S&P Global Ratings

Latin America

Inflation And Rising Yields Impact On Global Infrastructure And Utilities

Inflation Pass-Through Poses Greater Challenges For Toll Roads And Mass Transit Than For Utilities, Airports, And Ports

December 1, 2022

This report does not constitute a rating action.

Primary Credit Analyst

Julyana Yokota
Sao Paulo
+55 11 3097 9731
julyana.yokota@spglobal.com

Secondary Contacts

Cecilia Fullone
Buenos Aires
+ 54 11 4891 2170
cecilia.fullone@spglobal.com

Daniel Castineyra
Mexico City
+ 52(55)5081-4497
daniel.castineyra@spglobal.com

Marcelo Schwarz, CFA
Sao Paulo
+55 11 3039 9782
marcelo.schwarz@spglobal.com

Veronica Amendola
Buenos Aires
+54 11 4891 2175
veronica.amendola@spglobal.com

Key Takeaways

- Latin American toll-road operators are sensitive to protests against steep tariff increases.
- Apart from Argentina, regulatory framework for utilities are generally supportive across the region, but some utilities in Chile and Mexico won't receive higher tariffs to cover costlier expenses.
- Toll-road operators across the region have a high share of floating debt, which could raise risks, given the time lag of cost pass-throughs amid likely persistence of high interest rates in 2023.

Except for Argentina, the regulatory framework for utilities are favorable. We expect the rate-setting mechanisms to grant a full pass-through of inflation- and energy-related costs to electric utilities in Brazil and Colombia. We expect Mexico's Comision Federal de Electricidad (CFE) to do the same for its commercial and industrial clients, but a lower rate adjustment for residential clients will dent CFE’s cash flows. We forecast a decline of up to a 30% in EBITDA among some Chilean power generation companies, based on their contracted prices, because they will only be able to partly pass along the increased cost of fuel. In our view, the Chilean regulatory framework for utilities is the strongest in the region, reflecting its historical stability and transparency, along with the low likelihood of adverse changes to pricing regimes or contracts during the political cycle. For Argentine utilities, no changes in our expectation of the government's discretionary tariff adjustments. Despite our forecast for inflation averaging 70% in 2022, tariffs of the rated Argentine generation companies were raised by 40% in aggregate, while the distribution company Edenor received only an 8% tariff increase.

We also expect a full pass-through of inflation in tariffs for Chilean and Brazilian water utilities.

Affordability concerns weigh on some toll road operators, even if protests have so far remained limited. We're closely monitoring for pressures stemming from affordability concerns, given that toll rates are adjusted to inflation. In the past, governments in Brazil and Chile intervened to freeze toll-road rate hikes amid widespread protests, and concessions received either financial or economic (usually through contract extensions) compensations. This affirms our view of sovereign rating caps (60% of which in the region are speculative grade) on local toll-road operators.

On the positive side, heavy-vehicle traffic has been somewhat immune to inflationary-fueled toll-rate adjustment in 2022, given that heavy-vehicle volume increased 3x-5x higher than GDP growth thanks to a rebound in domestic demand after the pandemic and in exports.

(%)	2023 CPI Inflation Forecast (average)	2023 GDP Growth Forecast	Goods Exports to the U.S., % GDP
Argentina	90.0	1.0	0.51
Brazil	5.1	0.6	1.93
Chile	8.0	0.3	4.71
Colombia	6.4	1.9	3.50
Mexico	6.1	0.8	27.8
Peru	5.6	2.5	-

Source: S&P Global Ratings.

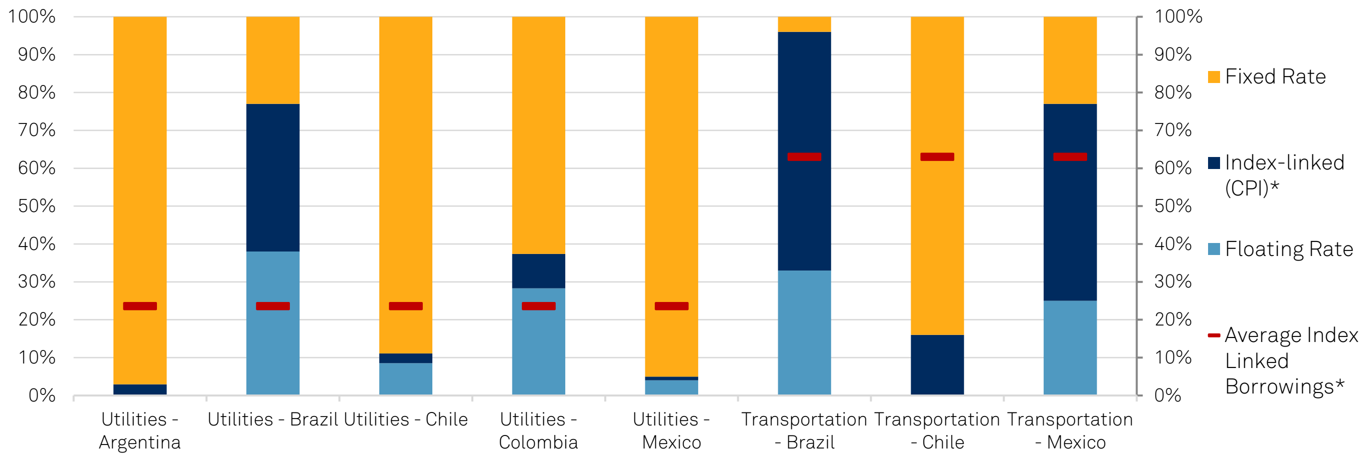
We see greater strains on operating margins of mass transit and rail operators, given affordability considerations and the time lapse between inflation-related adjustments on tariffs and increased labor and energy costs. This is because these segments are typically more intensive in terms of operating costs than toll roads.

Ports and airports are more sensitive to economic activity than to inflation. Given that port services are strongly correlated to demand trends, we expect the port operators' revenues to take a hit from deceleration in GDP growth of the region's largest six economies to 0.9% in 2023 from 2.8% in 2022, as lower import volumes and global trade activity depress exports to the U.S., Europe, and China.

Airport tariffs represent a small share of airline tickets, but the steep rise in jet-fuel prices will have a greater impact and likely sap demand for air travel. Air traffic across the region's airports reached above 80% of 2019 level, boosted by domestic and short-haul routes, but vulnerable to lower economic activity and consumers' discretionary spending.

Floating-rate debt accounts for 60% of funding of many rated transportation operators in the region, and only for 25% among utilities. Although positive from an investor point of view, inflation-linked debt increases credit risk as credit metrics will suffer initially because of the lag between higher interest costs and the cost pass-through.

Debt Composition For Latin America Infrastructure



Source: S&P Global Ratings

In response to the increase in rates and financing costs, companies aim to strengthen free cash flows and preserve higher cash positions through a longer pause of capital expenditures. Another mitigating factor is the likely absence of major refinancing in 2023 for most rated entities. At the same time, borrowing costs are unlikely to come down soon as the region's central banks approach the end of the interest-rate hike cycle and adopt a cautious monetary approach considering persistently high inflation.

Latest Related Research

- Plunge In Latin American Corporates' International Issuances Expected To Continue Into Next Year, Oct. 17, 2022
- Economic Outlook Latin America Q4 2022: A Period Of Below-Trend Growth Ahead, Sept. 26, 2022
- Regulatory Support Underpins Latin American Utilities' Credit Quality, Although Political Interference Is Rising In Some Countries, June 13, 2022