
# Covid-19 and the Credit Outlook for LatAm Economies

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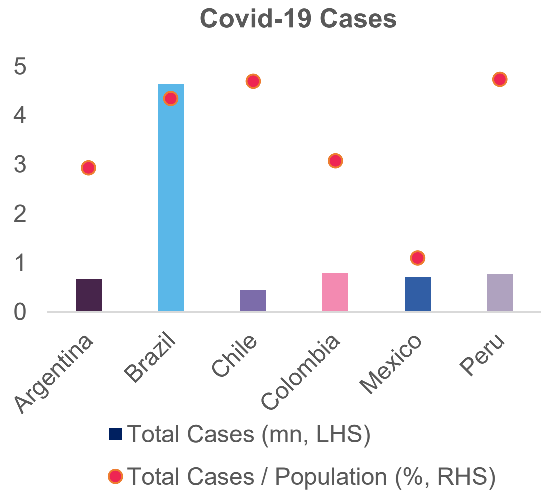
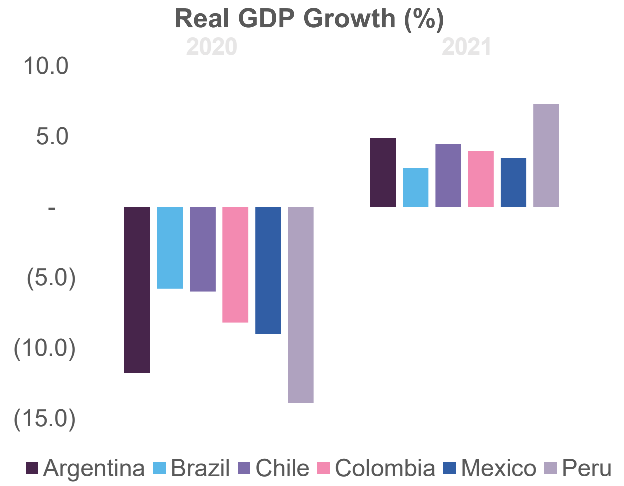
# Introduction

The six largest economies of LatAm – Argentina, Brazil, Chile, Colombia, Mexico and Peru – are among the top 12 countries with the most coronavirus cases in the world, which has led to negative GDP forecasts for 2020, depreciation of local currencies and deterioration in credit profiles. According to the IMF, these countries' GDPs are expected to shrink on average by 9.1% in 2020, while, when excluding Argentina, the cost of insuring their debt against default has risen 80% on average in the past 12 months (Argentina defaulted its ninth time in history).



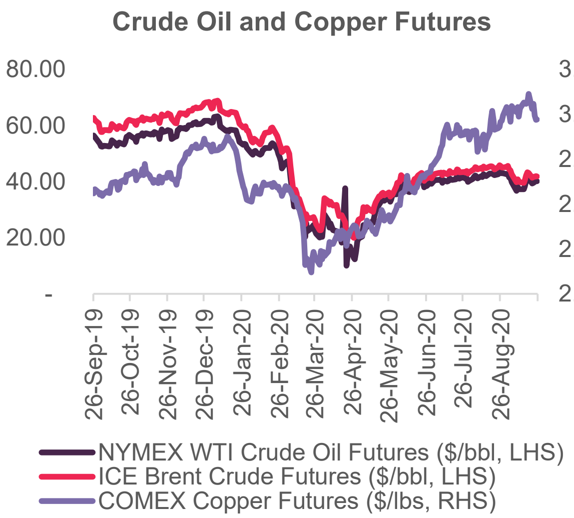



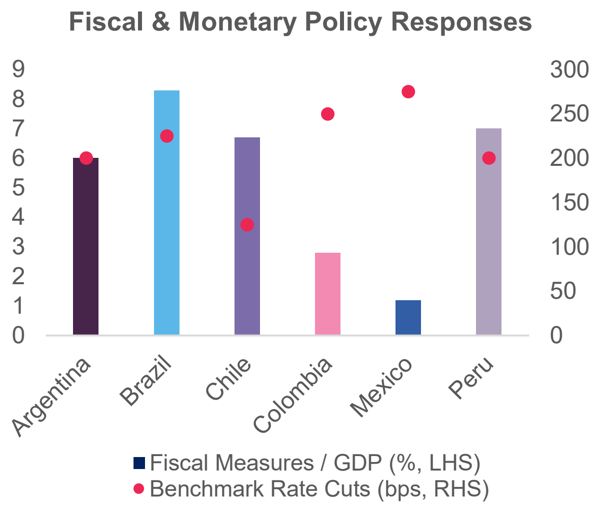

*Source: Worldmeters, Data as of 9/24/2020.*

*Source: IMF WEO, Data as of October 2020.*

Fitch, Moody's and S&P took negative credit actions on these countries' sovereign ratings – with the exception of Peru – due to the effects of the pandemic on their economic growth and debt levels. Additionally, Brazil, Colombia and Mexico have been negatively affected by the sharp drop in oil prices, with crude oil futures having declined more than 30% YTD.

On a positive note, while Chile and Peru were affected by the pandemic's initial decline in copper prices, the red metal is now trading higher than it was prior to the pandemic, mainly due to the recovery in China's economy (with GDP at +1.9% in 2020 and +8.2% in 2021) and lower inventory levels. Copper futures are currently trading at $2.97/lbs versus $2.50-2.60/lbs in February/March of this year.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020.*

*Source: IMF, Data as of 9/24/2020.*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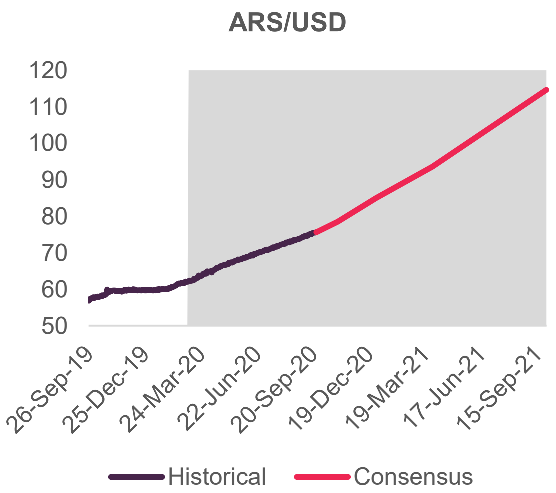
Monetary policy measures for each of the six countries to counter the crisis have included cuts to their benchmark rates of at least 200 bps, with the exception of Chile at a reduction of 125 bps. Moreover, the fiscal responses have averaged at 5.3% of the six countries' GDPs, with the most relevant measures including support for hard-hit sectors, aid for employment, cheap credit and higher health care spending.

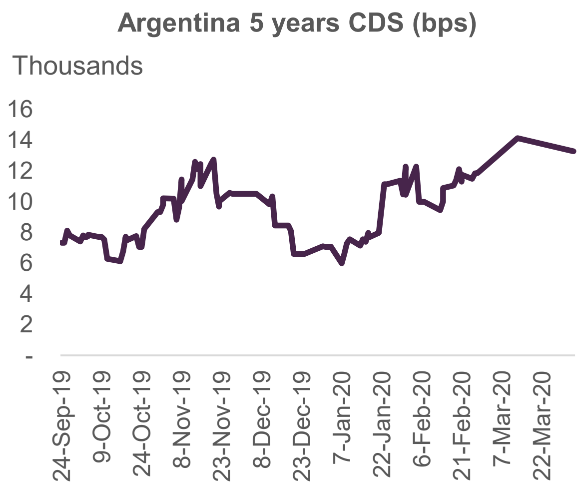
The economic recovery is expected to occur in 2021 as countries open their economies, with the GDP of the six countries expected to rise 4.5% on average throughout the year. In this context, Argentina is the only country with an inverted yield curve, reflecting the uncertainty about the country's recovery path.

## Argentina: Trying to Recover from Its Ninth Default in History

Argentina ranks 10th globally in total number of Covid-19 cases, at 665k cases, which represents 1.5% of the country's population. According to the IMF, its economy will drop 11.8% this year.

Argentina is currently rated in the CCC/CC/C range; it recently completed a distressed debt exchange on its foreign currency debt after the country failed to pay USD500mn in interest on three USD-denominated bonds due on April 22 and after the grace period expired on May 22. In this environment, the five-years CDS closed above 13,000 bps in early April, while the ARS/USD is trading at around $75, as the Argentinian peso has weakened 33.0% versus the US dollar in the past 12 months and 21.9% since the first Covid-19 case hit the country. According to a Reuters poll from October of this year, the consensus is that the ARS/USD will reach $85.00 by the end of the year and $114.65 in the next 12 months.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Argentina.*

As a response to the pandemic, Argentina's central bank cut its benchmark rate by 200 bps to 38%. Additionally, its major fiscal response measures, totalling ~6.0% of its GDP, have focused on monetary support for health care and other hard-hit sectors, workers and vulnerable groups, as well as forbearance and credit guarantees.

According to the IMF, Argentina's economy will recover by 4.9% in 2021; however, the accumulated compound growth rate in 2020-2021 will be negative (at -7.5%). Accordingly, Argentina has registered an inversion in its yield curve, with the one-year government bond yield being higher than the seven-year government bond yield, a trend that was exacerbated after the country defaulted on some of its debt in April/May. Currently, the 7y – 1y term spread is at negative 87.7 bps, while it had been positive 350 bps pre-Covid-19 and positive 45.3% in late November 2019. All in all, the path to recovery is far from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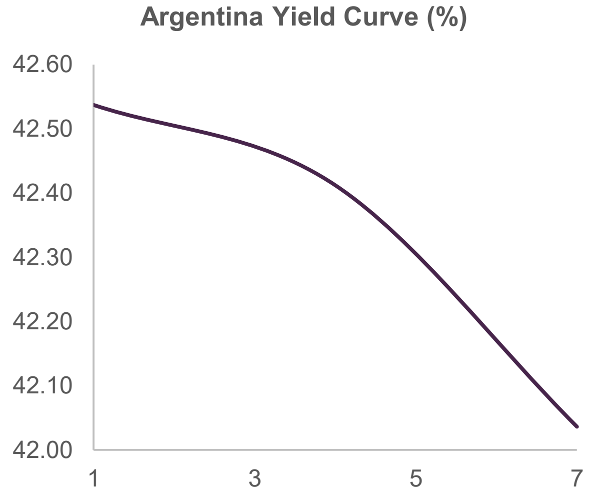
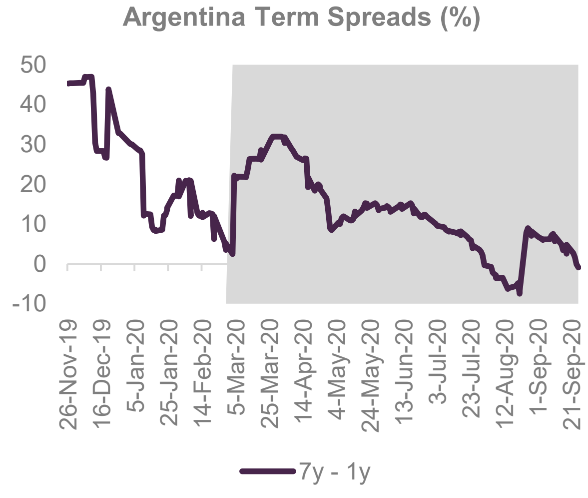
guaranteed, with Argentina having already entered the pandemic facing a recession as GDP in 2019 contracted at 2.1% and an annual inflation rate that was at a substantial 53.8%.



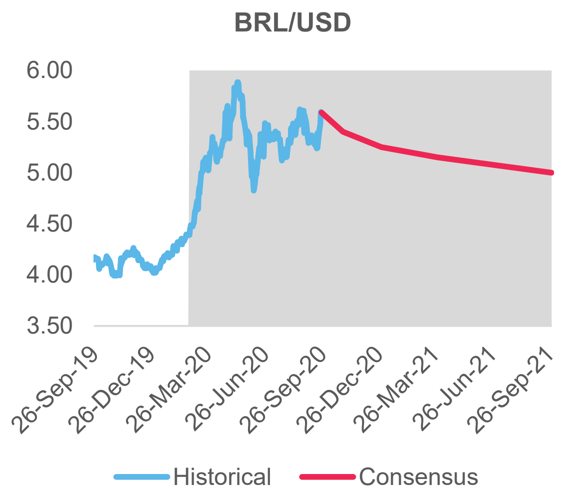



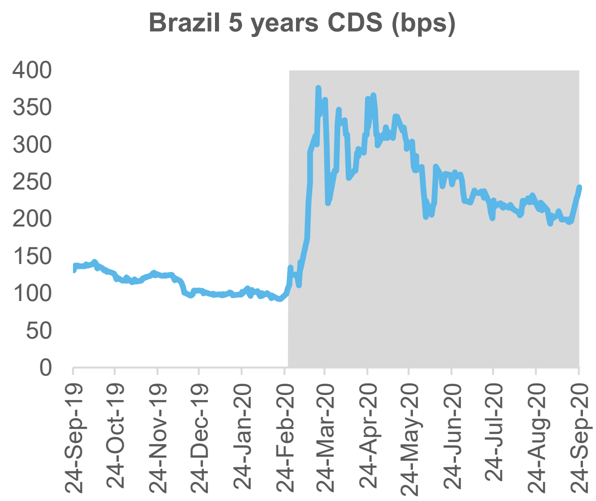

*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Argentina.*

## Brazil: Third-Highest Country with the Most Covid-19 Cases Worldwide

Brazil, the largest economy in the region in GDP and population, is the third-highest country worldwide in terms of total cases of coronavirus, at 4.6mn cases representing 2.2% of its population, trailing only the US and India. According to the IMF, the Brazilian economy is expected to shrink by 5.8% in 2020, while the Brazilian real is currently 34.7% lower versus the US dollar than it was a year ago and 27.3% lower since its first confirmed Covid-19 case. Accordingly, the five-years CDS is trading above 240 bps, which is 85.8% higher than a year ago and 126.8% higher than at the start of the pandemic.

In this scenario, on April 6, S&P revised its outlook to stable from positive on the country's 'BB-' rating, while on May 5, Fitch cut its outlook to negative on the country's 'BB-' rating; both rating actions were also affected by the decline in oil prices.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Brazil.*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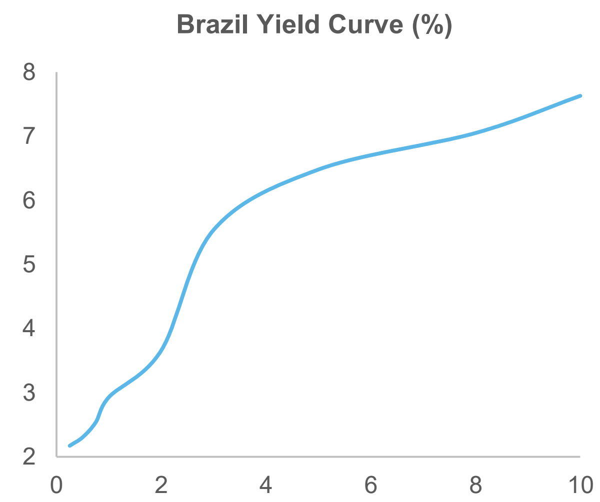
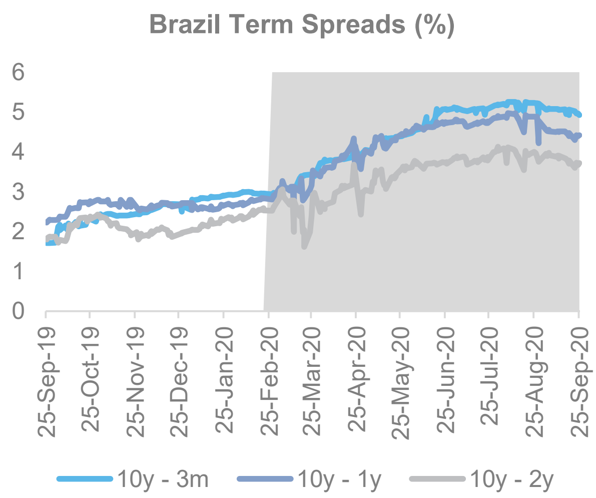
As a response to the crisis, the Brazilian monetary authority cut its benchmark rate by 225 bps to 2.0%. Moreover, Brazil's major fiscal measures, totalling 8.3% of its GDP in 2020, have included temporary income to vulnerable households, employment support, lower taxes on essential medical supplies and new transfers to states from the federal government.

According to the IMF, the Brazilian economy will expand by 2.8% in 2021, albeit still registering negative GDP growth of 3.2% when taking into account the cumulative compound growth rates of 2020 and 2021. Brazil went from growing modestly in the 1.1-1.3% range in 2017, 2018 and 2019 after having suffered a recession in the years prior.

In this context, the steep shape of the yield curve is in-line with the expectation of a quick 2021 recovery. Hence, different term spreads, such as the 10y – 3m, 10y – 1y and 10y – 2y, are currently at positive levels (~490 bps, ~440 bps and ~370 bps, respectively).




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Brazil.*

## Chile: Pandemic Crisis plus Social Crisis, Partly Offset by the Recent Surge in Copper

Chile ranks 12th globally in terms of Covid-19 cases, at 450k, which account for 2.3% of the country's population. According to the IMF, Chile's economy will shrink by 6.0% in 2020. Chile's foreign exchange rate had started to climb well before the Covid-19 crisis, having been affected by the social unrest that began in October 2019, and it has only partly recovered since the pandemic started due to the rise in copper prices. All in all, the Chilean peso weakened 8.5% versus the U.S. dollar over the past 12 months, despite it having strengthened 8.4% since the first confirmed Covid-19 case. On the other hand, the five-years CDS is currently trading at the 70-80 bps level, an increase of 113.9% over the past year and a decline of 47.8% since the first coronavirus case, a similar trend as that of the Chilean peso, again benefited by the recovery in copper prices. For context, each increase of USD 1 cent in the copper price results in an extra inflow of USD 60 million for the Chilean government. All in all, on April 27, S&P cut the country's 'A+' rating outlook to negative due to the previously mentioned social unrest and its effects on fiscal deficits and debt levels. Additionally, on August 25, Moody's assigned a negative outlook on the country's 'A1' rating. Most recently, on October 15, Fitch downgraded Chile's rating to 'A-' with a stable outlook.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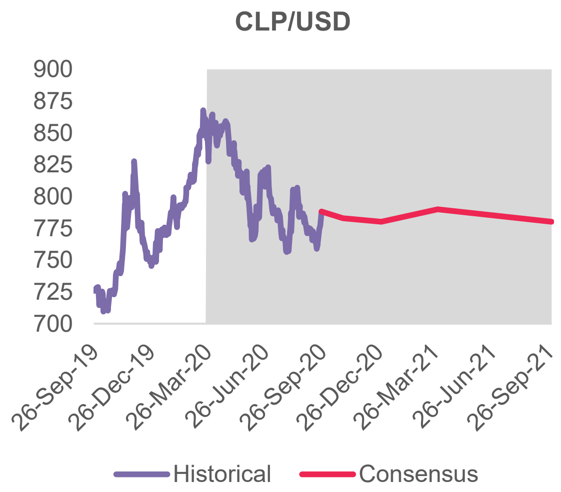
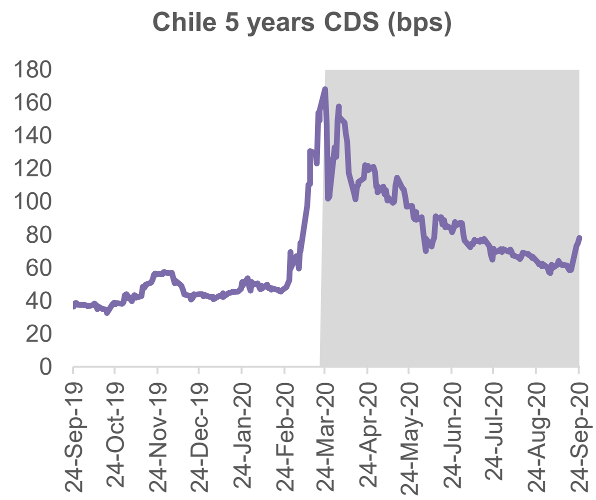
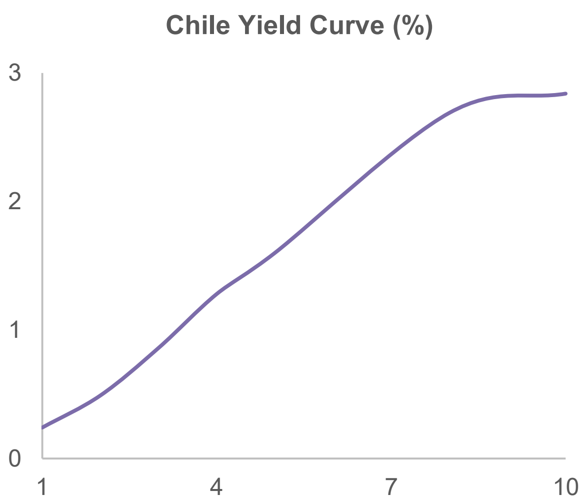
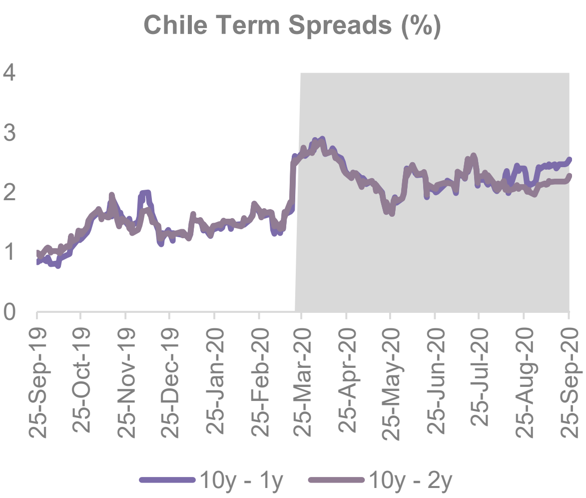



*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Chile.*

Chile's central bank has cut its benchmark rate by 125 bps to 0.5% in 2020. Additionally, Chile's fiscal measures, totalling ~6.7% of its GDP, have focused on protecting employment, liquidity injections and tax relief (particularly for SMEs), and aid for family income. Chile's GDP is expected to rebound 4.5% in 2021, which would register a negative 1.8% accumulative compound growth rate over 2020-2021. The country had grown 1.1% in 2019, when it was affected by the social crisis. A national vote on whether to create a new constitution will be held on Oct. 25, 2020. In this scenario, the shape of the yield curve is currently normal, with expectations of a quick and sustained rebound in 2021 supported by the copper surge. Accordingly, the 10y – 1y term spread is at ~250 bps, while the 10y – 2y term spread is at around 230 bps.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Chile.*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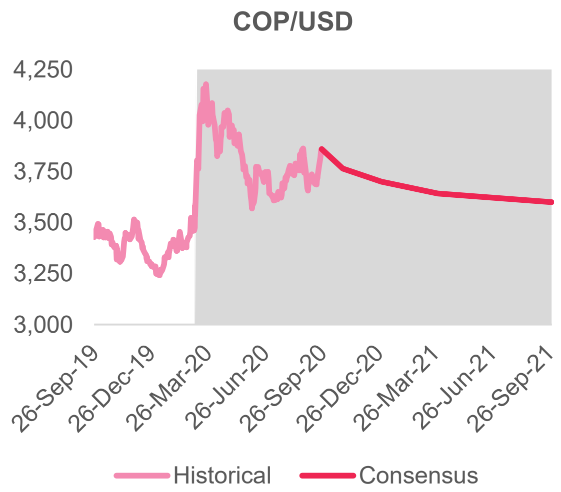
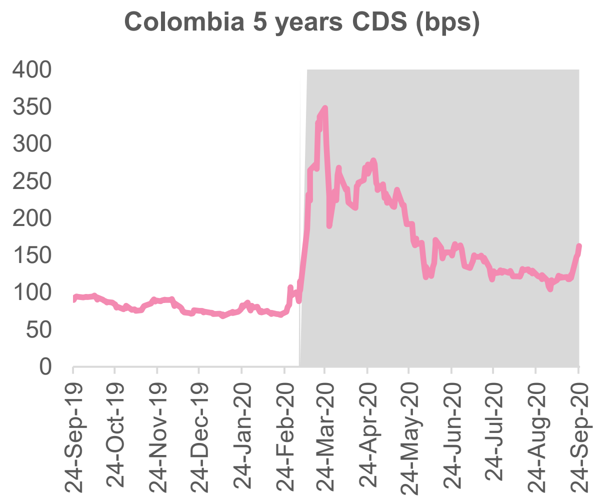
## Colombia: Coronavirus Pandemic Alongside an Oil Crisis

Colombia, with 784k Covid-19 cases that make up 1.5% of its population, currently ranks fifth globally in terms of total cases. According to the IMF, the country's GDP will contract by 8.2% in 2020. The Colombian peso has weakened 12.6% versus the U.S. dollar in one year and 7.7% since the first Covid-19 case in the country. In this context, the five-years CDS currently trades at 150-160 bps, which is ~80% more than a year ago and up ~40% since its first-recorded coronavirus case.

Additionally, Colombia has been significantly affected by the drop in oil prices, which in conjunction with the pandemic, resulted in S&P cutting its outlook to negative on the country's 'BBB-' rating on March 26 and Fitch downgrading its rating for the country to 'BBB-' with a negative outlook on April 1, thus placing it at risk of becoming a "fallen angel".




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Colombia.*

As a response to the coronavirus, Colombia's central bank cut its benchmark rate by 250 bps to 1.75%. Additionally, fiscal spending due to the crisis, totalling 2.8% of GDP, has included financial relief programs to households and SMEs as well as credit lines to provide liquidity to the coffee, education, public transportation, health care and tourism sectors.

According to the IMF, the Colombian economy will expand by 4.0% in 2021, making the cumulative compound GDP contraction in 2020-2021 to be 4.5%. During 2019, the country's economy grew by 3.3%, the largest expansion among the six economies studied.

In this scenario, the steep shape of the yield curve is in-line with a quick recovery that is expected to occur next year. Hence, the 10y – 1y term spread is positive at around 260 bps, slightly above that of Chile.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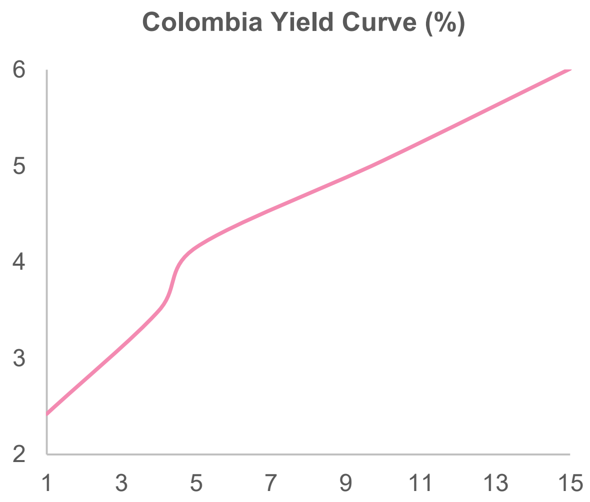
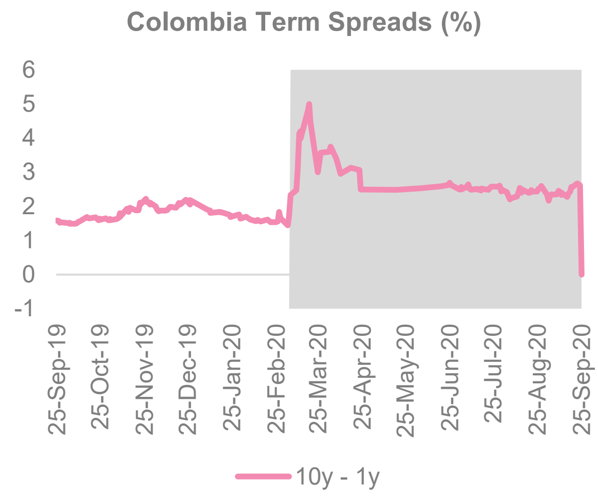


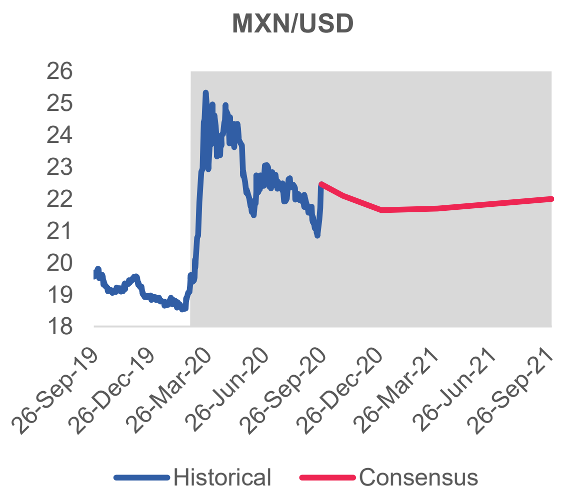



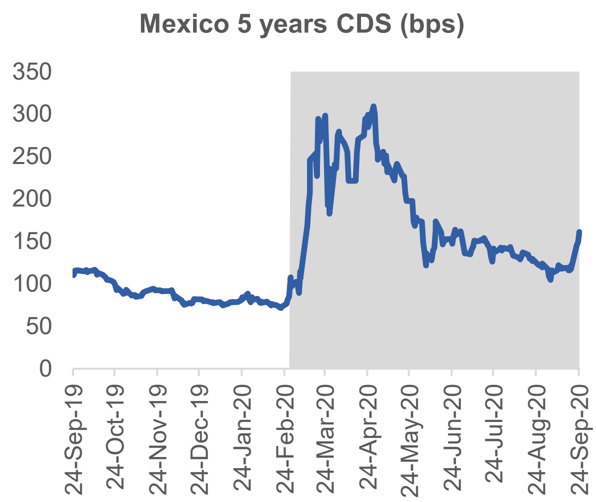

*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Colombia.*

## Mexico: Withstanding the Covid-19 and Oil Crises, but Also Its Exposure to the US

Mexico, with 710k cases that represents 0.5% of its population, currently ranks seventh globally in terms of total Covid-19 cases. According to the IMF, the country's economy will shrink by 9.0% this year, affected by the decline in oil prices and the 4.3% expected contraction in the US economy, Mexico's largest trading partner (~75% share in trading). The Mexican peso has weakened 14.8% versus the U.S. dollar from a year ago and 15.1% since the first Covid-19 case in the country. Mexico's five-years CDS is trading at 150-160 bps, similar to that of Colombia, and has risen 45.8% in the past 12 months and 49.6% since the first coronavirus case.

In this scenario, on March 26, S&P downgraded the country's rating to 'BBB' with a negative outlook. In similar moves, on April 15, Fitch downgraded Mexico's rating to 'BBB-' with a stable outlook on April 15, while Moody's downgraded the country's rating to 'Baa1' with a negative outlook on April 17.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first Covid-19 case in Mexico.*

In response to the pandemic, Mexico's monetary authority has cut its benchmark rate by 275 bps to 4.25%, the largest cut among the six LatAm countries studied. Additionally, the Mexican government's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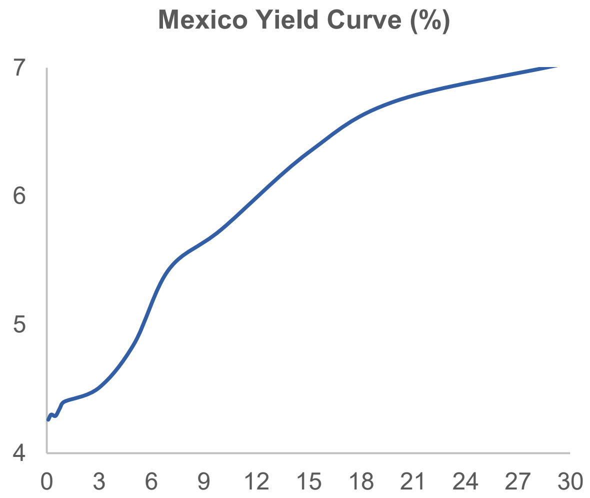
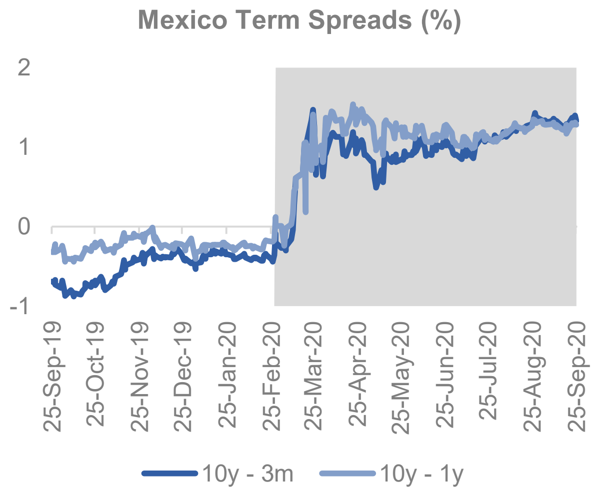
measures have focused on support to households and firms (0.5% of GDP), loans to formal and laid-off workers (0.5% of GDP), and health care (0.2% of GDP).

The Mexican economy should rebound 3.5% in 2021, according to the IMF, which would make the country's GDP contract by 5.8% over 2020-2021, compared with the US economy that is expected to expand by 3.1% in 2021 and register a contraction of 1.3% in 2020-2021.

In this context, the Mexican yield curve's steep slope is aligned with an expected quick recovery in 2021. Accordingly, different term spreads are currently at positive levels for the 10y – 3m and the 10y – 1y term spreads, at ~130 bps.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Mexico.*

## Peru: Sole Country without Negative Rating Actions, Benefited by the Recent Copper Rally

Peru is ranked sixth globally in terms of total Covid-19 cases, at 783k, which account for 2.4% of its population. The IMF forecasts the Peruvian economy to contract by 13.9% this year, while the Peruvian sol has only depreciated 6.4% versus the U.S. dollar from a year ago and 2.7% since Covid-19 hit the country, benefited mainly by the recent copper rally. Peru's five-years CDS is trading in at 80-90 bps, which equates to increases of 73.7% over the past year and 18.5% since the start of the pandemic.

Peru is the only country among the six studied that has not had any negative actions taken by Fitch, Moody's or S&P against its long-term foreign currency rating due to Covid-19, largely because the country has benefited from the surge in copper and maintained strong macro fundamentals.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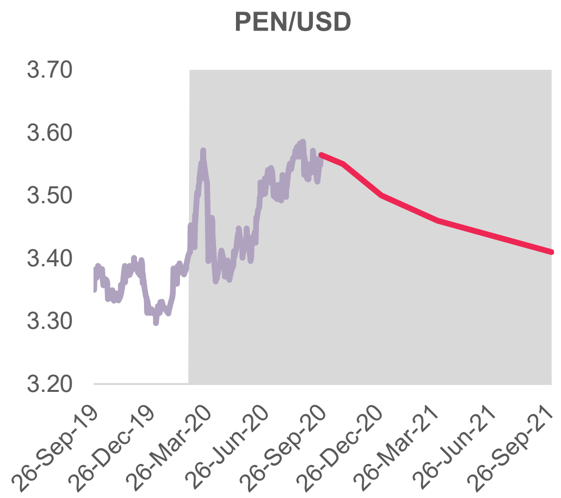
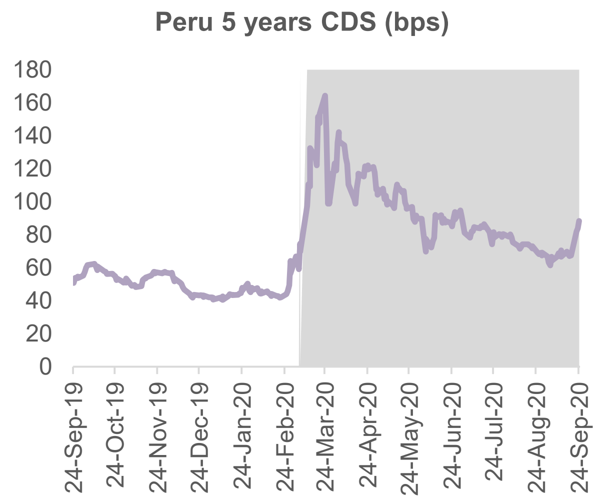


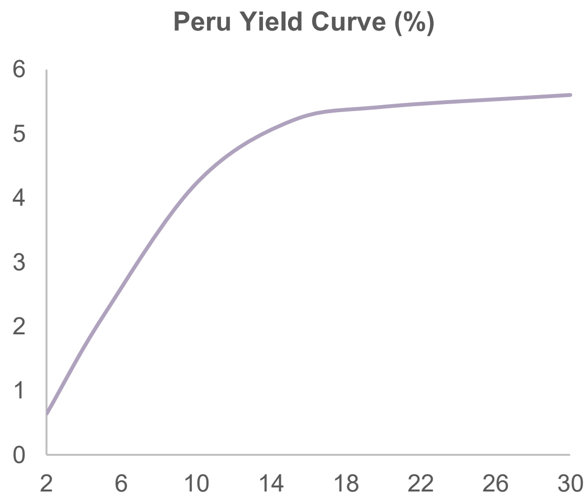



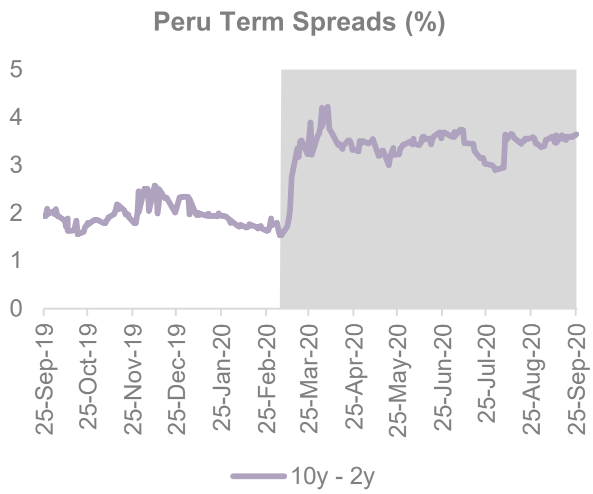

*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Peru.*

The Peruvian Central Bank cut its benchmark rate by 200 bps to 0.25% as a response to the pandemic. Its fiscal response to the crisis has totalled 7.0% of the country's GDP, with key measures including support for the health sector, direct transfers for vulnerable households, income tax extensions and the creation of a PEN 800mn fund to help SMEs.

According to the IMF, Peru's GDP will expand 7.3% next year, which would register economic growth in 2020-2021 of negative 7.6%. The Peruvian economy had gone from growing 2.2% in 2019 and having the lowest inflation rate among the six studied countries, at 1.9%, making up the strong macro fundamentals previously mentioned.

In this scenario, the shape of the yield curve is currently normal, in-line with that of Chile and expectations of a quick and more-sustained economic rebound supported by the rally in copper prices. Hence, the 10y – 2y spread is at positive levels, currently at ~360 bps.




*Source: Thomson Reuters Eikon, Data as of 9/24/2020. Gray shading starts from the first-recorded Covid-19 case in Peru.*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## Credit Outlook

We expect some rating downgrades to occur over the next 12-18 months among the six LatAm countries studied, largely owing to the deterioration in debt levels caused by higher fiscal spending and lower GDP growth prospects that are related to the pandemic.

On an individual-country basis, we expect Argentina's rating to be near default in the next 12 to 18 months due to the uncertainty of its economic recovery in a post-coronavirus outlook, as evidenced by its inverted yield curve and high inflation. The country's general government gross debt to GDP ratio is expected to deteriorate from 90.4% in 2019 to 96.7% in 2020, according to the IMF.

According to the IMF, Brazil's debt to GDP ratio should deteriorate from 89.5% in 2019 to 101.4% in 2020 and 102.8% in 2021, thus making the country the only one among the six studied with a debt level above 100%. In this context, we expect Brazil's rating to be in the low 'BBs' over the next 12-18 months.

Chile's general government gross debt to GDP should deteriorate from 27.9% in 2019 to 32.8% in 2020 and 37.5% in 2021, according to the IMF. Moreover, prior to Fitch's recent downgrade in October, Chile was the only country with a negative outlook on its rating by all three rating agencies, and its five-year CDS is already trading at a similar level than that of Peru. Hence, we expect Chile to be rated in the 'A-'/'BBB+' level over the next 12-18 months.

Colombia's debt to GDP ratio is expected to deteriorate from 52.3% in 2019 to 68.2% in 2020 and 68.1% in 2021; however, this ratio will likely start to improve slightly from 2023 onwards, and the country's five-years CDS rate is trading near that of Mexico. A key catalyst for the country to avoid becoming a "fallen angel" in the next 12 to 18 months is the direction of oil prices and its impact on the country's revenues.

Mexico's government debt to GDP is expected to deteriorate from 53.7% in 2019 to 65.5% in 2020 and 65.6% in 2021. The country's five-year CDS is trading similar to Colombia's levels, thus we expect the Mexican credit rating to be in the mid-to-low 'BBBs' over the next 12-18 months.

Finally, we expect Peru to remain with a 'A-'/'BBB+' rating over the next 12 to 18 months, as the country's five-years CDS is trading similar to that of Chile's and its macroeconomic framework remains sound. Peru's general government gross debt to GDP is expected to deteriorate from 27.1% in 2019 to 39.5% in 2020, with a further slight improvement to 39.1% in 2021.


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# Selected Covid-19 and Economic Indicators

| | Argentina | Brazil | Chile | Colombia | Mexico | Peru |
|---|---|---|---|---|---|---|
| Covid-19 Cases Global Ranking | 10 | 3 | 12 | 5 | 7 | 6 |
| Covid-19 Total Cases | 664,799 | 4,627,780 | 449,903 | 784,268 | 710,049 | 782,695 |
| Total Cases / Population (%) | 1.5 | 2.2 | 2.3 | 1.5 | 0.5 | 2.4 |
| Covid-19 Total Deaths | 14,376 | 139,065 | 12,345 | 24,746 | 74,949 | 31,870 |
| Total Deaths / 1mn Population | 317 | 653 | 645 | 485 | 580 | 964 |
| Real GDP Growth, 2019 (%) | (2.1) | 1.1 | 1.1 | 3.3 | (0.3) | 2.2 |
| Real GDP Growth, 2020 (%) | (11.8) | (5.8) | (6.0) | (8.2) | (9.0) | (13.9) |
| Real GDP Growth, 2021 (%) | 4.9 | 2.8 | 4.5 | 4.0 | 3.5 | 7.3 |
| Inflation Rate EOP, 2019 (%) | 53.8 | 4.3 | 3.0 | 3.8 | 2.8 | 1.9 |
| Inflation Rate EOP, 2020 (%) | na | 2.0 | 2.4 | 1.4 | 3.7 | 1.8 |
| Inflation Rate EOP, 2021 (%) | na | 2.9 | 2.9 | 2.4 | 2.9 | 2.0 |
| FX Rate | 75.64 | 5.59 | 788.17 | 3,860.18 | 22.46 | 3.56 |
| FX Rate, 1Y Var. (%)* | 32.98 | 34.68 | 8.49 | 12.58 | 14.78 | 6.40 |
| FX Rate, next 3 months | 85.00 | 5.25 | 780.00 | 3,700.00 | 21.65 | 3.50 |
| FX Rate, next 6 months | 93.62 | 5.15 | 790.00 | 3,642.50 | 21.70 | 3.46 |
| FX Rate, next 12 months | 114.65 | 5.00 | 780.00 | 3,600.00 | 22.00 | 3.41 |
| General gov gross debt / GDP, 2019 (%) | 90.4 | 89.5 | 27.9 | 52.3 | 53.7 | 27.1 |
| General gov gross debt / GDP, 2020 (%) | 96.7 | 101.4 | 32.8 | 68.2 | 65.5 | 39.5 |
| General gov gross debt / GDP, 2021 (%) | na | 102.8 | 37.5 | 68.1 | 65.6 | 39.1 |
| 5Y CDS (bps) | na | 243 | 78 | 162 | 161 | 88 |
| 5Y CDS, 1Y Var. (%) | na | 85.8 | 113.9 | 80.7 | 45.8 | 73.7 |
| Fitch - Rating / Outlook | CCC / na | BB- / Negative | A- / Stable | BBB- / Negative | BBB- / Stable | BBB+ / Stable |
| Moody's - Rating / Outlook | Ca / Stable | Ba2 / Stable | A1 / Negative | Baa2 / Stable | Baa1 / Negative | A3 / Stable |
| S&P - Rating / Outlook | CCC+ / Stable | BB- / Stable | A+ / Negative | BBB- / Negative | BBB / Negative | BBB+ / Stable |
| Fiscal Measures / GDP (%) | 6.0 | 8.3 | 6.7 | 2.8 | 1.2 | 7.0 |
| Benchmark Rate (%) | 38.00 | 2.00 | 0.50 | 1.75 | 4.25 | 0.25 |
| Benchmark Rate Cuts (bps) | 200 | 225 | 125 | 250 | 275 | 200 |
| 10Y Gov Bond Yield (%) | na | 7.15 | 2.77 | 5.09 | 5.68 | 4.30 |
| Yield Curve Shape | Inverted | Steep | Normal | Steep | Steep | Normal |
| Top Trading Partner, 2018 | Brazil | China | China | US | US | China |
| Top Trading Partner Share, 2018 (%) | 18.3 | 26.8 | 33.5 | 27.1 | 76.5 | 27.6 |
| Top Product Export, 2018 | Oil-cake and other solid residues, of soya bean | Soya beans, oil | Copper | Oil | Automobiles, oil | Copper |

*Source: IMF WEO October 2020, Thomson Reuters Eikon, World Bank, Worldmeters, Data as of 9/24/2020. Ratings as of 10/15/2020. *Positive (negative) variation means local currency has weakened (strengthened) versus the US dollar.*


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