S&P Global Ratings

Regional Credit Conditions Chair

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Credit Conditions Latin America:

Policy Uncertainty Undermines Growth Prospects

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Key Takeaways

- Overall: Growth prospects in Latin America continue weakening as policy uncertainty in the region's largest countries increases. We now expect slower growth for the largest economies in Latin America in 2019 and 2020. External conditions are also challenging, with rising trade tensions and geopolitical risks, which could undermine 2020 growth prospects.
- What's changed: Investment continues to slump in the largest economies in the region as policy uncertainty prevails. Upcoming elections in Argentina, delays in key reforms in Brazil, and lack of clarity and polemic decisions in Mexico act as a drag on the already fragile investor confidence. Weak global economic prospects and increasing trade frictions also weigh on other economies in the region.
- Risks and imbalances: Risks continue rising in Latin America and will probably mix with soft external conditions over the coming months, as trade tension between U.S. and China remain unresolved, and frictions in the Middle East escalate. Domestic political challenges continue intensifying and are the main drag on investor confidence and economic growth in the region.
- Financing conditions: The Federal Reserve's monetary easing gave room for the region's economies to lower their reference rates. The latter have improved financing conditions in Latin American economies, but not for all, because the appetite for lower-rated issuers remains limited.
- Macroeconomic conditions: We have lowered our growth outlook for most of the major economies in Latin America for the remainder of 2019 and for 2020. This is due to ongoing weakness in domestic demand, adverse domestic political dynamics, and volatile external conditions.
- Sector themes: Weaker growth will probably dent corporations' profits and bank's asset quality.

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions [Asia-Pacific, Latin America, North America, and Europe, the Middle East, and Africa]. Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the Latin America committee on Sept. 23, 2019.)

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Table 1

Top Latin America Risks

Regional Political Challenges

Risk level*	Very low	Moderate	Elevated	**High**	Very high	Risk trend**	Improving	**Unchanged**	Worsening

The lack of clarity over domestic policies continues to hamstring Latin America's economic growth prospects. Mexico's current administration has failed to boost investor confidence despite the announcement of its plans. Brazil has made some progress with respect to the pension reform, but it has become clearer that these changes won't be enough to fix the country's short-term fiscal challenges. These, along with President Bolsonaro's difficulties in dealing with a very fragmented Congress, have undermined investors' confidence and the country's growth prospects. Argentina's troubles deepened dramatically after the August primary elections, which gave a strong signal of the opposition's popularity. Policy uncertainty, as October's elections approach, will weigh on investors' confidence and add to Argentina's economic woes.

Other countries in the region--Chile, Panama, and Peru--are more sensitive to external changing conditions, especially to rising trade discord and its effect on global trade and commodity prices. Prospects for slower global economy prompt us to trim our growth forecasts for these countries.

Increasing U.S. protectionism

Risk level*	Very low	Moderate	Elevated	**High**	Very high	Risk trend**	Improving	**Unchanged**	Worsening

U.S.–China trade negotiations will resume in October, but the potential outcome remains uncertain. In terms of retaliatory tariffs, conditions have worsened since our last report, given that both countries announced new measures in August. Conditions remain fluid, and a potential agreement depends on many factors that transcend purely economic interests. S&P Global Ratings believes the uncertainty will further sap global business and investor confidence.

There seems to be some progress for the Unites States-Mexico-Canada Agreement (USMCA), as Nancy Pelosi (Speaker of the U.S House of Representatives) said that it will be part of the congress agenda. However, there will be many obstacles ahead as democrats still have doubts about the enforceability of labor and environmental standards within the new agreement.

Volatile capital flows that restrict market access

Risk level*	Very low	Moderate	**Elevated**	High	Very high	Risk trend**	Improving	**Unchanged**	Worsening

Lower interest rates in advanced economies have supported improving funding conditions and capital flows to Latin America to some degree over the recent months. Furthermore, domestic markets in the largest economies in the region have become a feasible alternative for financing, offering competitive conditions for local issuers. Nevertheless, volatile conditions remain, and investors are sensitive to changing domestic political developments and external conditions that could weigh on global economic growth. Debt maturity schedules remain manageable for Latin America issuers, and investors continue searching for yield; however, their appetite for lower rated issuers is waning.

Commodity price volatility

Risk level*	Very low	Moderate	**Elevated**	High	Very high	Risk trend**	Improving	**Unchanged**	Worsening

Commodity prices continue responding to mixed conditions, which ultimately results in volatility. We expect this trend to remain for the rest of the year and potentially into 2020. So far, supply shocks have dominated some key commodities for the region, such as oil and iron ore, prices for which have increased during the year. Higher commodity prices benefit some economies in the region, like Brazil and Colombia in the case of oil, but could pressure net crude importers (and related products), Mexico and Chile. We expect commodity-price volatility to remain over the coming months because of a potential for lower prices as global economic growth cools. On the other hand, supply shocks are mostly unpredictable. Nevertheless, geopolitical tensions in Middle East could continue pressuring oil prices.

Sources: S&P Global Ratings.

* Risk levels may be classified as very low, moderate, elevated, high, or very high, and are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically these risks are not factored into our base case rating assumptions unless the risk level is very high.

** Risk trend reflects our current view on whether the risk level could increase or decrease over the next 12 months.

Regional Credit Conditions

What's Changed?

Latin American countries' GDP growth has weakened, posing difficulties for issuers in the region. Policy uncertainty remains the biggest drag on economic prospects as investors remain hesitant about new administrations' ability to address financial and economic headwinds. Global economic unease also adds to regional investors' fears, given that global growth prospects for 2020 continue deteriorating in light of increasing trade tensions and geopolitical risks.

Political risks have gradually materialized in the region, undermining economic growth prospects as investor confidence erodes.

The AMLO administration's plans, such as a new business plan for PEMEX and the budget for 2020, have failed to boost investor confidence. In general, the government's aggressive assumptions have fueled skepticism in the domestic investors community. Furthermore, mixed signals from the executive and a lack of policy direction make investors uncomfortable. Lower interest rates and higher oil prices resulting from external conditions, could bring some relief to Mexican government's tight budget.

While pension reform has been progressing in Brazil, investors now believe that this particular reform won't fix all of the country's fiscal and economic problems. This, along with President Bolsonaro's difficulties in dealing with a very fragmented Congress has undermined investors' confidence and the country's growth prospects. The president's political capital is eroding, and the country still needs to pass substantial reforms to improve its fiscal position over the short term. Brazil's economy could improve if the government manages to pass the pension reform and advance other changes to reduce pressure on the fiscal side.

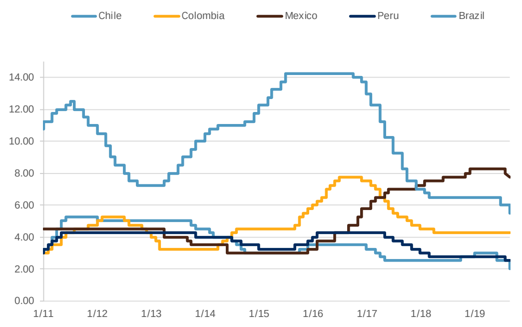
Argentina faces very complex economic and financial market dynamics, exacerbated by the timing of the electoral calendar. In our view, the increased vulnerabilities of Argentina's credit profile stem from the depreciating exchange rate, a likely acceleration in inflation, and a deepening recession. These factors will increasingly inhibit the ability of both the current and incoming administrations to contain market volatility and restore financial and economic stability.

We don't expect Argentina's troubles to spread across the region, given that the country has been experiencing economic and financial turmoil over the past few years.

Chart 1

Latin America's Policy Rates

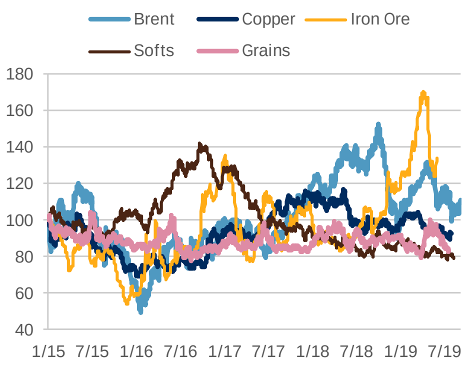
(Data as of Sept. 26, 2019)



Source: Central Banks

Chart 2

Commodity Prices (Jan. 2, 2015 = 100)



Source: Bloomberg

Financing Conditions

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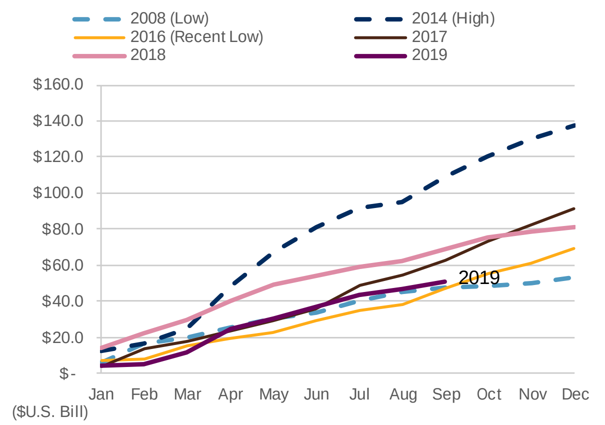
Favorable financing conditions, driven by central bank actions including the Federal Reserve, the European Central Bank (ECB), and others will likely lower the cost of financing through 2019. However, the souring economic prospects prompted lowering, instead of raising, interest rates reduced financing costs (as opposed to a reduction in risk premia). As a result, we're observing greater risk aversion at the bottom end of the credit spectrum, where issuers could face higher financing costs or worse, the lack of risk appetite altogether. Investors are more selective and looking for Latin American issuers with more solid fundamentals amid slumping regional economies and rising geopolitical risks. We expect banks to be more conservative in their loan originations, which will probably curb bank credit flows. Consequently, issuers could look for opportunities to refinance their debt in the market. We continue to see low appetite among corporations for increasing their leverage and invest. The majority of issuances so far in 2019 for Latin America was for refinancing purposes instead of corporate expansion or M&A.

While both financing conditions and the pace of bond issuances in Latin America have improved since the beginning of the year, $50.6 billion in bonds issued in the region as of Sept. 11, 2019, remains the lowest in five years. This trails year-to-date $47.1 billion in bond issuance in 2016 at the height of the Lava Jato scandal in Brazil. While refinancing appears manageable over the next few years, additional strains on borrowers with weaker credit fundamentals will inevitably appear, stemming from higher debt costs and refinancing needs, and potentially flagging economies once the currently benign conditions wane. (Recent actions by the Federal Reserve and ECB may allow benign conditions to linger longer.)

Chart 3

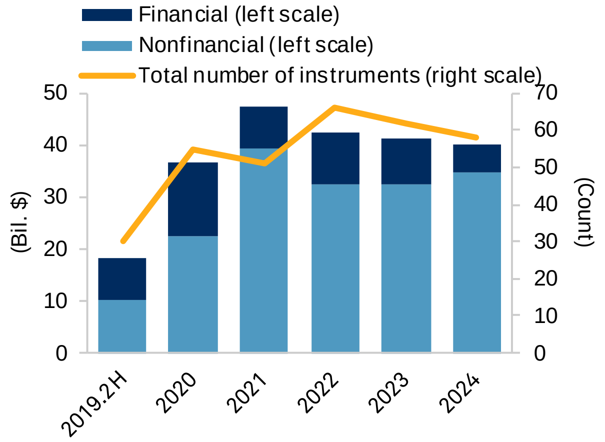
Latin America Corporate (FI And NF) Cumulative Issuance



Data as of Sept. 11, 2019. Source: S&P Global Ratings Research, Thomson Financial

Chart 4

Latin America Corporate Debt Maturities



Note: Includes bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings. Excludes debt instruments that do not have a global scale rating. Data as of July 1 2019. Source: S&P Global Ratings Research

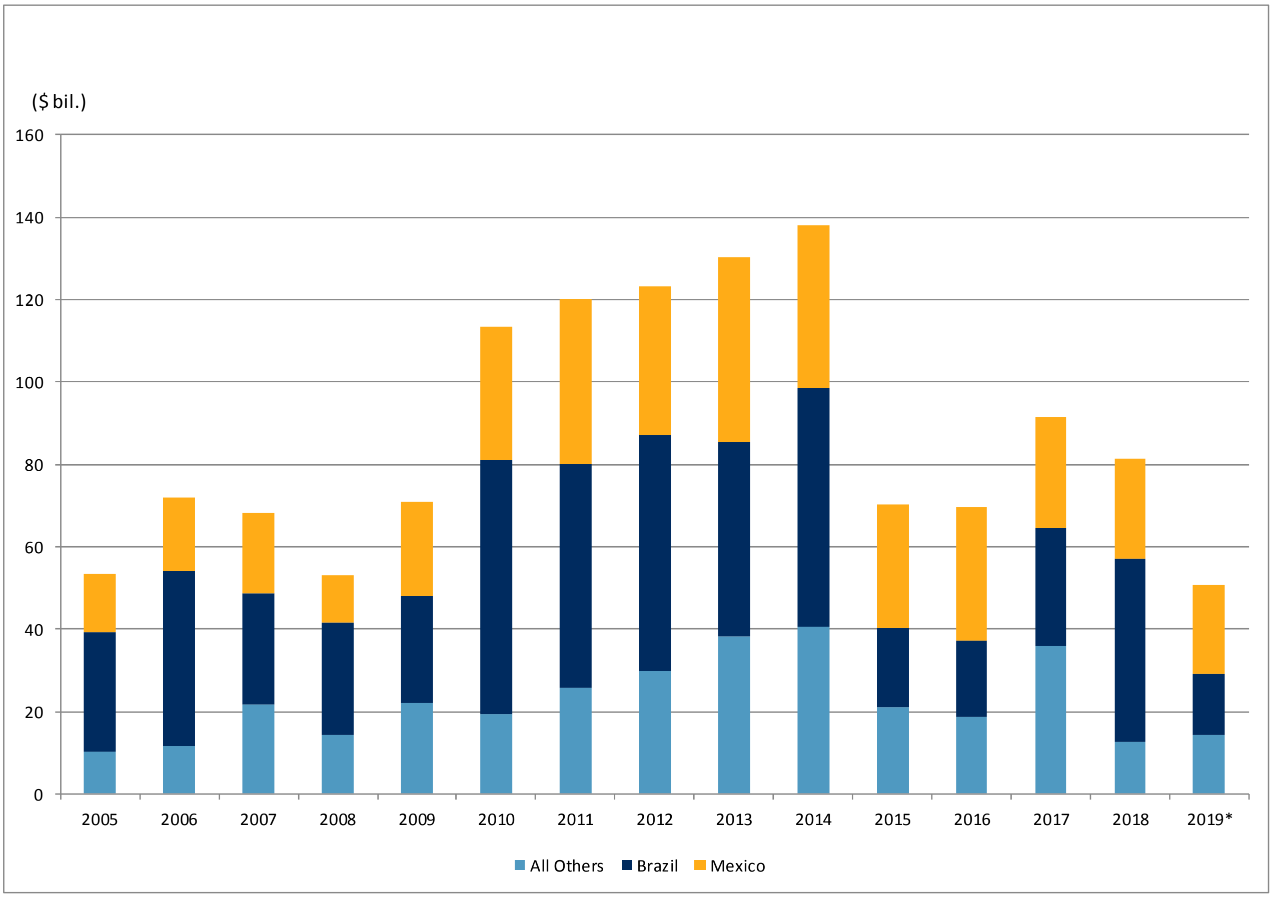
Neutral conditions. Generally, financing conditions remain balanced, though risk aversion is beginning to rear its head. More creditworthy borrowers with healthier balance sheets will continue to see lower funding costs in the short term and marginally improved demand for loans is likely to continue. However, nonperforming loans (NPLs) will likely rise and credit spreads will widen at the lowest end of the credit spectrum amid investor selectivity and subpar prospects for economic growth.

Maturing debt. S&P Global Fixed Income Research expects $226 billion of rated financial and nonfinancial corporate debt from Latin America (including the Caribbean) to mature through 2024--a small fraction of the $12 trillion in corporate debt set to mature globally in the same period. Of the total corporate debt maturing in Latin America through 2023, $18.4 billion is due 2019, and scheduled maturities rise to a peak of $47.5 billion in 2021. The majority (74%) of the debt due 2019 is investment grade (rated 'BBB-' or higher), which should help mitigate refinancing risk, given that investor demand for investment-grade debt remains high. We expect the region's corporate refinancing demands to remain largely manageable, especially because corporate issuers have a multiyear window in which to refinance before the largest sums come due in 2021 and 2022, though this schedule is contingent on favorable lending conditions, which are likely to remain so for the remainder of this year but likely to wane further out in the horizon.

New issuances. The $50.6 billion in new bond issuances as of Sept. 11, 2019, is dominated by Mexican issuers ($21.4 billion), followed by those in Brazil ($15.1 billion) and the remaining $14.2 billion issued elsewhere in Latin America. Nearly 80% of issuances is domestic or privately placed (Euro/144A), with Minera y Metalurgica del Boleo, NAFINSA, and America Movil S.A.B. de C.V. (all of which are Mexican entities) issuing the largest deals so far this year.

Chart 5

Latin America Corporate (FI And NFI) Issuance Volumes



Source: Data as of September 11, 2019. Source: Thomson Financial; S&P Global Fixed Income Research.

Macroeconomic Developments And Assumptions

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(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.)

The Region's Growth Will Remain Disappointing Next Year

We have lowered our growth outlook for most of the major economies in Latin America for the remainder of 2019 and for 2020. This is due to ongoing weakness in domestic demand, unfavorable domestic political dynamics, and volatile external conditions. Aggregate GDP growth in the six largest economies in the region (LatAm 6) was shy of 0.5% year over year (y/y) in the first half of 2019, compared with 1.4% in 2018, mostly due to an about 1% y/y contraction in investment in the first half of 2019. We project growth of 0.7% in 2019 and 1.6% in 2020 for LatAm 6, which is still very low by historical standards (the 10-year average is about 2%) and compared with other emerging markets that are averaging 4%.

From a country-specific level, our downward revisions to growth stand out for Argentina and Mexico. In Argentina, the rising likelihood of an opposition winning the October presidential election and a recent change in policy direction will hamper domestic demand, as financial conditions tighten. We now see the Argentine economy contracting 3% in 2019 and 1% in 2020. In Mexico, fixed investment has fallen more than we expected, partly due to delays in public investment, but also due to lack of private investment amid the lack of policy direction under the current administration. We now see GDP growth of 0.4% in 2019 and 1.3% in 2020.

GDP growth in LatAm 6 has remained below 2% since 2014 due to weak investment, which in most cases has been a result of uncertainty over domestic policy direction, magnified by unfavorable external dynamics, and more recently the U.S. – China trade tensions. As we look into 2020, it is hard to argue in favor of a meaningful improvement in domestic political dynamics or for a smooth and long-term resolution to the U.S. – China trade conflict, especially as the U.S. 2020 presidential campaign heats up. This is why our expectations for 2020 reflect another year of sluggish GDP growth for the region (below 2% for LatAm 6), albeit higher than in 2019. The reason we expect stronger growth in 2020 than in 2019 has to do mostly with greater levels of monetary stimulus both across major advanced economies as well as in regional economies. The ECB has renewed a QE program, we now expect more easing by the Fed than previously, the People's Bank of China continues to introduce stimulus measures, and nearly every major central bank in Latin America is in the process of lowering interest rates. While high domestic political uncertainty means that the meaningful resurgence in investment the region needs to sustain higher GDP growth is unlikely, we believe the sheer size of monetary stimulus will help stabilize investment dynamics in several economies in the region. We have seen signs of this happening in the second-quarter GDP and in early third-quarter data in some countries.

Forecast Changes

- Argentina: The economic difficulties will persist regardless of the outcome of the October presidential election. We expect Argentina's economy to contract 3% this year and 1% next year, which will imply three consecutive years of GDP contraction.
- Brazil: The data continues to point to a sluggish recovery, with GDP growth of 0.7% y/y in the first half of 2019; however, signs of a recovery appeared in the second quarter, particularly in investment. We expect growth of 0.8% in 2019 and 2.0% in 2020 (compared with 1% and 2.2% from our previous report). The social security reform approval continues to progress and the central bank is loosening monetary policy, which underpin our expectations for a pickup in growth next year.
- Mexico: Data has been significantly weaker than we expected, with GDP expanding just 0.2% y/y in the first half of 2019, due to a 4% decline in investment, which has been partly due to the delays in public-sector investment that are typical during a transition in government, but also due to a decline private-sector investment. On the supply side, an ongoing contraction in oil

production, which fell about 10% y/y in the first half of the year, has kept a lid on GDP growth. We project the latter at 0.4% this year and 1.3% in 2020.

– Chile, Colombia, and Peru: We also lowered our growth outlooks for Chile and Peru, in part due to weakness in copper production this year. For Chile, we forecast 2.4% in 2019 and 2.8% in 2020, and for Peru 2.6% and 3%, respectively. Conversely, better-than-expected data in the second quarter and upward revisions to historical GDP data prompted us to increase our growth projections for Colombia. We now forecast 3.2% growth for both 2019 and 2020, an improvement from the 2.6% expansion in 2018.

Key assumptions

– We now expect the effective Fed funds rate to end 2019 at 1.625%, one more 25-bps interest rate cut than what we projected in the previous quarter.
– We expect an orderly deceleration in GDP growth in most advanced economies through the rest of 2019 and into 2020. We see a 30% - 35% probability of recession in the U.S. in the next 12 months, and growth remaining close to potential in 2020.
– We assume recent policy easing in China will stabilize the economy.
– Regardless of who wins Argentina's presidential election, we assume that policy direction will pivot, in line with recent steps to stabilize the currency, such as capital controls. This means domestic financial conditions will be tighter than we previously assumed.
– Our macroeconomic projections for Brazil assume some version of the pension reform will be approved this year.
– Our baseline GDP forecast for Mexico assumes continued uncertainty over policies under President Andres Manuel López Obrador that reduces private-sector investment participation in key sectors, such as energy.

Table 2

Latin America's GDP Growth

			Baseline scenario				Downside scenario			
(%)	2017	2018	2019f	2020f	2021f	2022f	2019f	2020f	2021f	2022f
Argentina	2.7	-2.5	-3.0	-1.0	1.5	2.0	-4.0	-2.5	0.0	1.0
Brazil	1.1	1.1	0.8	2.0	2.2	2.5	0.5	1.0	1.2	1.5
Chile	1.5	4.0	2.4	2.8	3.0	3.0	2.0	2.4	2.5	2.5
Colombia	1.4	2.6	3.2	3.2	3.3	3.3	2.7	2.5	2.5	2.5
Mexico	2.4	2.0	0.4	1.3	1.7	1.9	0.2	0.6	0.9	1.0
Panama	5.3	3.7	3.5	4.0	4.5	5.0	2.5	3.0	3.5	3.5
Peru	2.5	4.0	2.6	3.0	3.2	3.5	2.0	2.5	2.8	2.8
Uruguay	2.6	1.6	0.5	1.5	2.3	2.8	0.2	1.0	1.8	2.0
Venezuela	-15.7	-20.0	-20.0	-5.0	0.0	3.5	-30.0	-15.0	-5.0	-5.0
Latin America	0.9	0.4	-0.3	1.3	2.1	2.5	-1.2	0.0	1.0	1.2
Latin America ex. Venezuela	1.7	1.4	0.7	1.6	2.2	2.4	0.3	0.8	1.2	1.5

f--Forecast. Source: S&P Global Economics. Note the Latin American GDP aggregate forecasts are based on three-year average (2015-2017) PPP GDP weights. Our GDP numbers are based on seasonally-adjusted series when available.

Table 3

Changes In Baseline GDP Growth Forecast From The Second-Quarter 2019 Credit Conditions Report

(%)	2019	2020
Argentina	-1.4	-3.2
Brazil	-0.2	-0.2
Chile	-0.1	-0.1
Colombia	0.3	0.2
Mexico	-0.9	-0.5
Panama	-1.0	-0.5
Peru	-0.8	-0.7
Uruguay	-0.4	-0.4
Venezuela	0.0	0.0
Latin America	-0.5	-0.6
Latin America ex. Venezuela	-0.5	-0.6

Source: S&P Global Economics.

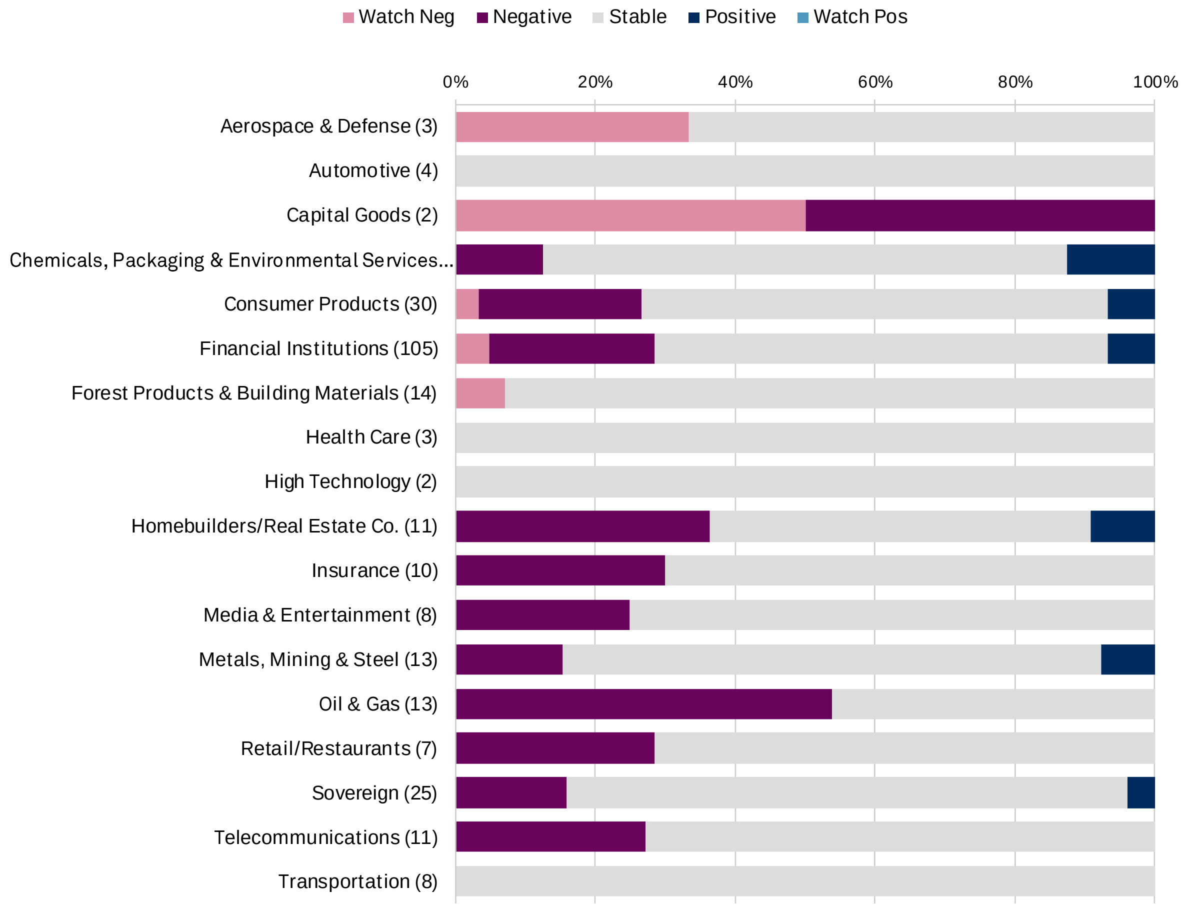
Risks to our macroeconomic outlook

- A more pronounced deceleration in real GDP growth in the major advanced economies than what we currently assume could impede the mild economic recovery we forecast for most Latin American economies in 2020.
- The ongoing trade dispute between the U.S. and China, if it continues to escalate, could renew risk aversion and lower appetite for emerging markets assets, resulting in periods of capital outflows from Latin America.
- The ratification of the USMCA is still at risk, especially given political polarization and the 2020 presidential election in the U.S. A significant delay in ratifying the treaty that would replace NAFTA could generate another round of uncertainty over trade and investment relations between the U.S. and Mexico. The ratification of the USMCA has been further complicated by the recent threat by the U.S. to impose tariffs on Mexican goods.
- The political situation in Argentina is fluctuating, and pressure on the currency and on the government's debt profile could trigger more drastic policy measures that result in a more protracted downturn in domestic demand than we currently project.
- Failure to approve a modest to ambitious pension reform in Brazil would reverse the recent increase in business optimism and discourage investment, which would prompt us to revisit our macroeconomic assumptions for the country.
- A more significant change in policy direction by President Andres López Obrador that either restricts or discourages fixed investment further, would lead us to revisit our assumptions for Mexico again.

Sector Themes

Chart 6

Outlook Bias Distribution Of Latin American Issuers By Sector, September 2019



Source: S&P Global Fixed Income Research. Data as of Sept. 11, 2019.

Sovereigns

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- Argentina recently defaulted on its short-term foreign and local currency debt and is likely to default soon on its long-term debt.
- The Mexican economy is slowing and investor confidence remains low.
- Fears of escalating trade conflicts between the US and China have taken a toll on investment and commodity prices, reducing growth throughout the region.

What's changed?

The most prominent development was default in Argentina. The Macri administration decided to unilaterally extend maturities of short-term foreign and domestic currency debt after investor confidence plummeted following primary elections in August. The strong showing of opposition candidate Alberto Fernandez provoked capital outflows, weakened the currency, and effectively derailed the government's difficult economic adjustment program negotiated with the IMF. The government announced plans to restructure its long-term debt as well. The process could be difficult because the national elections are next month.

Mexico's president Lopez Obrador retains high popularity, except with most investors. A slowdown in private investment has trimmed economic growth in Mexico. The government has largely adhered to its budgetary targets by cutting spending to compensate for lower oil and non-oil revenues (compared with the budget forecasts). However, this may not be sustainable for long. The upcoming 2020 budget is likely to show moderate deficits, but GDP growth may continue to remain weak, and potentially jeopardize the government's fiscal plans.

A segment of the FARC guerrillas in Colombia abandoned the 2016 peace agreement and resumed armed opposition. While this is not a serious security setback, it adds to political tensions. President Duque's low popularity limits his ability to advance legislation in Congress. The political and humanitarian crisis in Venezuela shows no sign of resolution.

Key assumptions

- Commercial disputes between the U.S. and China don't damage global supply chains and overall investor confidence substantially.
- Broad continuity in fiscal, exchange rate, and monetary policy in Mexico despite anemic GDP growth.
- The spillover from Argentina's default is minimal for other sovereigns in the region.

Key risks

- Heightened risk aversion sparks substantial capital outflows from the region, undercutting stability and growth.
- Poor economic performance leads to unexpected policy changes in Mexico, sparking capital outflows and weakening the currency.
- Combination of delays in pension reform, tepid GDP growth, and potential scandals weakens the Bolsonaro administration in Brazil, raising the risk of weak leadership and prolonged low GDP growth.

What to look for over the next quarter

- Will Argentina have an 'orderly' sovereign default of its long-term debt or will there be a financial crisis affecting the banking sector?
- Will negotiations result in a political change, or a new government, in Venezuela?
- Will Brazil's Congress approve pension reform and will the government have enough political capital afterwards to advance with other fiscal reforms?

Local And Regional Governments (LRGs)

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- Argentina's default has ratcheted up financial pressures on provinces, given their financial obligations in foreign currency and weaker fiscal performance in 2019. However, differences in the credit strength among provinces and cities exist, even amid the sovereign's very weak fundamentals. The institutional framework under which LRGs operate remains the weakest than those of global peers.
- Fiscal woes for Brazilian LRGs will continue for the rest of 2019, given that operating expenditures continue growing at a greater pace than revenues amid a subdued economy. With limited access to external financing, capital expenditures will remain low. Pension reform wouldn't create be sufficient for public-finance sustainability in the medium to long term.
- Mexican states and municipalities will be facing fiscal strains, given the 2019 reduction in federal transfers in 2019 and the recently presented tight federal for 2020. LRGs with higher operating expenditures would likely need to raise local taxes to partly compensate for lower transfers, while reliance of those on short-term debt would likely rise. Debt could increase if LRGs increase capital spending towards the end of 2029 and into 2020.

What's changed?

Argentina's political and economic malaise worsened over the last few months, leading to downgrades at sovereign and provincial levels. After the August 11th primary elections, governors started to plan for a potential change in national government because President Macri lost support in most of the provinces, with the exception of the city of Buenos Aires. Although the majority of governors were reelected in recent elections, we consider that political and economic decisions at the national level could add to the troubles for most provinces toward the end of 2019 and in 2020. s at national level could add challenges for most provinces toward the end of 2019 and in 2020.

Although Brazil's pension reform at the national level could be overall positive, we don't expect it to bring meaningful fiscal flexibility for states and municipalities in the short to medium term.

With prospects for sluggish economic growth in Mexico, reductions in federal transfers to states and municipalities, and fiscal constraints, LRGs will struggle to repay or refinance debt, unless they levy local taxes more efficiently.

Key assumptions

- Argentina will remain in recession for the rest of 2019, higher-than-expected inflation wil squeeze provincial budgets, and debt issuances will remain subdued. Debt burden, by itself, is not a credit constraint, but servicing foreign debt will be a risk in the next few months.
- Brazil's central government is likely to keep the commitment to guarantee states' debts, and we believe this has brought transparency and ongoing monitoring of LRGs' finances. We also consider that access to external financing will remain restricted for the rest of the year. If passed, pension reform in Brazil wouldn't benefit states and municipalities in the shorter term, but probably over the longer term. Earmarked operating expenditures continue to constrain budgets.
- Fiscal pitfalls among Mexico's LRGs would likely deepen if they don't address mainly operating expenditures toward the end of 2019 and into 2020. The relatively weak institutional framework, under which LRGs have been operating over the past years, continues to limit creditworthiness because rule of law is vulnerable to political decisions.

Key risks

- Argentina defaulting in the next few months and the increasing financial needs among provinces refinancing their foreign debt over the next few months.
- In Brazil, the rising budgetary pressures, which continue to weaken liquidity, could push more local governments to delay debt repayments. This would prompt us to revise our assessment of the institutional framework to a weaker category, which could hit LRGs' creditworthiness.

- Some of the issues that could undermine our base-case scenario for Mexico's LRGs: consistent decrease of federal transfers up to a point where states start reporting operating deficits, higher reliance on short-term debt to finance operating expenditures, a diminishing fiscal transparency, and political discretion to manage federal funds.

What to look for over the next quarter

- Monitor political developments in Argentina, because a change in government and public policies could generate more uncertainties over debt repayment and refinancing towards the end of 2019 and in 2020. Provinces with foreign currency debt face higher risk, given the very limited access to external financing.
- Concerns over the most financially stressed states in Brazil, given the absence of plans to foster fiscal sustainability in the longer term. We'll continue monitoring for any changes in the institutional framework--predictability, revenue and expenditure balance, and transparency and accountability.
- Assess budgetary performance for the remainder of 2019, given that states were unable to compensate for lower federal transfers, and the proposed budget for 2020 contains lower amounts set for LRGs. The lackluster economic growth for 2019 and 2020 will strain public finances.

Nonfinancial Corporations

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- Second-quarter performance improved mildly in most of the sectors we cover.
- Recent bond issuances amid a small group of Mexican corporations reinforce our views about favorable access to credit markets for investment-grade entities, although pricing divergence across these transactions provides evidence of still unfavorable market sentiment towards quasi-sovereigns.
- Business conditions in Argentina likely to worsen in third quarter as depreciation fueled another inflation peak following the primary elections results. Although it's hard to assess vulnerabilities across sectors, corporations with currency mismatch and short-term debt concentration are the ones more exposed.

What's changed?

Market access generally improved in June and August with more than eight issuances per month, compared with less than half of that in the previous months (with the exception of April). The market remains fairly open except for Argentine issuers whose ratings have been trimmed lately on the back of the slippage of the sovereign's credit quality (see the Sovereigns section).

Because of Argentina's sudden weakening after the primary elections, we downgraded many domestic issuers (please read "11 Argentine Corporate And Infrastructure Entities Downgraded, Three Placed On Watch Negative On Sovereign's Downgrade," Aug. 20, 2019). Entities with currency mismatch and/or short-term debt concentration face heightened refinancing risks. Business conditions are likely to worsen as well due to volatile macro and political uncertainties.

In contrast, conditions in Brazil improved slightly in the second quarter for many sectors, including protein producers, consumers, airlines, homebuilders, metals and miners, and transportation in general. A combination of external factors such as the African Swine Fever (ASF), the collapse of Avianca Brasil, and the overall favorable fundamentals for iron ore and steel prices prompted stronger performances in those sectors.

Mexican corporations remain under scrutiny, given that the largest government-owned corporations don't seem to have a clear and compelling business strategy, or at least investors doubt on the value of recent decisions (see "PEMEX's New Business Plan: Making A U-Turn Is A Risky Move," July 22, 2019). Still, our corporate ratings in Mexico remained largely unaffected, and we expect conditions to remain supportive.

Key assumptions

We expect Argentine entities' access to international debt markets to remain volatile in general, and we don't see chances of improvement at least for the next six months--until the first round of the presidential elections takes place (October 27th) and the new administration reveals plans and policies.

Domestic consumption in Brazil and Chile should remain fairly stable, while Mexico could face economic headwinds and conditions in Argentina will remain weak for some time.

Key risks

Argentine issuers with currency mismatch and short term debt concentration face heightened refinancing risks. Also, some sectors may face above-average downside risks if conditions continue weakening, such as utilities; engineering & construction and real estate (for more details please read "Key Corporate Risks To Monitor As Argentina Heads For Presidential Primaries," Aug. 7, 2019).

Country risks in Mexico, Brazil, and Argentina could limit the domestic companies' market access and curb performance.

In general, we view on commodity prices as remaining supportive, but recent weakening of copper and pulp prices may pressure the sector players' leverages. We will continue monitoring the companies' counteractive measures.

The strike on Aramco's Abqaiq oil-processing facility and the Khurais oilfield in Saudi Arabia on September 14th has not only triggered higher oil prices, but will also heighten geopolitical tensions in Middle East. The attack will have significant ramifications for oil markets. Given that one combined strike can knock out not just 5% of global supply, but more than double the amount of global spare-production capacity, highlights oil market vulnerabilities. Oil price increases jumped by double digits, although it's too early to tell what the credit impact will be for industry players, and the magnitude of the impact will largely depend on how long and how much oil production is off the market.

What to look for over the next quarter

Mexico's government continues to put together a plan to provide financial support to PEMEX and bring more certainty to the company's bondholders. In the meantime, prospect for slower GDP growth are generally holding back investment decisions, and corporations are keeping capital expenditures (capex) allocations at maintenance levels. Mexico's consumer confidence index reached a record high in February, although the recent slowdown in retail and auto sales could signal that consumption is cooling. The health of export manufacturing remains closely linked to a still growing U.S. economy, although the risk of slower global growth and the unresolved new free trade agreement among Mexico, Canada, and the U.S. could undermine trade between Mexico and North America.

The Bolsonaro administration continues to push reforms. In particular, the proposed pension reform would save up to R$1 trillion in the next 10 years. Its approval would dissipate investors' fears about the proposal's execution and perhaps pave the way for additional reforms.

Argentina's decision to 're-profile' its debt needs, to be formally discussed in Congress, is likely difficult to execute due to the current administration's political weakening after the larger-than-expected loss at the primary elections. Moreover, Argentina's political scenario is changing rapidly and will have a major influence on the credit quality of domestic corporations, because many issuers need to refinance debt maturities and are exposed to currency risks.

Infrastructure

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- Uncertainty surrounding future rate adjustments for Argentine regulated utilities has increased, particularly after the primary elections and subsequent economic developments. In an adverse scenario, we believe the future government may seek to dilute planned rate increases, lessening the burden on households' disposable income, but potentially hampering the utility sector's operating performance and the individual players' cash flows.
- Mexico-based Comision Federal de Electricidad (CFE) and several pipeline operators reached agreements in August 2019, which we view as a credit positive. The agreements prevented the long and complicated arbitrage process in international courts, which would have delayed further the entrance in operations of idle pipelines and meeting the country's natural gas supply needs.
- In Chile, we continue to see decreases in the electricity demand, particularly from distribution companies (discos) as a result of a slower GDP growth, and more importantly, the migration of energy users from the regulated to the free market. This trend dented the credit metrics of some sector players (mostly single assets with take-and-pay contracts), but so far their ratings remain unchanged.

What's changed?

The volatility in Argentina exacerbated after the primary elections. We believe the risk of the sovereign interfering with the ability of domestic companies to access, convert, and transfer money abroad is increasing. We also expect a further depreciation of the domestic currency and inflation to rise higher than we previously projected, between 45% and 55% for 2019 and 2020. We lowered the ratings on several Argentine infrastructure entities due to the likely lower cash flows, because we now consider future rate adjustments won't cover 100% of inflation cost pass-through, and due to debt because most of their financial obligations are in dollars. We will continue monitoring potential modifications of the regulatory framework that could impair the companies' repayment capacity.

The agreements between CFE and pipeline operators establish a new rate structure that doesn't include step-ups over time and incorporate a 10-year extension of the contracts. We updated our base-case scenario for all companies involved in the dispute and concluded that the agreements won't affect materially our expectations for financial performance. Consequently, the measures were credit neutral.

The Chilean discos' demand for electricity plunged in the past months, in some cases at about 30%. This was due to Chile's slowing GDP growth and the ongoing migration of energy users from the regulated spectrum to the unregulated segment. Therefore, we revised downward our demand haircut assumption that affected some projects that are mostly contracted with discos with take-and-pay contracts. So far, no rating changes occurred due to this trend, but we will continue monitoring it and its impact on the rated issuers' credit metrics.

Key assumptions

GDP growth and inflation. We correlate GDP performance to electricity demand and traffic levels at the transportation assets. On the other hand, inflation affects availability projects and regulated assets, such as transmission lines, pipelines, etc.

Key risks

- Slower GDP growth.
- Volatility spot prices in the electricity markets, and shorter-tenor power purchase agreements amid more volatile conditions.
- Incremental risk of re-contracting coal-fired power plants, particularly in Chile, which is planning for a greener energy matrix by 2025.

What to look for over the next quarter

The release of CFE's business plan that has been postponed since mid-year.

Potential modifications of Argentina's electricity regulatory framework, including rate adjustments. We expect capex to fall in the near future, at least until clarity of the economic and political landscapes increases.

Colombia will finally have the renewable energy auction on Oct. 22, 2019.

The terms of the sale of Sempra Energy's South American businesses, including Luz del Sur S.A.A. in Peru and Chilquinta Energía S.A. in Chile.

A new energy auction in Brazil (LEN A-6 with delivery by January 2025) is likely to occur on October 17. For this auction, 1,829 projects are registered to bid totaling 100 gigawatt (GW) in capacity, including 42 GW of gas thermal plants, 30 GW of solar and 25 GW of wind.

Financial Services

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- Pronounced financial market turbulence, with the Argentine peso's sharp depreciation and a spike in interest rates, following primary elections and subsequent unilateral extension of the maturities of all short-term sovereign debt, has substantially weakened the economic conditions for banks operating in Argentina. As a result, we have placed Argentine banks that we rate on CreditWatch with negative implications.
- Mexican banks' credit fundamentals remain resilient despite the stagnant economy and low credit demand.
- The Brazilian government is moving forward with its privatization agenda and reducing its participation in the banking system. Lending from private banks is growing at low-double digits, but government-owned banks are not posting growth, and BNDES is contracting its lending portfolio and divesting its equity exposures.
- The region's persistently soft economic conditions and low investment in general have resulted in low credit demand. Moreover, low interest rates have promoted disintermediation in some countries, such as Brazil, Chile, Peru, and Colombia, given that corporations are issuing in the local markets. As a result, we expect credit growth in the region to remain low.
- We expect interest rates to keep falling in line with the Federal Reserve's more dovish stance, which will pressure banks' margins. This, in turn, could prompt banks to enter riskier lending segments.

What's changed?

Argentine financial institutions are operating under very difficult conditions stemming from economic woes. Banks have been able to cope with the withdrawals since the primary elections thanks to the high levels of liquidity and the short-term nature of the dollar loans. Asset quality has weakened as lending continues shrinking in real terms as a result of the weak economy, and high inflation and interest rates. Non-performing loans to total loans reached 4.7% as of July 2019, still a manageable level thanks to the low banking penetration and banks' focus on the higher-income clients. On Aug. 20, 2019, we downgraded three Argentine banks to 'B-' from 'B', and revised the outlook to negative on all rated banks in the country, reflecting the sovereign rating action.

The Brazilian government is moving forward with its privatization agenda and reducing its participation in the banking system. Lending from private banks is growing at double-low digits, but lending among public has posted flat growth and BNDES is reducing its lending and divesting its equity exposures. We expect loan growth of 5%-8% this year, as corporations' demand for credit remains subdued. Asset quality metrics continue improving despite the still soft operating environment, and we expect this trend to continue.

Lending growth in Mexico is moderating because of the stagnating economy. In particular, growth of corporate and commercial loans--which make up about 65% of total loans--and the engine of credit growth--are slowing due to the lack of credit demand in light of low investment and weakening consumption. Nevertheless, banks' asset quality metrics remain resilient.

After the Concesión Ruta del Sol 2's contracts were declared invalid--due to the corruption probe of Brazil-based Odebrecht group--we expect nonperforming assets in Colombia's banking system to represent around 4% of total loans by the end of 2019, which are fully covered by reserves. We expect this metric to fall to about 3.75% and 3.5% in 2020 and 2021, respectively, based on improving economic prospects and increasing credit demand.

Low interest rates in Chile and Peru are prompting corporations to increasingly seek financing in domestic and international debt markets, resulting in low bank lending growth. Moreover, the softer economic growth and low investment confidence in both countries are reducing the corporate demand for credit.

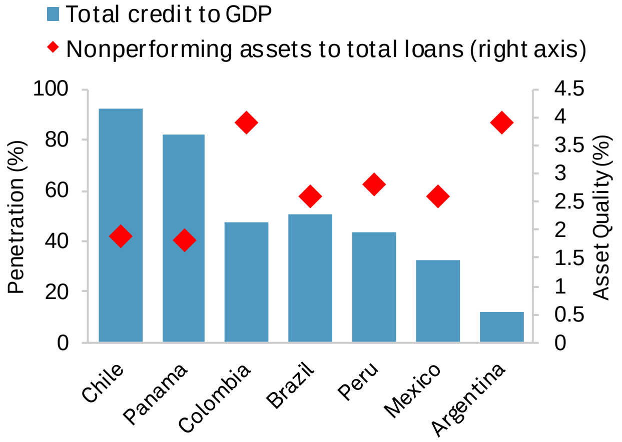
Key assumptions

The adverse political dynamics, weakening domestic demand, and volatile external conditions will keep curb economic growth pace in the region. Therefore, we expect modest credit expansion and pressure on asset quality.

As a result of the Federal Reserve's current monetary policy, we expect the potential easing cycle in interest rates--in most countries--to pressure banks' profitability with a lag of 12-18 months.

Chart 7

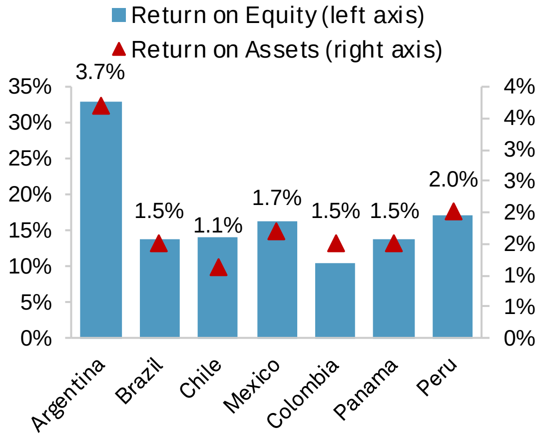
Credit To GDP And Asset Quality, 2019 Forecast



Source: S&P Global Ratings

Chart 8

Latin American Banks' Return On Equity



Source: S&P Global Ratings

Key risks

- A prolonged period of poor economic growth in the region--if political uncertainties prevail discouraging business and consumer confidence--could mute credit demand and cause nonperforming assets to rise.
- Volatile deposits in Argentina could continue pressuring banks' funding profiles.
- Venezuelan immigration to Colombia could pressure employment and wages, potentially affecting asset quality.
- Even though banking losses related to cyber security gaps are currently manageable, risks keep rising.

What to look for over the next quarter

- Mexican banks' asset quality and profitability amid ailing economy.
- Argentine banks' deposits and asset quality performance.
- Credit demand in Colombia amid stable economic prospects and the next steps for the implementation of Basel III capitalization rules.

Structured Finance

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- The recent developments in Argentina have significantly increased the downside risk for rated entities in the sector.
- Issuances in Brazil continue growing at a double-digit rate.
- We have observed renewed interest in new asset classes in Mexico, despite the weakening economy.

What's changed?

Structured finance issuances in Latin America during the first half of 2019 totaled about $4.7 billion, down about 20% in the same period of 2018. The drop mainly resulted from lower issuance volume in the cross-border market. Brazil accounted for the bulk of structured finance issuances in the region and should continue to drive the market.

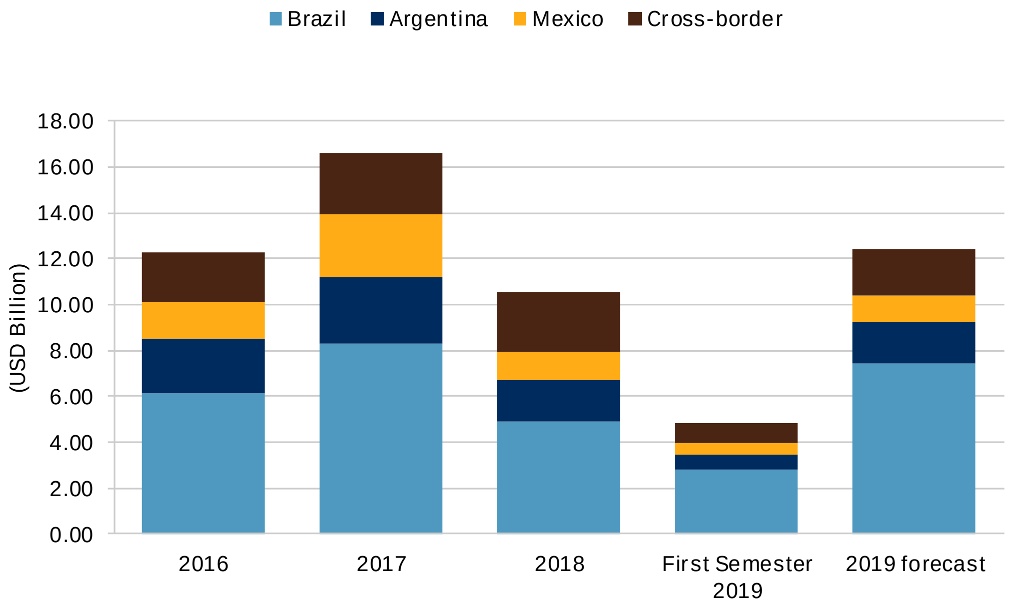
As a result of the rating actions on Argentina, we placed 36 structured finance issue ratings on CreditWatch negative. The weakening of the sovereign will likely take a toll on the credit quality of the assets that back up the structured finance issues we rate. In addition, the Argentine ratings distribution will likely change, given the weaker macroeconomic conditions. About 80% of issuances that we rate in Argentina are backed by consumer credit as an underlying asset. Low- and medium-income individuals represent the bulk of borrowers from financial trusts, given that they have limited access to bank credit due to tight origination policies.

As we had expected, issuances in Brazil this year have increased significantly from 2018, albeit at a slower pace than we expected. Certificates of agribusiness receivables remain the most active class in the market, and this should persist for the remainder of the year. Nevertheless, we continue to observe interest in Fundos de Investimentos em Direitos Creditórios and new originators (particularly in covered bonds and fintech). On Aug. 19, 2019, the National Monetary Council, one of Brazil's financial regulatory bodies, approved Resolution No. 4.739, which is intended to widen the pool of funds available to finance purchases of homes in the country. In practice, the new resolution will allow residential mortgages to be linked to Brazil's Consumer Price Index (IPCA), which will attract significantly more investors to Brazil's incipient residential mortgage-backed securities (RMBS) through Certificados de Recebíveis Imobiliários (CRIs) and covered bonds through Letras Imobiliárias Garantidas (LIGs). We believe that indexing mortgages to IPCA comes with risks that must be monitored. The high volatility of Brazil's economy increases the risk of a sudden rise in inflation, which could result in a higher debt burden to homeowners, a rise in delinquencies, and weaker credit quality of securitized mortgages.

Issuances in Mexico during the second quarter of 2019 were in line with our expectations. Activity has resumed in the market across several asset classes, mainly asset based security (ABS) equipment and RMBS. We continue to follow closely the performance of ABS consumer and equipment transactions. Despite the subpar second-quarter 2019 GDP growth in Mexico, we didn't observe further weakness in our rated portfolio relative to the first quarter of 2019.

Chart 9

Structured Finance Issuances In Latin America



Source: S&P Global Ratings

Key assumptions

- New issuance in Latin America between $11 billion and $13 billion, driven primarily by a rebound in Brazilian securitization.
- Stable collateral performance. Nevertheless, the sudden weakening of Argentina's credit quality will likely lead to downgrades of rated players.
- There are infrastructure projects that could bring securitization opportunities in the region.

Key risks

- Argentina's depressed economy remains a key risk to our expectations of new issuances and collateral performance.
- Mexico's GDP growth could continue to weaken and unemployment could rise, which could weigh on ABS transactions backed by consumer credit and equipment leasing.

What to look for over the next quarter

- Collateral performance and new issuances in Argentina.
- Debut of new issuers in Brazil and market sentiment.
- Mexico's GDP growth prospects and collateral performance domestic ABS market.
- New issuances in the cross-border market.

Related Research

- Credit Conditions Asia-Pacific: China Slows, Trade Tensions Blow, Sept. 30, 2019
- Credit Conditions EMEA: Lingering In The Lowzone, Sept. 30, 2019
- Credit Conditions North America: Rising Recession Risk Adds To Trade, Rate Uncertainty, Sept. 30, 2019
- Trending Assets: Brazil Continues To Lead Structured Finance Issuance In Latin America; Sept, 23, 2019
- Argentine Banks In 2001 Versus 2019: The Parallels And Differences, Sept. 18, 2019
- As Inventories Cushion Oil Price Impact, Abqaiq Strike Spotlights Risks To Spare Capacity, Sept. 16, 2019
- Key Corporate Risks To Monitor As Argentina Heads For Presidential Primaries; Aug. 07, 2019
- PEMEX's New Business Plan: Making A U-Turn Is A Risky Move, July 22, 2019

This report does not constitute a rating action.

Appendix 1: Ratings Trends And Surveys

Table 4

Latin American Sovereigns And IPF

	Economic conditions	Economic conditions outlook	Budgetary performance	Sector outlook
Brazil	Weak	No change	Same	Stable
Mexico	Weak	Weak	Same	Negative
South America (excluding Brazil)	Satisfactory	No change	Same	Stable
Central America & Caribbean	Weak	No change	Same	Stable
Mexico IPF	Weak	Weak	Same	Negative
Argentina IPF	Satisfactory	No change	Same	Stable
Brazil IPF	Weak	No change	same	Negative

IPF—international public finance. Source: S&P Global Ratings.

Table 5

Latin American Corporate And Infrastructure Sector Trends

	Current business conditions	Business conditions outlook	Financial trends outlook	Sector outlook
Aerospace and defense	Satisfactory	No change	Lower	Stable
Auto suppliers	Satisfactory	No change	Same	Stable
Building materials	Weak	Somewhat weaker	Lower	Stable to Negative
Chemicals	Satisfactory	Somewhat weaker	Lower	Stable
Consumer products A (including protein and bottler)	Satisfactory	No change	Same	Stable to Negative
Consumer products B (agro)	Satisfactory	Somewhat stronger	Same	Stable
Forest products	Weak	No change	Lower	Stable to Negative
Merchant power	Satisfactory	Somewhat weaker	Same	Stable to Negative
Metals and mining	Satisfactory	No change	Same	Stable
Oil and gas	Satisfactory	No change	Same	Stable
PPP/Infrastructure project finance	Satisfactory	No change	Same	Stable
Real estate: homebuilders	Weak	Somewhat weaker	Same	Stable to Negative
Regulated utilities	Satisfactory	No change	Same	Stable
Retail	Satisfactory	No change	Same	Stable to Negative
Telecom	Satisfactory	No change	Same	Stable
Transportation	Satisfactory	No Change	Higher	Stable

Source: S&P Global Ratings.

Table 6

Latin American Banking Industry Trends

		Economic risk factors					Industry risk factors				
Country	BICRA group	Economic resilience	Economic imbalances	Credit risk in the economy	Economic risk score	Economic risk trend	Institutional framework	Competitive dynamics	System wide funding	Industry risk score	Industry risk trend
Argentina	9	Extremely high	High	Extremely High	10	Stable	High	High	Very high	7	Negative
Brazil	6	Very high	High	High	7	Stable	Intermediate	High	Intermediate	5	Stable
Mexico	4	High	Low	High	5	Negative	Intermediate	Intermediate	Low	3	Stable
Colombia	6	High	High	High	7	Stable	High	Intermediate	Intermediate	5	Positive
Peru	5	High	Very low	Very high	6	Stable	Low	Intermediate	Intermediate	3	Stable
Chile	3	High	Low	Intermediate	4	Stable	Low	Intermediate	Low	3	Stable

Source: S&P Global Ratings. Data as of September 2019.

Table 7

Latin American Insurers And Reinsurers Sector Trends

	Current business conditions	Business conditions outlook	Sector outlook
Mexico	Satisfactory	No change	Stable
Brazil	Weak	Improving	Stable
Colombia	Satisfactory	No change	Stable

Source: S&P Global Ratings.

Table 8

Latin American Structured Finance Sector Trends

	Current collateral performance	Collateral performance outlook	Sector fundamentals	Ratings trends
Argentina				
Consumer assets	Satisfactory	Weaker	Negative	Negative
Brazil				
Commercial assets	Satisfactory	No change	Stable	Stable
Consumer assets	Satisfactory	No change	Stable	Stable
RMBS	Satisfactory	No change	Stable	Stable
Future flows	Satisfactory	No change	Stable	Stable
Mexico				
Commercial assets	Satisfactory	No change	Stable	Stable
Consumer assets	Satisfactory	No change	Stable	Stable
RMBS	Satisfactory	No change	Stable	Stable
Future flows	Satisfactory	No change	Stable	Stable
Cross-border				
Future flows	Satisfactory	No change	Stable	Stable

Source: S&P Global Ratings.

Appendix 2: Economic Forecasts

Table 9

Latin America CPI Inflation

(%)	2017	2018	2019f	2020f	2021f	2022f
Argentina	24.8	47.6	55.0	40.0	25.0	19.0
Brazil	2.9	3.7	3.5	3.8	4.0	4.0
Chile	2.3	2.1	2.7	3.0	3.0	3.0
Colombia	4.1	3.2	3.6	3.0	3.0	3.0
Mexico	6.8	4.8	3.1	3.0	3.0	3.0
Peru	1.4	2.2	2.4	2.2	2.0	2.0

f--Forecast. Source: S&P Global Economics.

Table 10

Latin America Policy Rate

(%, year-end)	2017	2018	2019f	2020f	2021f	2022f
Argentina	28.75	59.25	80.00	50.00	40.00	30.00
Brazil	7.00	6.50	5.00	5.00	5.75	6.25
Chile	2.50	2.75	1.75	1.75	2.25	2.75
Colombia	4.75	4.25	4.25	4.25	5.00	5.00
Mexico	7.25	8.25	7.50	7.00	7.00	7.00
Peru	3.25	2.75	2.25	2.25	2.75	3.25

f--Forecast. Source: S&P Global Economics.

Table 11

Latin America Exchange Rate ($, Year-End)

	2017	2018	2019f	2020f	2021f	2022f
Argentina	18.65	37.70	67.00	85.00	90.00	95.00
Brazil	3.31	3.87	4.10	4.15	4.20	4.20
Chile	615	696	710	715	720	720
Colombia	2,984	3,250	3,350	3,400	3,400	3,400
Mexico	19.67	19.65	20.50	20.75	21.00	21.00
Peru	3.24	3.37	3.40	3.45	3.50	3.50

f--Forecast. Source: S&P Global Economics.

Table 12

Latin America Exchange Rate ($, Average)

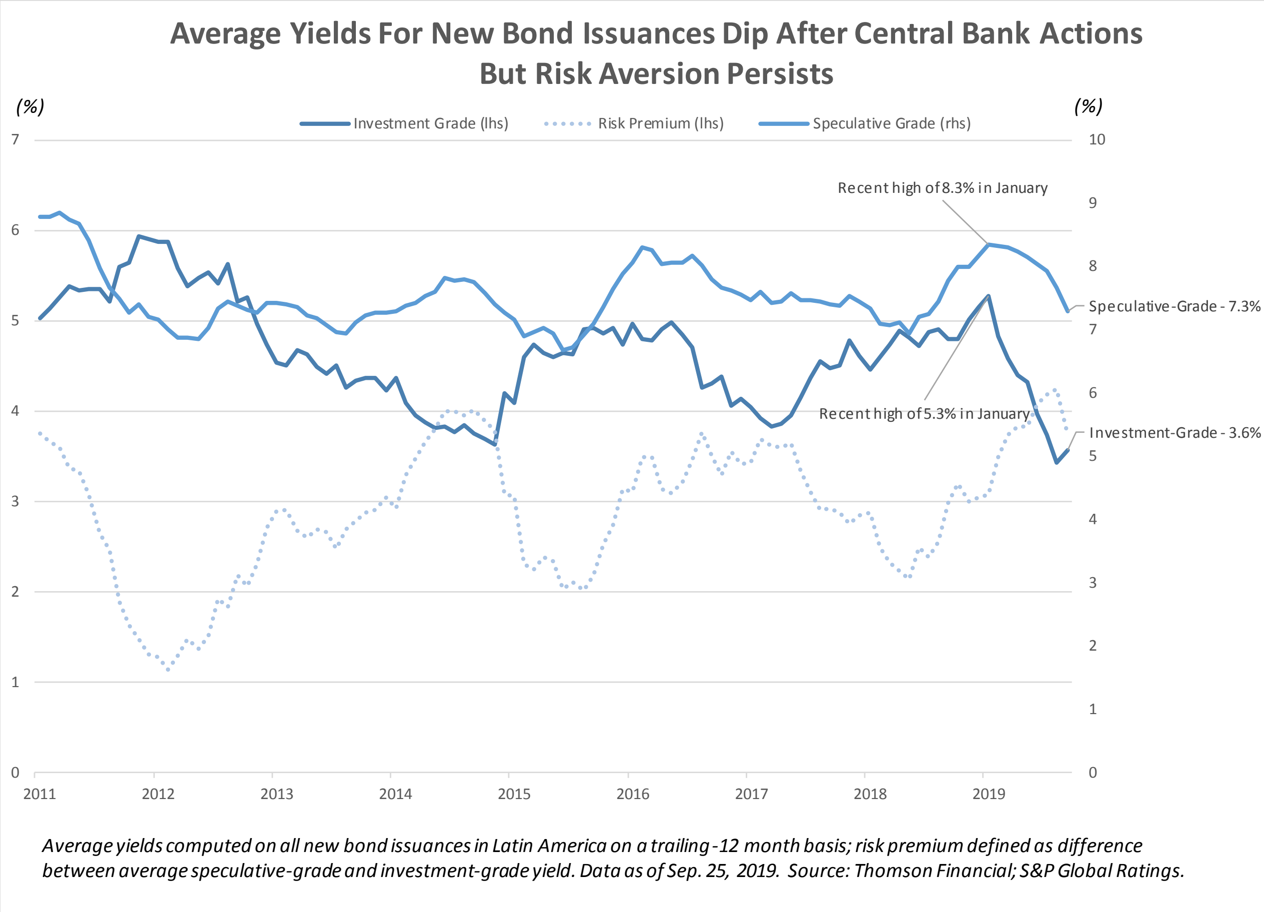
	2017	2018	2019f	2020f	2021f	2022f
Argentina	16.56	27.81	52.00	75.00	88.00	93.00
Brazil	3.19	3.65	3.95	4.12	4.17	4.20
Chile	649	641	690	712	717	720
Colombia	2,951	2,956	3,300	3,375	3,400	3,400
Mexico	18.91	19.23	19.50	20.65	20.85	21.00
Peru	3.26	3.29	3.35	3.43	3.48	3.50

f--Forecast. Source: S&P Global Economics.

Appendix 3: Reference Charts

Chart 10

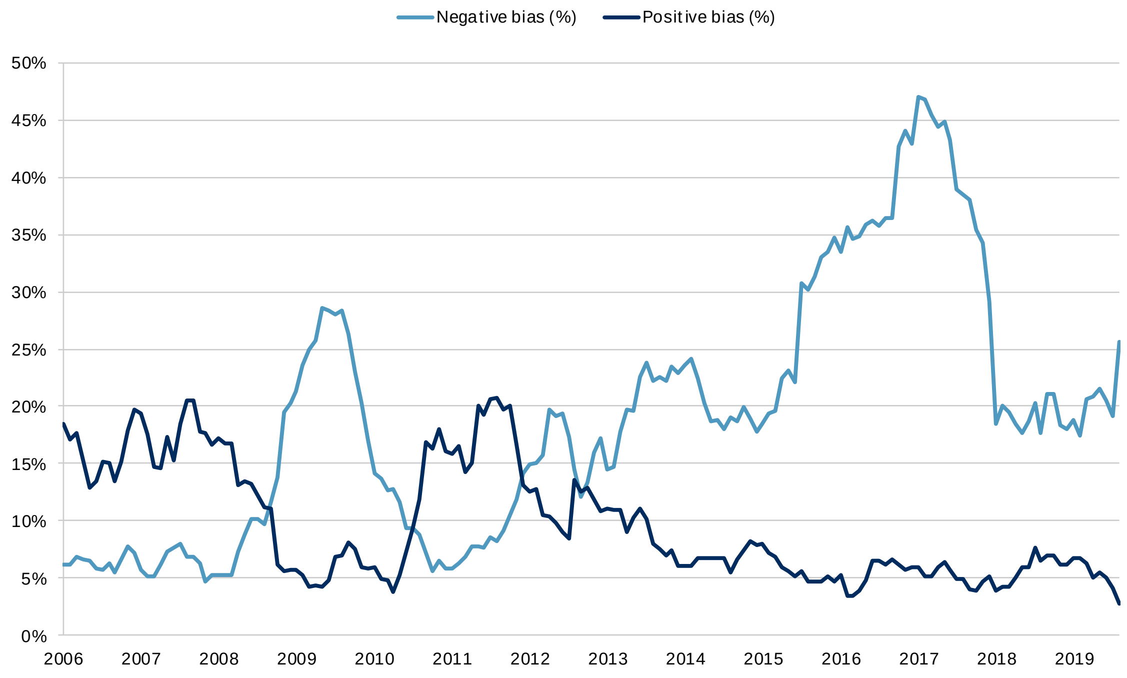
Average Yields For New Bond Issuances Dip After Central Bank Actions But Risk Aversion Persists



Average yields computed on all new bond issuances in Latin America on a trailing-12 month basis; risk premium defined as difference between average speculative-grade and investment-grade yield. Data as of Sep. 25, 2019. Source: Thomson Financial; S&P Global Ratings.

Chart 11

Latin America Negative And Positive Bias (%)



Source: S&P Global Ratings Research, S&P CreditPro. Data as of Aug. 31, 2019.

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