

Colombia's Rating Matters Above Investment Grade

- Is a Moody's downgrade to Colombian debt priced-in?

We recently discussed how the stiffness of public spending and the apparent flexibility of the fiscal rule could trigger a one notch downgrade of the nation's debt in Colombia (in our latest [Global Outlook report](#), page 28). It's worth recalling that this potential cut will not imply a loss of investment grade, since the reduction would probably be made by Moody's agency, which, as shown in Table 1, currently classifies Colombian debt as Baa2 (equivalent to the BBB rating of Fitch) with a negative outlook. Do Colombian asset prices reflect the possibility of this rating adjustment? If they don't, could the announcement generate local market volatility in the local market?

Table 1. Colombian government rating

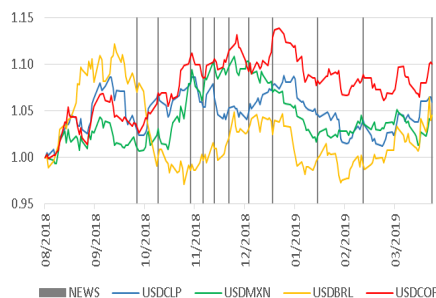
	Moody's	S&P	Fitch
Dates	22/02/2018	11/12/2017	14/11/2018
Credit Score	Baa2*	BBB-	BBB
Outlook	Negative	Stable	Stable

Source: Bloomberg.

One way to answer this question is in a factual manner: did recent international agency comments on Colombia move markets? On September 27, 2018 Moody's stated that the nation would face obstacles in reaching its fiscal objective. Since this date 10 other news have been published with negative comments from the rating agencies, where concerns about fiscal sustainability have been highlighted. Taking a closer look at market's reaction to the international agencies' announcements, we noticed that they were not accompanied by downward movements in asset prices that could be attributable to the news or that distanced themselves from a generalized behavior of the LATAM market.

For example, in the fourth quarter of 2018 the Colombian peso devalued 9% q/q, more than the 4% evidenced by a reference basket composed by the Chilean, Mexican, Colombian peso and Brazilian real. The overreaction compared to the basket is due to lower oil prices and financial law noise. In the first quarter of 2019, the FX LaTam reference basket rose by 1%, very much in line with the recovery of the Colombian peso of 2%. Chart 1 shows that international agencies' comments on Colombian debt did not affect short or longer-term COP dynamics, which corroborates that recent news about a possible rating downgrade (still investment grade) hasn't had much impact on asset pricing.

Graph 1. Region exchange rates (Normalized)



Sources: Bloomberg, Scotiabank.

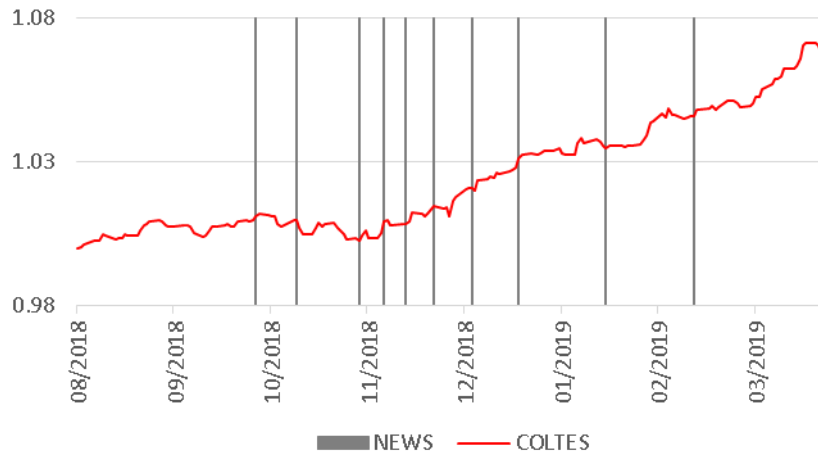
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Regarding the sovereign debt (TES), there has been a constant appreciation throughout 2018 and 2019. In fact, the valuations of Colombian securities have increased YTD, mainly due to higher EM risk appetite due to FED and ECB dovishness.

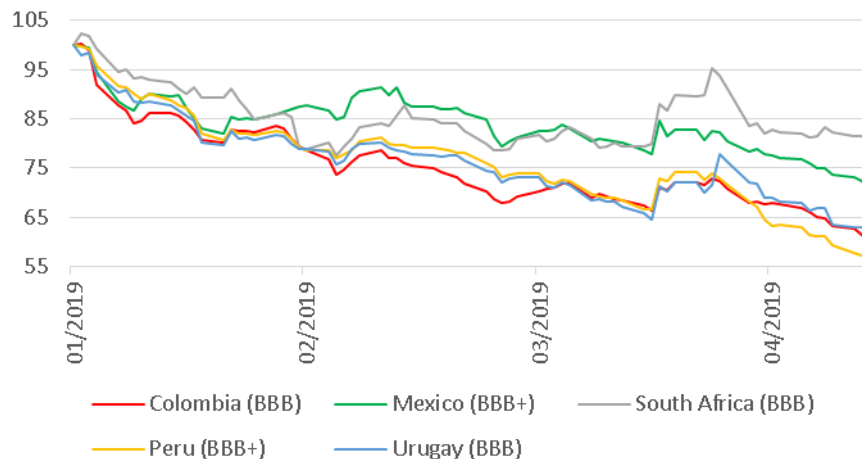
Graph 2. Reference index COLTES (Normalized)



Sources: Bloomberg, Scotiabank.

Additionally, Colombian risk perception measured by the CDS value has not deteriorated on the back of rating agencies comments. In fact, YTD Colombian CDS-5y has dropped 39%, even more than other investment grade countries (peers with BBB+ to BBB) that have fallen by only 34%.

Graph 3. CDS-5Y (Normalized)



Sources: Bloomberg, Scotiabank.

Bottom line, our analysis shows that current prices of Colombian assets do not reflect a potential scenario of rating downgrade; we think assets behaviour is much more correlated with the international liquidity, and decisions taken by the FED, the ECB and the Chinese Government. These currently favor conditions of high liquidity that will continue to seek attractive returns in emerging countries. If Moody's decides to cut our rating to Baa3, we would expect some volatility in the short term, but not a decrease in the appetite for Colombian assets and valuation opportunities.

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