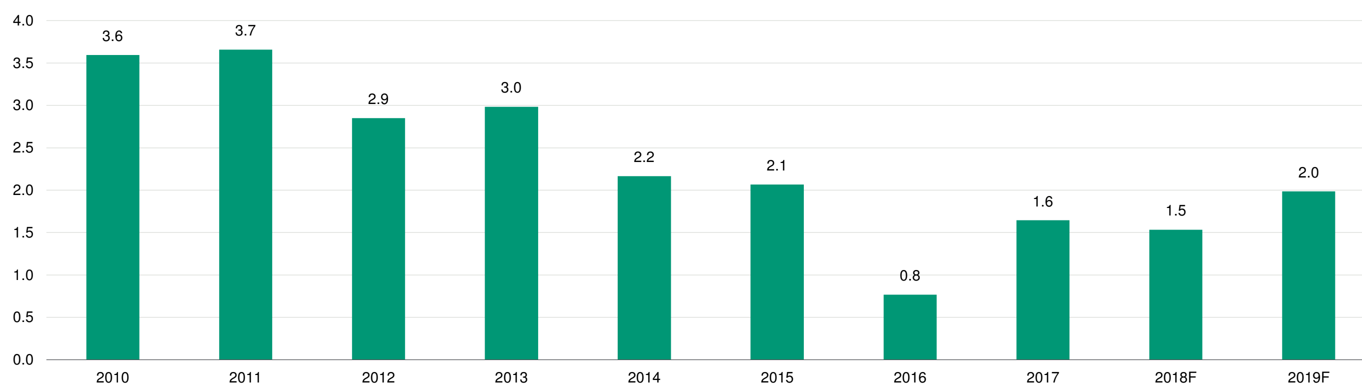
» **Commodity-exporting economies will grow at a similar pace to 2018.** We expect commodity prices to recover only mildly in 2019, with oil prices remaining volatile around current levels. Robust domestic demand and private investment will drive economic growth in Chile and Peru (A3 stable), but growth will slow as the economies move closer to potential. A recovering energy sector will support economic growth in Trinidad & Tobago, while gradual fiscal consolidation to address macroeconomic imbalances will keep growth subdued in Ecuador (B3 negative).

» **Slower global growth in 2019, driven by trade tensions between the United States (Aaa stable) and China (A1 stable), a waning fiscal impulse in the US and increasingly restrictive monetary policies in advanced economies will disproportionately affect countries with close ties to the US.** The contentious international trade environment is likely to weaken global demand. The Mexican, Central American and Caribbean economies will be most impacted by the trade rift because of their high exposure to demand from the US. In Mexico, manufacturing, primary metals, and food and beverage will be among the sectors most affected. Less favorable external conditions could curb upside potential for commodity-exporting economies, but they are unlikely to materially dent their economic prospects barring a significant escalation.

Exhibit 4

Recovery remains subdued despite higher growth in 2019

LatAm and Caribbean simple average, real GDP annual % change



Note: We use a simple average because a weighted average would mostly reflect Brazil, Mexico and Argentina.
Source: Moody's Investors Service

» **Despite easing, economic growth in the US will remain sufficiently healthy to support family remittance and tourism flows to the region.** Weaker but still healthy US growth next year will continue to alleviate pressures on the external and fiscal accounts of sovereigns that depend on remittances and tourism,[1] such as El Salvador, Guatemala, the Dominican Republic and Jamaica. In El Salvador and Guatemala, remittance flows represent 17% and 10% of GDP, respectively, and underpin private consumption. Tourism receipts provide important support to the Dominican Republic's external accounts, and remittance flows in the order of 7% of GDP compensate for oil-driven trade deficits. In Jamaica, where tourism-related activity already accounts for about 33% of GDP,[2] the share will likely grow as more sector-specific projects are completed.

Exhibit 5

Most LatAm and Caribbean economies will expand by 1.0%-2.0% in 2019

Legend: Above 3.0% (green); 1.0% to 3.0% (blue); Below 1.0% (red)

Latin American sovereigns

Country	Average growth 2014-18F	Average growth 2018F-19F	2018F	2019F
Panama	5.3	5.0	4.5	5.5
Bolivia	4.7	4.4	4.5	4.3
Paraguay	4.3	4.1	4.3	4.0
Peru	3.2	3.8	3.9	3.7
Chile	2.2	3.8	4.0	3.6
Honduras	3.8	3.6	3.7	3.5
Guatemala	3.4	3.1	2.8	3.4
Colombia	2.8	2.9	2.6	3.3
Costa Rica	3.5	2.6	2.7	2.5
El Salvador	2.3	2.4	2.5	2.4
Uruguay	2.0	2.2	2.0	2.4
Mexico	2.7	2.2	2.3	2.2
Brazil	-0.7	1.9	1.8	2.0
Ecuador	1.2	1.0	1.0	1.1
Nicaragua	3.3	-1.5	-2.5	-0.5
Argentina	-0.2	-2.0	-2.5	-1.5
Venezuela	-9.0	-6.5	-8.0	-5.0

Caribbean sovereigns

Country	Average growth 2014-18F	Average growth 2018F-19F	2018F	2019F
Dominican Republic	6.3	5.5	5.8	5.2
St. Vincent and the Grenadines	1.0	2.4	2.3	2.5
Cayman Islands	2.8	2.5	2.6	2.4
Jamaica	1.1	2.0	1.8	2.2
Suriname	-0.7	2.1	2.0	2.2
Trinidad & Tobago	-1.2	2.0	1.9	2.2
Belize	2.0	1.9	1.8	2.0
Bermuda	0.7	1.5	1.1	2.0
Bahamas	0.5	1.9	2.0	1.8
Cuba	1.7	1.5	1.4	1.6
Barbados	0.5	-0.7	-0.8	-0.5
St. Maarten	-1.9	-5.0	-7.0	-3.0

Source: Moody's Investors Service

Government debt burdens remain a credit constraint; favorable debt structures limit vulnerabilities

We see little material change in LatAm sovereigns' debt burdens this year, with most countries' debt ratios remaining close to 2018 levels (see Exhibit 6). We do not expect many to pursue aggressive fiscal consolidation for political reasons so as not to unsettle the economic growth momentum. In an environment of lower global growth and worsening financial conditions, the absence of balance sheet repair could erode debt affordability, limiting upward rating movements in some cases and posing downside risks in others.

» **High debt burdens pose the greatest challenges for Caribbean countries,**[3] limiting their ability to implement countercyclical fiscal policies, respond to natural disasters or increase capital spending, and perpetuating low-growth cycles seen in most of the region over the past decade. Seven of the 12 Caribbean countries we rate had debt burdens above 50% of GDP in 2018.

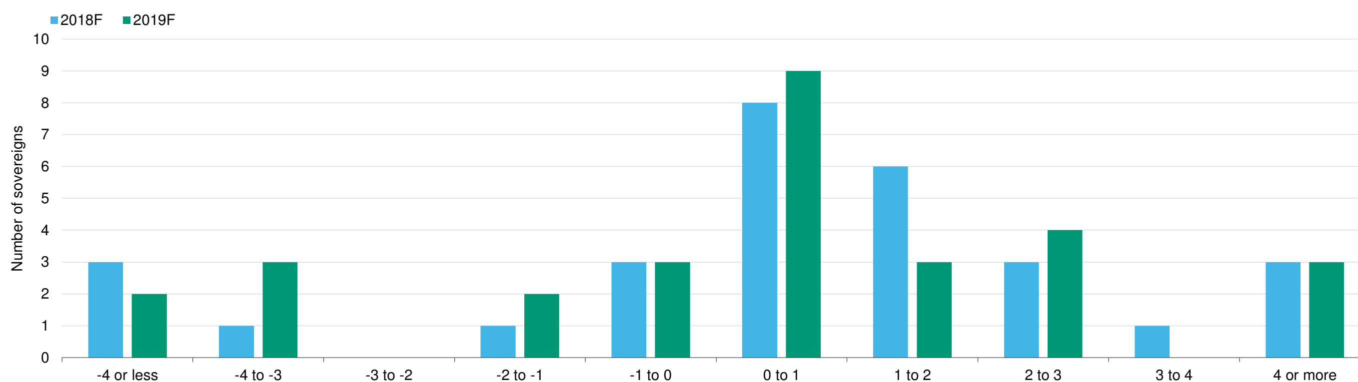
» **We expect narrower fiscal deficits in Chile, Barbados, Argentina, Colombia, Peru and Brazil**, but this will only lead to debt stabilization in the case of Chile. We expect Barbados to implement the largest adjustment, with a deficit of 1.8% of GDP turning into a 2.5% surplus in 2019, while Colombia's fiscal deficit will narrow to 1.3% of GDP from 2.0% in 2018.

» **Sovereign credit exposure to tighter external funding conditions and a stronger US dollar is relatively contained in LatAm given improved debt structures.** Proactive liability management operations have lengthened debt maturities for several countries and lowered the share of foreign-currency-denominated debt.[4] Additionally, some governments have financial buffers in the form of liquid assets or flexible credit lines with the International Monetary Fund (IMF). Chile, Peru, Uruguay and Mexico appear only moderately vulnerable to a shift in global financing conditions on account of (i) moderate government borrowing needs, (ii) the length of their average debt maturities, and (iii) the presence of financial buffers (see Exhibit 7).

» **Argentina, Costa Rica and Ecuador are exceptions and are highly exposed to changing global financing conditions.**[5] All three have short average debt maturities and high borrowing needs, combined with a dependence on external creditors. In Argentina, following a currency crisis and the government's inability to restore market confidence, the signing of an agreement with the IMF provided significant credit support, allowing the sovereign to cover its external financing needs through 2019. In Costa Rica, a deterioration in debt metrics and higher interest rates have led to rapidly rising borrowing requirements. Although the share of external creditors in total government debt is comparatively low, going forward, Costa Rica will have to rely on external markets to fund much of its funding needs as domestic markets reach their capacity. In Ecuador, elevated public spending coupled with lower oil prices have increased dependence on external public debt inflows to support foreign exchange reserves, making the country highly susceptible to changing global funding conditions and investor appetite. Even if the authorities adopt fiscal adjustment measures – as outlined in their 2019 budget – they could still seek IMF assistance ahead of a bond payment due in 2020.

Exhibit 6

Government debt burdens will continue to rise moderately in LatAm and the Caribbean
Change in government debt/GDP, percentage points



Sources: Haver Analytics, Moody's Investors Service

» **Reliance on financing from multilaterals to meet funding needs mitigates funding risks for some sovereigns with high shares of foreign-currency-denominated debt**. Nicaragua, Paraguay (Ba1 stable), Honduras and Guatemala depend more heavily on multilateral financing than do regional peers (see Exhibit 8). Multilateral financing terms tend to be more generous, generally characterized by longer average debt maturities, reducing both rollover and liquidity risks.

Exhibit 7

Credit exposure to shifts in global financing conditions

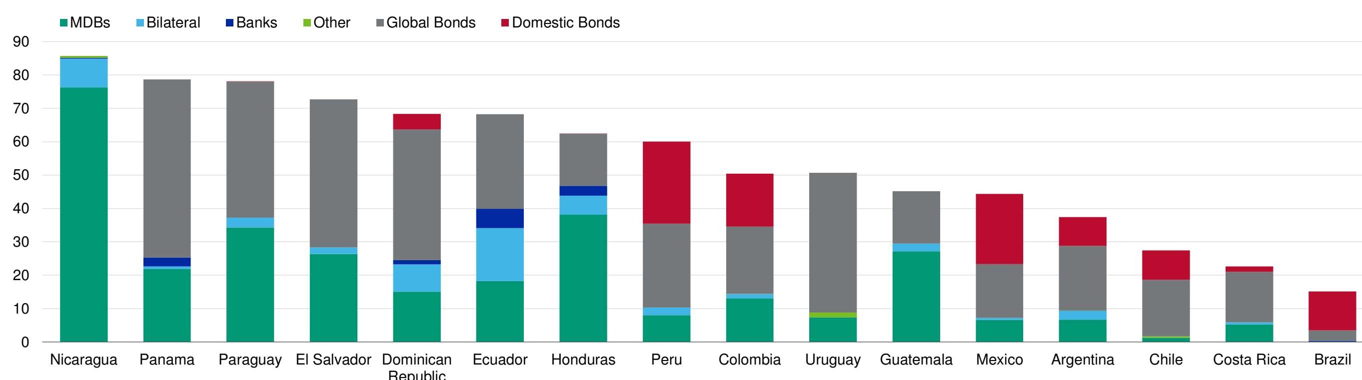
	Credit risk exposure		Credit risk mitigants	
	Balance sheet risks (Share of foreign-currency debt)	Liquidity risks (Share of external creditors)	Borrowing profile (Government borrowing needs and average maturities)	Fiscal buffers
Argentina	High	Moderate	Weak	No
Ecuador	--	High	Moderate	No
Dominican Republic	High	High	Moderate	No
El Salvador	--	High	Moderate	No
Guatemala	High	Moderate	Moderate	No
Honduras	High	Moderate	Moderate	No
Paraguay	High	High	Strong	No
Costa Rica	Moderate	Low	Weak	No
Nicaragua	High	Moderate	Strong	No
Panama	--	High	Strong	Yes (Assets)
Brazil	Low	Low	Weak	No
Colombia	Moderate	Moderate	Strong	Yes (FCL)
Mexico	Low	Moderate	Moderate	Yes (FCL)
Uruguay	Moderate	Moderate	Strong	Yes (Assets)
Peru	Moderate	Moderate	Strong	Yes (Assets)
Chile	Low	Low	Strong	Yes (Assets)

Note: For complete report see Exposure to credit risks from tightening global funding conditions varies depending on debt structures, 1 October 2018.
Although Brazil is listed as having no fiscal buffers, the government currently has a strong cash position, equivalent to 10-13 months of debt payments. This is a relatively recent feature with a short track record, having increased from just four months of debt payments in 2014. The Treasury does not target a specific level for its cash position. For more information, see Strong cash position, low market rollover needs mitigate credit risks from high gross borrowing requirements, 5 December 2018.
Source: Moody's Investors Service

Exhibit 8

External debt by residency of creditor

% of total debt, 2017



Note: Uruguay and El Salvador are special cases in that large portions of debt issued abroad are held by residents. Their totals in this exhibit show debt held by nonresident creditors only.
Source: Moody's Investors Service

With few exceptions, moderate balance-of-payments risks limit country vulnerability to tightening global liquidity

Vulnerability to tighter external funding conditions is largely contained given improved debt structures and relatively low dependence on external capital inflows. Flexible exchange rates, favorable external positions and moderate gross borrowing requirements also counteract balance-of-payments risks. For most countries, reserves exceed upcoming external debt payment needs (see Exhibit 9).

» **Despite slightly wider current account deficits in 2019, external imbalances are largely covered by FDI inflows.** Argentina and Venezuela are exceptions. In Argentina, current account deficits have averaged 3.8% of GDP between 2016-18, with FDI inflows covering only 20% of the imbalance. Although we expect the economic contraction to narrow the current account deficit this year, FDI inflows will remain low. In Venezuela, declining oil production has exacerbated macroeconomic stress brought about by long-standing economic distortions and a policy framework that crippled the economy's productive capacity, features that we expect to remain in place for the foreseeable future.

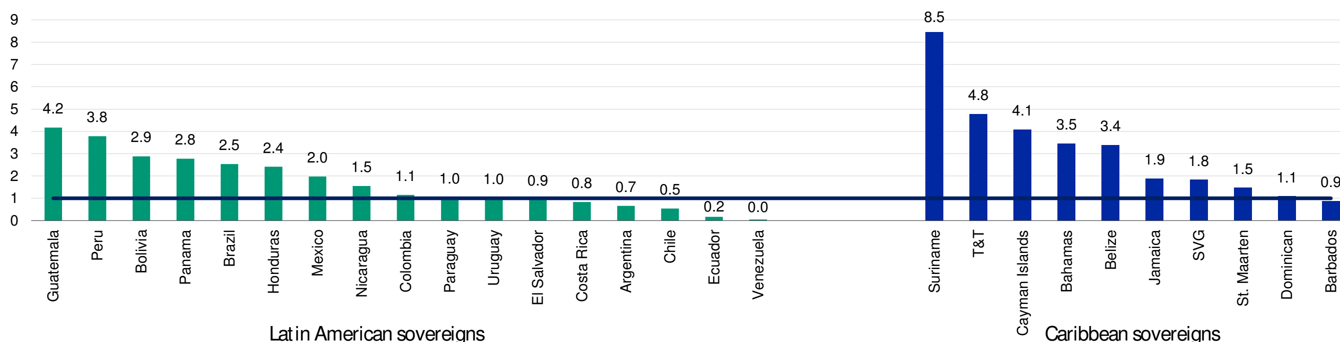
» **In the Caribbean, Jamaica and the Dominican Republic are the most exposed to exchange rate shocks** given their high reliance on foreign-currency debt and flexible exchange rates. Despite similarly high shares of foreign-currency debt in the Cayman Islands (Aa3 stable) and Bermuda (A2 stable), pegged exchange rates mitigate currency risks there.

» **Adjusting to lower capital flows can reduce overtime vulnerability to external funding conditions.** A key factor behind lower capital flows has been the strengthening US dollar, which reduces capital flows into the region as higher US yields make LatAm assets less attractive. According to the Institute of International Finance, monthly portfolio inflows into LatAm averaged $3.0 billion in January to November 2018 compared to the $9.6 billion monthly average in 2010-14, as shown in Exhibit 10.

Exhibit 9

Foreign exchange reserves act as buffers for most LatAm and Caribbean sovereigns

Inverse of Moody's External Vulnerability Indicator,[6] above 1 implies full coverage, 2019

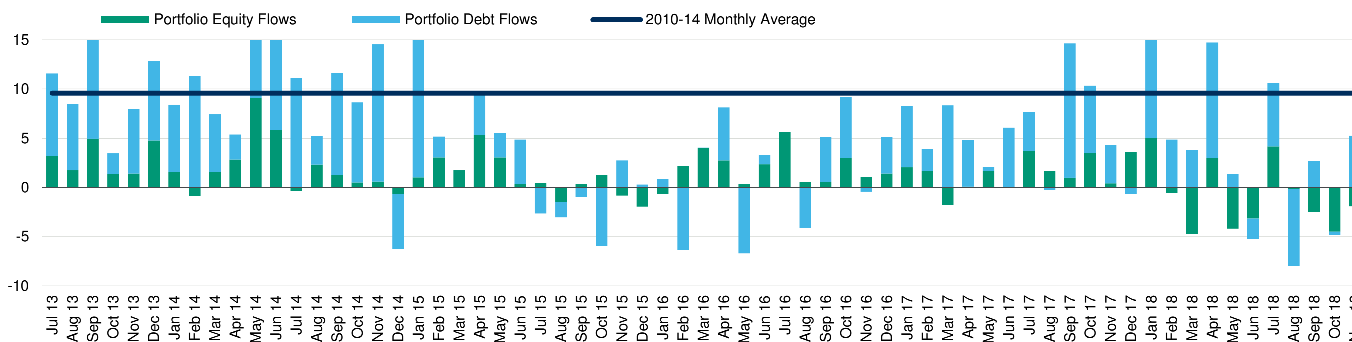


Source: Moody's Investors Service

Exhibit 10

Capital flows to Latin American[7] economies are now lower than the historical average

US$ billion



Sources: Institute of International Finance, Moody's Investors Service

Downside risks stem from the potential economic and financial spillovers of policy shifts driven by an evolving political landscape

The potential policy implications of domestic political events pose the greatest tail risk to the current constellation of LatAm ratings. While relatively few sovereigns are directly exposed to these risks, for those that are, their crystallization could adversely affect credit fundamentals. Moreover, domestic political conditions could lead to a change in policy priorities that, if not supportive of medium-term growth and fiscal prospects, would undermine sovereign creditworthiness.

» **The outcome of recent elections in the region reveals increased political polarization, with the political center all but dissipated.** As part of new political dynamics, a shift in policy priorities has introduced uncertainty in some countries about policy continuity and the future role of existing institutions.

» **In Mexico, adverse investor sentiment reflects concerns about the decision-making process of the new administration and its ability to deliver on promises of fiscal responsibility.** A strong fiscal starting point provides a near-term buffer for the sovereign. Looking beyond 2019, the evolution of Mexico's credit profile will depend on the authorities' ability to preserve fiscal rectitude, promote sustained growth and build up policy credibility. If negative market sentiment extends to business confidence, medium-term growth and investment prospects would be adversely affected, potentially undermining fiscal strength and sovereign creditworthiness.

» **We expect an aggressive push for market-oriented economic reforms in Brazil, but the government's ability to pass credit-positive measures remains uncertain.** Jair Bolsonaro's election as president has had a positive effect on investor sentiment and reduced exchange-rate volatility. A low domestic interest rate environment will support economic activity and government debt dynamics. Still, high unemployment reflects a large output gap and persistently low levels of private investment. The final outcome of pension reform will be a key factor affecting Brazil's medium-term sovereign credit prospects.

» **In Argentina, the main challenge will be to manage the political consequences of the severe macro-fiscal adjustment adopted by the authorities.** The ruling Cambiemos coalition lacks a majority in congress. Moreover, last year's currency crisis, which led to the signing of an IMF agreement, has reduced President Mauricio Macri's approval ratings. Social discontent and political consequences will rise ahead of this year's national elections, introducing material risks to policy continuity.

» **In Colombia, the government needs to secure congressional support to ensure compliance with near- and medium-term fiscal targets.** Colombia's congress recently approved a tax reform bill that falls short of the government's original revenue goals and will likely force the government to freeze spending to meet fiscal targets. Additional political support will be needed to pass measures that allow the government to reach the 2020-22 targets outlined in its medium-term fiscal framework.

» **Presidential elections in El Salvador could signal a break of the traditional two-party system**. Since the leading candidate, Nayib Bukele, is not a member of any of the two parties that have ruled the country over the last 30 years, his election this year would mark a major break with the past. The reconfiguration of political forces would introduce uncertainty about the terms in which the executive and legislative branch would work given ARENA's (right-of-center party) control of the legislative assembly and the need for a two-thirds majority vote to approve long-term debt issuance, including for budget deficit financing.

Exhibit 11

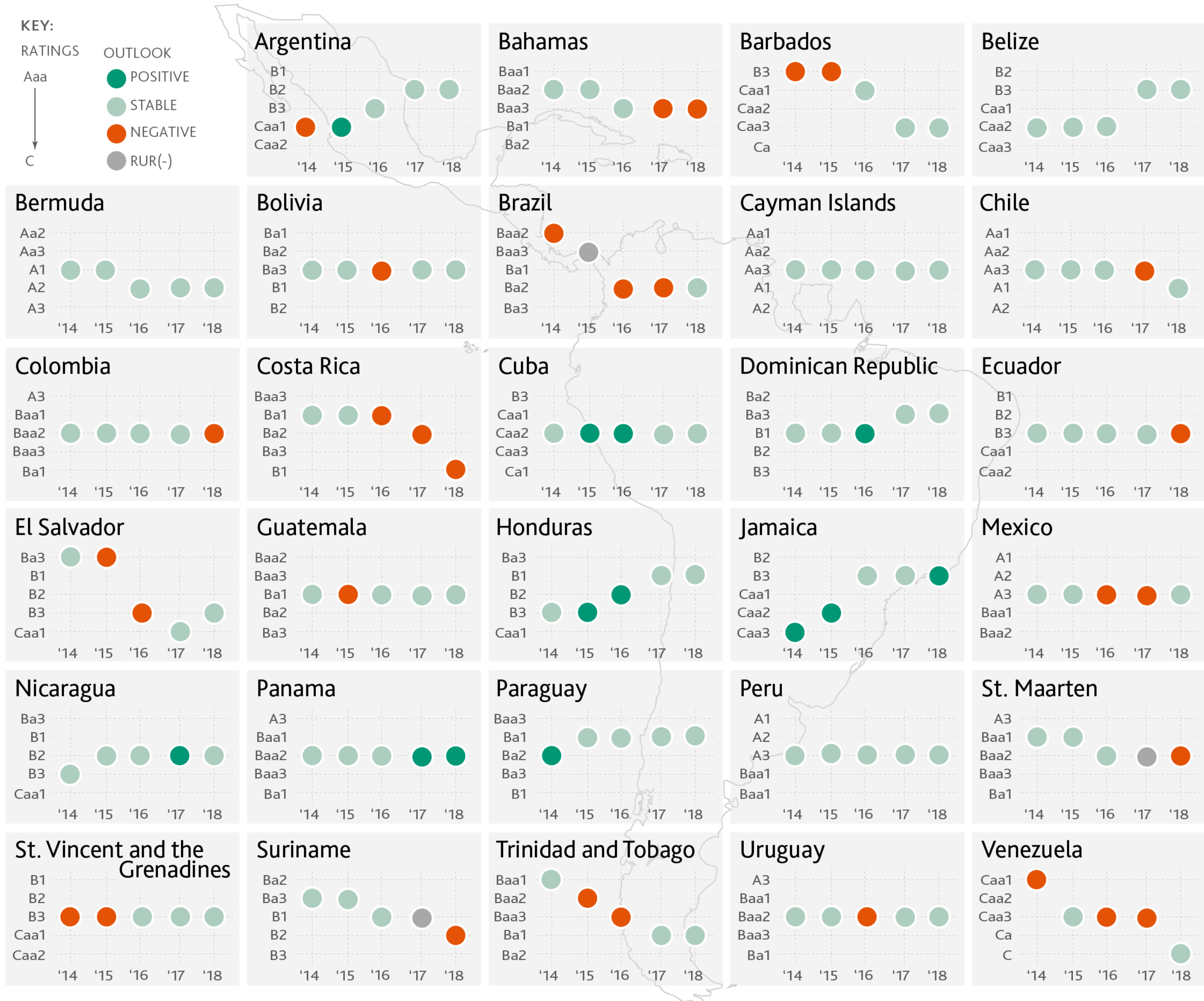
Changes in political risk scores since 2013

A negative change reflects an increase in political risk

Source: Moody's Investors Service

Appendix

LatAm and Caribbean rating movements since 2014



Source: Moody's Investors Service

Moody's related publications

Issuer research

- Government of El Salvador: Legislative approval of 2019 budget and debt financing reduces refinancing risk, a credit positive, 4 January 2019
- Government of Jamaica: Economic growth acceleration will support the government's debt reduction efforts, 4 January 2019
- Government of Mexico: Budget maintains fiscal responsibility, but with little room for maneuver, 18 December 2018
- Government of Brazil: Strong cash position, low market rollover needs mitigate credit risks from high gross borrowing requirements, 5 December 2018
- Government of Chile: Proposed pension reform would increase government spending, but limited near-term impact on fiscal strength, 19 November 2018
- Government of Argentina: 2019 budget approval paves the way for continued IMF support, 16 November 2018
- Government of Peru: Efforts to narrow infrastructure gap held back by corruption; finding new mechanisms key for long-term growth, 8 November 2018
- Government of Colombia: Proposed tax measures support fiscal consolidation efforts, 7 November 2018
- Government of the Bahamas: Improved fiscal data dissemination standards will strengthen budgetary framework, 1 November 2018
- Government of Panama: Changes to fiscal rule will strengthen framework but wider deficits in the short term will lead to higher debt, 18 October 2018
- Government of El Salvador: 2019 budget proposal indicates improved political dynamics intact, but fiscal challenges remain, 10 October 2018
- Government of Chile: 2019 budget forecasts continued fiscal consolidation and above-potential growth, a credit positive, 9 October 2018
- Government of Trinidad & Tobago: 2019 budget forecasts continued fiscal consolidation, a credit positive, 5 October 2018
- Government of Argentina: IMF's advancement of funding will shield Argentina from refinancing risks through 2019, 1 October 2018
- Government of Colombia: Lower potential growth highlights importance of structural reforms to meet fiscal targets, 27 September 2018
- Government of Jamaica: Fourth IMF program review signals continued fiscal consolidation and improving institutional effectiveness, 25 September 2018
- Government of Peru: Proposed judicial reforms would strengthen institutional framework, 23 September 2018
- Government of Argentina: FAQ on the credit implications of the IMF program, 23 September 2018
- Government of Costa Rica: Growing social unrest complicates fiscal consolidation efforts, 20 September 2018
- Government of Chile: Chile's upward revision to 2018 growth forecast is credit positive, 13 September 2018
- Government of Barbados: Barbados' debt restructuring and IMF program will support fiscal and debt sustainability, 13 September 2018
- Governments of Chile and Qatar: Peer Comparison - Commodity dependence and size of fiscal space determine credit trajectories, 6 September 2018

Sector research

» Sovereigns - Caribbean: Limited export diversification increases susceptibility to external shocks but mitigants exist, 8 January 2019

» Cross-Sector - Mexico: A rocky start for the new administration signals challenges ahead, 4 December 2018

» Sovereigns - Latin America: Moderate economy-wide leverage supports region's resilience to shocks, with pockets of vulnerability, 30 October 2018

» Cross-Sector - Brazil: Bolsonaro victory signals continuity, but policies and congress support still unclear, 29 October 2018

» Sovereigns - Caribbean: Large debt burdens and institutional factors constrain most fiscal profiles, 23 October 2018

» Sovereigns - Latin America: Exposure to credit risks from tightening global funding conditions varies depending on debt structures, 1 October 2018

» Sovereigns - Latin America: Currency weakness will primarily impact sovereigns with large external imbalances, 4 June 2018

» Sovereigns - Caribbean: Small size and subdued growth prospects constrain economic strength in most countries, 18 June 2018

» Cross-Sector - Colombia: Colombia's next president will face fiscal challenges even as growth accelerates, 12 June 2018

Rating methodology

» Sovereign Bond Ratings, 27 November 2018

Endnotes

1 According to the Caribbean Tourism Organization, the US is the primary tourist source market for the region.

2 See World Travel & Tourism Council Economic Impact 2018 Report on Jamaica.

3 See Sovereigns – Caribbean, Large debt burdens and institutional factors constrain most fiscal profiles, 23 October 2018.

4 Based on data available, we find that given the composition of creditors and holders of debt, on average Latin American governments' debt stocks have a maturity of 11.5 years.

5 While the Dominican Republic's government balance sheet faces exchange rate risk given its high share of foreign-currency-denominated financial obligations, the government's debt structure has improved with a higher share of debt now at fixed rates.

6 External Vulnerability Indicator = ST external debt + currently maturing LT debt + total nonresident deposits over one year / official foreign exchange reserves

7 The IIF only includes Brazil, Chile and Mexico in its LatAm portfolio flow monitor.

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