Colombia Flash

Fitch Ratings upgrades Colombia’s rating to BBB

Today Fitch Ratings surprised the market with its upgrade of Colombian sovereign bonds to BBB. Even though Fitch Ratings had previously established a positive outlook, the market had not expected the confirmation of the event to occur until next year. This upgrade places Colombia at the same rating of Brazil and Panama, and one notch below that of Peru

- ### Three reasons why it is positive news

  This is very positive news for Colombia for three reasons. First it is the second of the three main rating agencies to upgrade Colombia’s sovereign rating to BBB, after Standard & Poor’s did so in April of 2013. This allows a larger pool of institutional investors to consider Colombia for their asset allocation, as they normally require ratings to coincide by at least two main agencies. Second, the short term rating was upgraded to F2, enlarging the pool of investors which might find Colombian assets attractive for their short term portfolios. Third, the timing of the upgrade is significant since it confirms the view that Colombia’s economy is robust enough to withstand the announced Federal Reserve (Fed) tapering and normalization of international financial conditions, despite recent economic notes (eg. The Economist, Wells Fargo) that have highlighted the country’s susceptibility to reversals of capital flows.

  The rating agency could have waited until the bond purchase tapering begun and evaluated its impact on capital flows and the economy. The upgrade at this time is a sign of confidence towards Colombia’s economy, especially with the existing uncertainty regarding the impact of the Fed tapering on emerging markets.

- ### Improvement in external accounts and debt dynamics are the main drivers

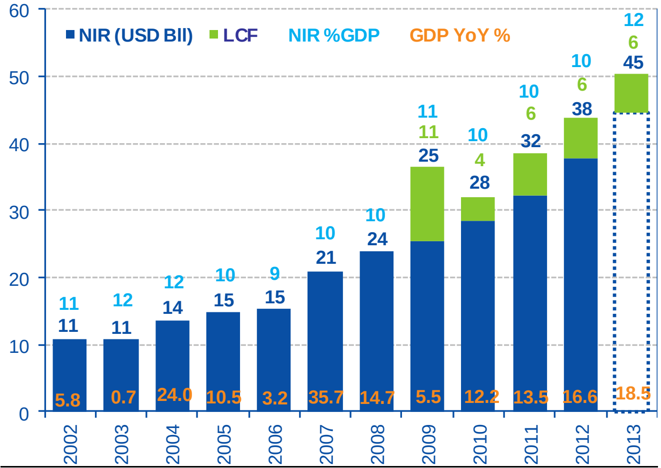
  The statement highlights improvements in external accounts and the positive government debt dynamics as the main drivers of the upgrade. The strengthening of external buffers has been achieved by a sustained accumulation of international reserves, access to IMF’s Flexible Credit Line and a net sovereign external creditor position in 2013. All of which allow the country to better withstand the anticipated change in external financial conditions as the tapering begins and capital flows lose appetite towards emerging markets. The ratings agency considers that net foreign direct investment (FDI) as a single source of funding compensates for Colombia’s higher external financing needs (current account balance plus external amortizations as a percentage of international reserves) than the BBB median. Furthermore, they highlight that Colombia’s general government debt (37% of GDP) remains below peers, external debt burden is moderate and that government debt relies on a high percentage of fixed-rate instruments (94%), which jointly reduce exchange rate and interest rate risk.

- ### Structural improvements remain

  However, they highlight that Colombia lags in structural factors such as weaker governance, low GDP per capita and limited trade openness when compared to peers. These are issues that need to be improved significantly, together with stronger GDP growth that supports faster debt reduction, before any further upgrade can be achieved.

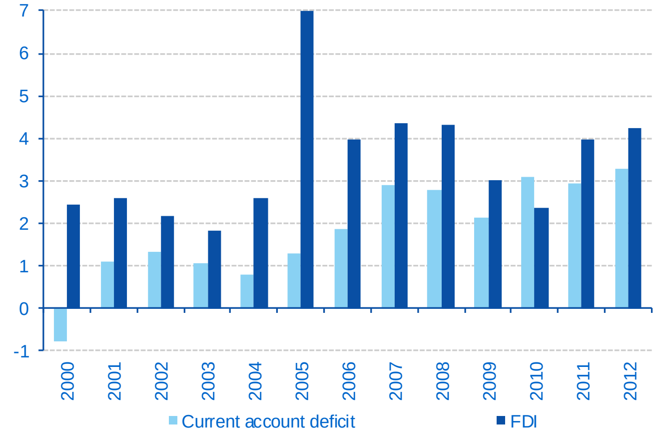
  This longer term view reflects BBVA position that Colombia continues to be an attractive economy with improving fundamentals and the potential of withstanding the anticipated shift in international financial conditions.

Chart 1
International Reserves (Billion USD, % GDP and annual variation)



Source: Banco de la República and BBVA Research

Chart 2
Current account financing (Precentage of GDP)



Source: Banco de la República and BBVA Research

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