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FEATURED Q&A

How Serious Is Colombia's Loss of Investment Grade?



Colombian President Iván Duque's failure to pass a tax reform was among the factors that led to the country's loss of its investment-grade status. // File Photo: Colombian Government.

Q Colombia on July 1 lost its coveted investment-grade rating when Fitch became the second major agency to cut the South American country's ratings to junk status, following similar action in May by Standard & Poor's. The second ratings agency's move could lead to forced selling of Colombian debt by some investors. How significant is the lowering to junk status for Colombia's economy? How difficult will it be for Colombia to regain its investment-status ratings, and what would the country's president and Congress need to do to make that happen? Which industries in Colombia will be most affected by the country's loss of investment-grade status, and why?

A Gustavo Medeiros, deputy head of research at Ashmore Avenida: "Fitch's downgrade was largely expected, so outflows are likely to be modest and offset by active investors' purchases. Colombia's creditworthiness has not materially changed due to the downgrade, as the country does not depend on foreign capital to fund its debt. The downgrade will make it marginally more costly for the sovereign and high-quality corporations (which will be the most affected) to borrow abroad. Regaining investment-grade status will depend on the country's ability to implement tax reforms that rebalance the fiscal deficit and whether it can sustain a high level of GDP growth. The combination of better fiscal and higher GDP growth would lead to a stabilization and decline of the debt/GDP ratio. However, this is likely to be a long-term process, and we do not expect Colombia to recover

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TODAY'S NEWS

POLITICAL

Haitian Officials Reject Claims of Involvement in Assassination

Haitian authorities rejected allegations that current government officials were involved in last week's assassination of President Jovenel Moïse.

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ECONOMIC

IMF, Argentina in 'Productive' Talks for New Loan Deal

The International Monetary Fund and Argentina are in "very productive" talks to reach a new loan agreement to help the country deal with its \$45 billion debt to the lender, said an IMF spokesman.

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POLITICAL

U.S. Rights Chief Calls on Cuba to Release Protesters

U.N. High Commissioner for Human Rights Michelle Bachelet called on Cuba's government to release protesters who were arrested during massive demonstrations earlier this week.

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Bachelet // File Photo: United Nations.

POLITICAL NEWS

U.N. Human Rights Chief Calls on Cuba to Release Prisoners

U.N. High Commissioner for Human Rights Michelle Bachelet today issued a statement urging for the release of protesters detained in Cuba this week and calling on the government of President Miguel Díaz-Canel to address their demands. "I am very concerned at the alleged use of excessive force against demonstrators in Cuba and the arrest of a large number of people, including several journalists," Bachelet said in the statement. "It is particularly worrying that these include individuals allegedly held incommunicado and people whose whereabouts are unknown. All those detained for exercising their rights must be promptly released," she added. She also urged the government to "address the protesters' grievances through dialogue" and called for an end to sanctions against Cuba "given their negative impact on human rights, including the

right to health." The island nation this week has seen the largest anti-government protests in decades, driven by food shortages, a dire economic situation and years of limits on civil liberties, the Associated Press reported. Cuba initially blamed the U.S. government as well as

“All those detained for exercising their rights must be promptly released.”

— Michelle Bachelet

social media for the widespread protests, but Díaz-Canel later recognized shortcomings in his government's management of shortages, according to the AP. Earlier this week, Díaz-Canel deployed security forces to crack down against protesters and blocked Internet access on the island in a bid to control the uprising. Activists have said more than 100 people have been arrested or are missing in Cuba since protests began on Sunday, and one person was killed during clashes with the police on Monday, according to Cuba's Ministry of Interior, CNN reported.

NEWS BRIEFS

IMF, Argentina in Talks for New Loan Agreement

The International Monetary Fund and Argentina are in talks to reach a new Extended Fund Facility program to help the South American nation deal with \$45 billion in debt it owes the lender, IMF spokesman Gerry Rice said Thursday, Reuters reported. Rice said the negotiations had been "very productive" over the last several days between representatives of the IMF and the Argentine government. He declined to provide a timeline for a potential deal.

Brazil's Bolsonaro Unlikely to Need Surgery, May Leave Hospital Today

Brazilian President Jair Bolsonaro said he is unlikely to need surgery and may leave the hospital as soon as today after being hospitalized on Wednesday with what his doctor diagnosed as an intestinal obstruction, Reuters reported. His doctor, Antônio Macedo, appeared alongside the president during a brief television interview on Thursday. Macedo said Bolsonaro's condition had improved and that his intestines had resumed function, the wire service reported.

Ecuador Needs Clear Mining Sector Rules to Attract Investors: Official

Ecuador must establish clear regulations for the mining sector in order to attract investment, the leader of the country's mining industry association said Thursday, Reuters reported. The comments by Nathan Monash, the head of the Mining Chamber of Ecuador, followed citizen-led ballot initiatives by environmental activists and Indigenous groups related to mining. In February, citizens of Cuenca voted to ban future mining activity near rivers. Local consultations "cannot decide on issues that are of national interest," said Monash, adding these issues are in the government's purview.

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investment-grade status over the next couple of years. In the short term, higher oil prices are likely to help slow the decline in oil production. A stronger economic performance from its largest trading partner, the United States, will also support the current GDP rebound, which is likely to surprise to the upside. In spite of the strong economic rebound, inflation has remained low, which allows the central bank to keep monetary policy at expansionist levels for longer. On the fiscal front, we believe the current administration will be able to pass in Congress a tax reform that starts addressing the deficit, although further reforms will be necessary. In summary, we believe the investment grade loss does not represent a large fundamental impact to Colombia. The main challenge is finding a sustainable path to higher GDP growth while implementing a socially acceptable fiscal adjustment."

A **María Angélica Arbeláez, consultant and research associate at Fedesarrollo:** "The loss of the investment grade is bad news for Colombia, and it adds to a very difficult economic and social situation. Although it is not the most serious problem the country faces, it does have important implications. It increases the cost of the government's indebtedness, just as the debt has reached a figure of about 65 percent of GDP, and it has negative effects on foreign investment and growth in the medium term. Colombia's loss of investment-grade status did not come as a surprise. It was expected, given the absence of a credible fiscal adjustment for the post-pandemic period and the government's failure to win passage of a tax reform, which, although it had valuable elements, was presented at the wrong time. We are still waiting for a new reform proposal that is

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Haiti Rejects Claims of Involvement in Assassination

Haitian authorities on Thursday pushed back against accusations that current government officials were involved in the assassination of Haitian President Jovenel Moïse last week, calling them “a lie,” the Associated Press reported. The head of Haiti’s National Police, Léon Charles, denied a report from Colombian TV station Caracol that claimed interim Prime Minister Claude Joseph was the mastermind behind the murder. “The police warns of all propaganda creating a diversion,” Charles said, adding that the government has seen no evidence that supports those accusations. In Colombia, Gen. Jorge Luis Vargas, who heads the Andean nation’s national police force, said he had no information suggesting Joseph had any role in the assassination plot. Vargas had previously confirmed that at least 13 of the Colombian nationals arrested as part of the group who killed Moïse were former soldiers who had retired since 2018, NPR reported. On Thursday, Lt. Col. Ken Hoffman, a spokesman at the U.S. Department of Defense, told The Washington Post that some of the Colombian servicemen had previously been trained in the United States while they were active members of the Colombian Military Forces. He did not detail how many of the men received training, or what that training entailed.

BUSINESS NEWS

A.M. Best Maintains Negative Outlook for Mexico Insurance

Insurance industry-focused ratings agency A.M. Best said Thursday that it is maintaining its negative outlook on Mexico’s insurance sector. The ratings agency, based in Oldwick, N.J., said that several “aggravating factors” from the Covid-19 pandemic are affecting

macro and microeconomic fundamentals in Mexico. “In 2020, Mexico’s insurers were able to generate minimal business, reflecting the limited economic response to the pandemic on a local level, as well as the global slowdown that affected its main underlying industries,” A.M. Best said in a report. “Additionally, claims were muted by restrictions in mobility of the population.” The agency added that it expects premiums to recover slowly this year “amid limited expansionary policies and slow vaccination efforts.” Mexico’s \$29.8 billion insurance sector contracted 2.6 percent in real terms last year, the agency said, adding that it shrank 2.1 percent in real terms in the first quarter of

this year. Overall, the property and casualty segments, excluding automobile insurance, contracted 2.2 percent in real terms in the first quarter of 2021. A.M. Best added that the underlying industries for insurance consumption, including auto and tourism, are beginning to gain momentum in Mexico this year. In 2020, the life insurance segments, including accident and health insurance, “remained afloat given a greater awareness of insurance protection due to the pandemic, with major medical expenses driving the growth of the market,” the ratings agency said. Mexico’s insurance sector faces downside risks this year, including a “challenging security environment.”

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USMCA 1ST ANNIVERSARY EVALUATION AND THE ROAD AHEAD

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12:00 p.m. ET/11:00 a.m. CT

SPEAKERS

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planned for July 20, which, as has been said, will have very different elements from the last reform that the president withdrew. The last time the country lost investment grade, it took 12 years to get it back. It is difficult to know how long it will take this time, but what is clear is that regaining confidence is a harder process. This will depend on whether in coming years (probably not during this government), the country designs a credible program to clean up its public finances and gradually reduce debt. Hopefully, this will also include resuming the fiscal rule, which should in the future incorporate a debt anchor and whose adoption helped Colombia regain investment grade in the past. Given the prevailing social needs, for which the adjustment should be gradual, it is essential that it is accompanied by a clear strategy to accelerate economic growth."

A **Andrés Martínez-Fernández,** senior analyst for Latin America at FrontierView: "A collapse in revenue and a surge in emergency spending during the pandemic has left Colombia with a greatly deteriorated fiscal situation and debt levels estimated to reach 69.2 percent of GDP in 2021. The latest downgrade by Fitch reflects a lack of confidence in the ability of Colombia's revamped fiscal plan and tax reform to restore fiscal balance. Additional downgrades of Colombian debt by ratings agencies have been built into market expectations since S&P's downgrade and the government's withdrawal of its original tax reform. For this reason, we expect a limited and transitory impact on Colombia's borrowing costs and foreign exchange rate relative to the impacts seen after S&P's downgrade. However, Colombia faces a long and difficult road ahead before it can regain its investment grade. Considering the details of the new watered-down tax reform, it is clear that additional fiscal reforms will be required in the near future. As the government significantly increases its social spending in response to growing

public demands, it will need to expand its relatively small tax base to include a greater portion of the population. Recent events show that there is little tolerance for such an expansion, so it will fall to Colombia's political and social leaders to promote a reasoned public debate about tax burdens and the role of the state. Next year's presidential election would be a natural forum for this debate. Unfortunately, the rise of economic anxiety, polarization, populism and misinformation in Colombia has not left fertile ground for such a conversation."

A **María del Pilar López-Uribe,** assistant professor of economics at the University of the Andes: "The decision to lower Colombia to junk status implies that interest rates to fund public and private spending might increase. However, the financial market is still very liquid, and the country will continue to have access to credit markets. The lowering reflects the deterioration of public finances and larger fiscal deficits in recent years. Public debt has recently increased substantially. However, the main concern is the government's capacity to make credible commitments that the path of the increasing debt will change. Debt was already increasing before the pandemic, and it has worsened since it started. In addition, the recent protests and riots have had some short-term effects on the economy and will affect the expected recovery in 2021. Political support for the government and its credibility have also worsened recently. In recent years, spending has grown faster than revenues, which means that spending has been financed with debt. This is not sustainable over time. For this reason, a structural tax reform that transforms and increases permanent government revenues urgently needs to be approved. This would be a clear signal to the market that some actions are being taken and that the uncertainty about the country's fiscal situation is being revised."

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