S&P Global
Ratings

Latin American Corporate Credit Outlook 2022

Modest Optimism Faces Increasingly Complex Crosscurrents

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This report does not constitute a rating action

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Key Takeaways

- **Growth trends remain healthy but have moderated**, while they mask differences among the region's countries. Governments are dealing with rising inflation and fiscal pressures. Brazil and Colombia will hold presidential elections that could generate volatility and alter dynamics of strategic decisions, as probably is the case with Chile under the new administration.
- **External risk factors are global inflation, China's growth, logistics and supply hurdles, new variants of COVID-19, and geopolitical tensions**, which are likely to curtail growth trends, undermine some sectors' fundamentals, and raise currency volatility. Risk aversion increases as uncertainty grows. Overall, Latin American companies are well positioned to face a potential deterioration of business conditions.
- **Companies benefit from stronger financials and adoption of precautionary measures.** Leverage and cash flow indicators are stronger than in the past two years, while cash to short-term debt ratios look healthy. In addition, companies are taking steps to deal with uncertainty. Rating outlooks are predominantly stable and the default rate is among the world's lowest.
- **Access to market remained fluid in 2021 but that's not guaranteed in 2022.** Companies issued debt more often in 2021 to take advantage of favorable market conditions, while refinancing needs for 2022 are low. Rising concerns and higher rates are likely to reduce cross-border credit supply. In such a context, we expect a reinvigoration of some domestic debt markets.

S&P Global Ratings believes that the recent rapid spread of the Omicron variant highlights the inherent uncertainties of the pandemic but also the importance and benefits of vaccines. While the risk of new, more severe variants displacing Omicron and evading existing immunity cannot be ruled out, our current base case assumes that existing vaccines can continue to provide significant protection against severe illness. Furthermore, many governments, businesses and households around the world are tailoring policies to limit the adverse economic impact of recurring COVID-19 waves. Consequently, we do not expect a repeat of the sharp global economic contraction of 2nd quarter 2020. Meanwhile, we continue to assess how well individual issuers adapt to new waves in their geography or industry.

As 2022 rolls in, Latin American corporations and investors are confronting the rising complexity of factors. On the one hand, one of the biggest tailwinds of Latin America's growth, the Chinese economy, is slowing down amid a slew of recent regulations to ease financial risks and lower greenhouse gas (GHG) emissions. While we don't expect a serious blow to the demand for main commodities that Latin American corporations produce, it's a concern for some large exporters. Also, the tensions between Russia and Ukraine, combined with the Federal Reserve's signaling of rising interest rates and a potential quantitative tightening, are fostering a considerable correction in asset valuations across the world and heightening risk aversion. These trends are occurring amid the looming changes to the region's political landscape, with big swings in political power in Chile, and potentially in other markets such as Brazil and Colombia, and tightening monetary policies to tame rising inflation in most of the economies.

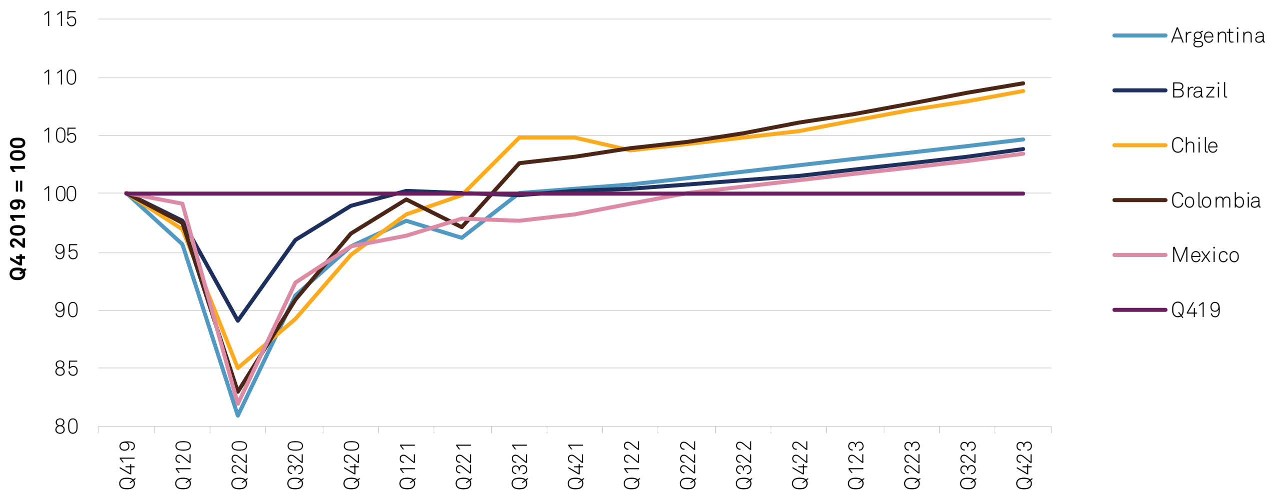
Still, growth estimates suggest a relatively benign environment while most of the Latin American companies have re-gained their credit strength with fairly robust balance sheets and comfortable financial flexibility.

Forecasts Of Growth Returning To 2%-3%, Except For Brazil

The recovery of the major Latin American economies in 2021 is slowing down in 2022, as we had expected. Among the main factors are the rising inflation, which is triggering tighter monetary responses from most of the region's central banks; supply-chain bottlenecks in key industrial sectors mainly in Brazil and Mexico; risks of a delayed recovery of certain sectors such as airlines, tourism, and hotels due to newer COVID-19 variants; and more cautious investment decisions due to uncertainty over policymaking due to shifts in political power. The latter recently became more evident perhaps in Chile and Peru, and it's also possible in Brazil and Colombia. Chart 1 shows our latest GDP forecasts for selected economies. For more detail on our projections, please read "Economic Outlook Latin America Q1 2022: High Inflation And Labor Market Weakness Will Keep Risks Elevated In 2022" published Nov. 29, 2021.

Chart 1

Projected Gdp Level Versus Pre-Pandemic Level*



*December 2019 = 100. Source: Oxford Economics, Haver Analytics, and S&P Global Ratings.

Argentina. After recovering most of the lost ground in 2021, Argentina's GDP will grow 2.1% in 2022 due to our expectation that inflation is likely to stay close to 50% year over year, fueled by wage adjustments and high cost of imported goods. The exchange rate will remain under pressure, given the combination of lower foreign-exchange reserves and a heavy foreign-currency debt burden. The government faces large fiscal imbalances and has limited access to international capital markets following the restructuring of $65 billion of debt last year. This means that the government will continue to finance its large fiscal deficit through local debt issuances, which will add pressure to the currency and inflation. Moreover, the amount of debt principal that comes due in the first quarter of 2022 is meaningful, particularly the International Monetary Fund (IMF) loan. The country and the IMF haven't reached to a new agreement yet. We cap most of the domestic companies we rate at 'CCC+', the level of our Argentina transfer and convertibility assessment, which signals a high chance of these entities unable to make foreign currency payments if the country restricts their access to foreign currencies to protect its reserves.

Brazil. Our GDP projections for Brazil for 2022 are the lowest among the region's main economies mainly due to the abrupt monetary tightening amid persistently high inflation and a more challenging fiscal scenario. We expect GDP to grow modestly 0.8% in 2022 while inflation would stay close to a 10% year-over-year level. We expect the policy rate to be above 11% by the end of 2022. Plans to maintain government stimulus measures have increased the fiscal risk premia, which partly explains the rise in rates to compensate for the extra risk. Uncertainty over the October general election--in which former President Luiz Inácio Lula da Silva is likely to run against the current president Bolsonaro--will bring political turmoil and exacerbate volatility. We view the risks to our 2022 growth outlook skewed to the downside. Several Brazilian entities have anticipated most of their financing needs for 2022 and are keeping a conservative stance, and the outlook on corporate ratings is predominantly stable with a slight positive bias. But some key sectors of the economy, such as homebuilding and retail, are showing strains and their influence on other sectors is material.

Chile. We expect GDP to grow 2.0% in 2022. The third round of pension withdrawals, combined with an ongoing reopening of the services sectors following lockdowns in the second quarter, boosted consumption of services by 12% between the second and third quarters of 2021. However, this suggests consumption will slow down in 2022 as more pension-withdrawal-related spending seems less likely. Uncertainty over the rewriting of Chile's constitution and the potential shift in policymaking under President Boric's administration are likely to temper investment plans. We believe there's a potential for increase in tax rates on the private sector, particularly on the mining industry, although that wouldn't hurt ratings on industry players because copper fundamentals remain sound.

Colombia. We forecast GDP to grow 3.5% in 2022. The removal of stimulus measures will likely curb consumption growth in 2022, acting as a drag on GDP growth. Uncertainty surrounding the March 2022 legislative election and May 2022 presidential election is likely to keep investment subdued.

Mexico. The supply-side bottlenecks, especially those in the semiconductor segment, have taken a large toll on Mexico's auto production and telecom sectors, and we expect disruption to continue into 2022. As a result, we expect GDP to grow 2.8% in 2022. The investment outlook outside of the manufacturing sector remains downbeat, partly due to government policies that have undermined investment incentives in key sectors, especially energy. However, the country will continue to benefit from a strong U.S. recovery, which is also filtering through record-high remittances. This, in our view, will keep GDP growth above trend in 2022. Our forecast implies average quarter-over-quarter growth of 0.75% through the year, above our trend growth estimate of 0.55%.

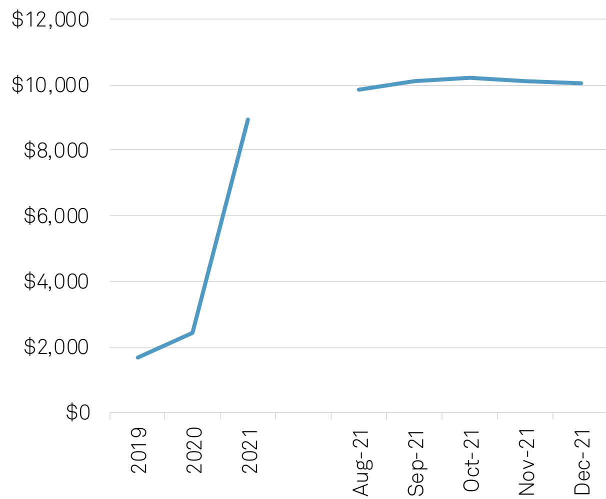
Logistics Hurdles And Global Inflation Are Likely To Continue

According to December 2021 industry reports, port congestion in the container sector remained severe with the Containership Port Congestion Index showing an average of 36.2% of the global containership fleet at ports, well above the 2019 average of 31%. The global recovery in 2021, along with supply disruptions, are causing transport tariffs to soar (see Chart 2). As of December 2021, the cost of transporting goods from China to any port in South America was five times pre-pandemic levels.

Commodity food prices remained elevated in 2021 thanks to strong demand and abundant money supply, with a significant demand from China for grain inputs--to recover its hog herd after the African Swine Flu--and for proteins (see Chart 3). Although exports were important to sustain margins, the weakening economy lowered consumers' disposable income, which together with labor, and oil and raw material inflation, lowered the regional integrated food producers' margins (see Chart 4 in which we compare margins to 2019 to exclude COVID-19 effects).

Chart 2

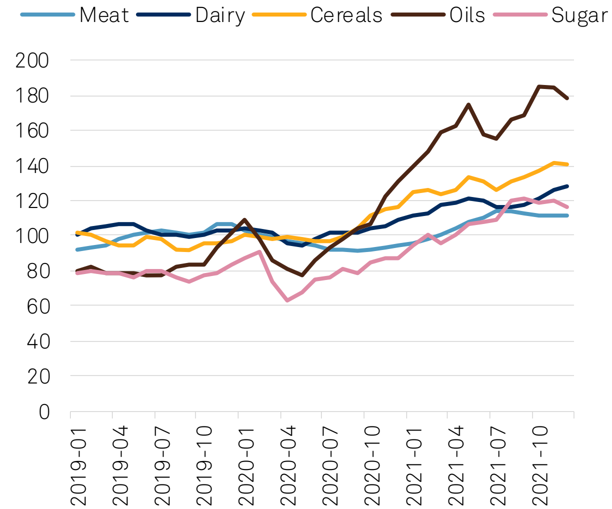
Average Freight Rates To Transport 1 TEU From Shanghai To South America



As of December 2021. Source: Clarksons Research.

Chart 3

Food Inflation*



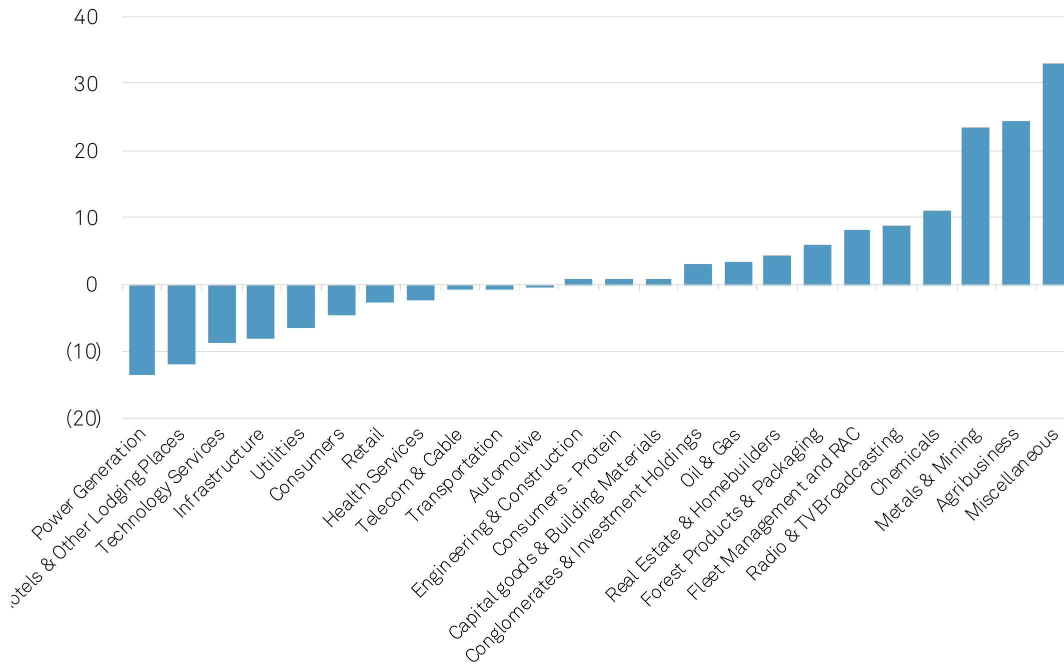
*2014-2016=100. Source: FAO Food Price Index.

As Chart 4 also shows, the post-pandemic recovery came at the expense of margin compression for some sectors. While raw material inflation, including energy prices, explains the bulk of these margin drops, the deep declines in activity for hotels and some subsectors of transportation like airlines stem from weak revenues and suboptimal capacity utilization. However, large commodity export-oriented businesses such as protein producers, the forest and paper products, chemicals, and metals and mining companies enjoyed stronger prices than in 2019.

While the world is taking counteractive measures to deal with rising inflation, we believe it will take time for them to settle and anchor expectations. Raw material inflation is fueled by many factors such as money supply, logistics hurdles, and even climate and sanitary conditions that impact cattle herds, and dairy and agricultural production. And some of those impediments aren't likely to vanish soon.

Chart 4

Gross Margin Contractions/Expansion Medians By Sector*



*For 12 months ended September 2021 versus 2019 (basic points). Source: S&P Global Ratings based on financial data in CapIQ Pro.

China’s Reforms Are Likely To Diminish Growth And Alter Some Sectors' Dynamics

Our latest growth forecast for China is 4.9% for 2022 and 2023. The country has been implementing aggressively measures to address domestic risks since mid-2020 and during a global pandemic, underscoring their importance to Beijing.

On the one hand, the Chinese government is trying to tackle the high corporate debt, which is 160% of GDP, compared with global average of 100%. This is a longstanding risk for which the government seeks to channel credit from troubled sectors like real estate/homebuilding to more favored ones such as high tech and renewable energy. Also, the property developers' woes are spilling over to local and regional governments (LRGs) that used to generate up to 25% of their fiscal revenues from the sale of land. Now that the real estate sector is unable to buy land at the past rates, the flow of money to LRGs will shrink and so is their capacity to support/lend to state-owned entities. On the other hand, Beijing is implementing a set of policies under the banner of “common prosperity” to cope with social tensions that have been rising due to diminished social mobility, widening wealth gaps, unaffordable home prices, and the perception that a small group of entities dominate social media. As a result, regulators have blocked IPO listings, fined big internet companies for anticompetitive activities, and implemented stricter rules for overtime work. Authorities also may introduce tax changes that would favor lower revenue-generating sectors and increase tax burden on wealthier sectors. For more on this topic, please read “China Balances Policy Risk With A Need For Reform,” published Oct. 12, 2021.

These and future policies will keep shaping China’s economy as it shifts from real estate/industrial export-driven growth model to a more consumer, domestic based one. Also,

China's target to be carbon neutral by 2060 and its recent decision to cut steel capacity of the more polluting mills will likely pull back base metals demand in the near future. We believe iron ore demand is likely to soften in the next few years as infrastructure spending diminishes, but better iron ore qualities would continue to be favored by Chinese steel mills that are under pressure to contain their GHG emissions. That provides Brazilian miners a competitive advantage over their peers. However, copper enjoys solid fundamentals thanks to nascent electric vehicle industry and the global expansion of renewable sources of energy that are likely more than compensate for the decline in demand for urban infrastructure, while no significant new capacity is in the pipeline. The expansion of the electric vehicle production and renewables also bolster demand for other metals and chemicals such as lithium, cobalt, and zinc.

We also expect some volatility in pulp demand. While hardwood pulp for toiletry and tissue products is likely to remain healthy, general prices could erode in the second half of 2022 due to new pulp capacity additions and as logistics problems, which hit the sector in the past quarters, are likely to fade.

We forecast protein prices to remain attractive, although somewhat softer than in 2021 as China's pork production recovers. Demand patterns look healthy in Asia and the U.S. We expect limited new capacity in the industry because of the workforce shortages and low visibility on new plants in the U.S. and due to high raw material costs in Brazil, particularly for cattle, corn, and soybeans.

Ratings Have Largely Recovered To Pre-Pandemic Levels And Outlooks Stabilized

Although in the aggregate, corporate ratings have rebounded to pre-pandemic levels, credit quality of several sectors remains below 2019 levels. Among these are hotels, gaming and travel (grouped into Miscellaneous in Table 1), transportation (only airlines), and retail. Median ratings among the forest products, metals and mining, and fleet management companies are lower mostly because of sample differences, rather than to intrinsic credit drivers. Given the majority of positive outlooks in the fleet management and rent-a-car sector, it's likely to see positive rating actions soon.

Table 1

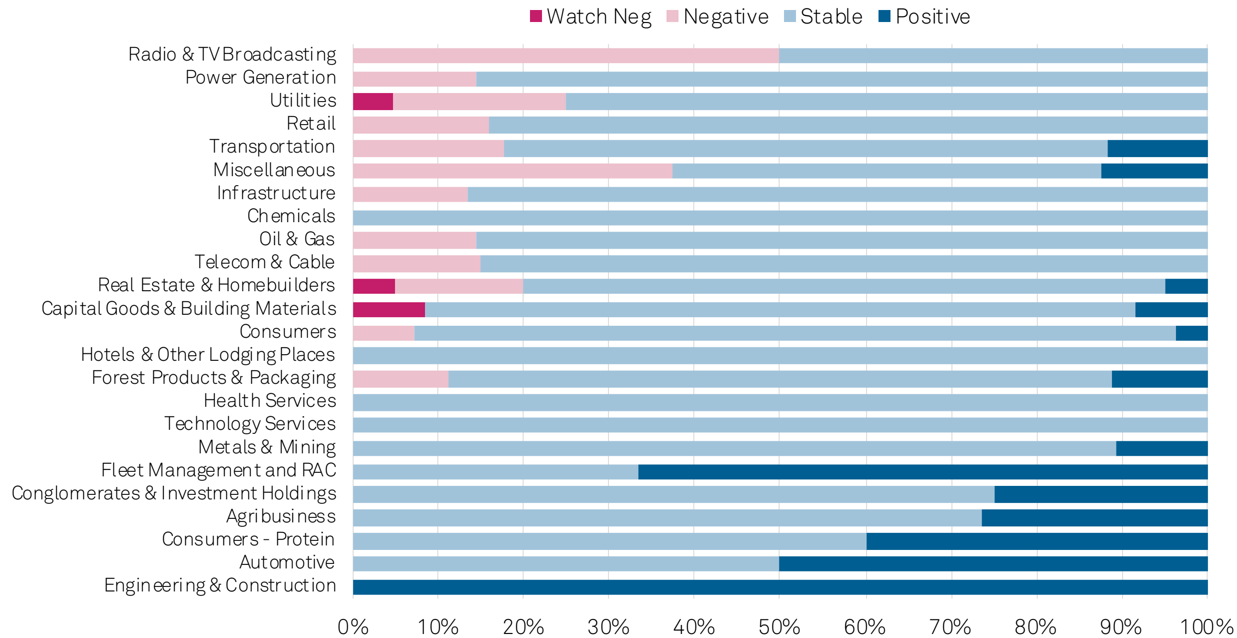
Comparison Of Median Ratings For Selected Corporate Sectors

Sector	Feb-20	Jan-22	Change
Hotels & Other Lodging places	BB-	B-	▼ -3
Fleet Management and RAC	BB+	BB-	▼ -2
Miscellaneous	B+	B-	▼ -2
Transportation	BB-	B+	▼ -1
Retail	BB	B-	▼ -1
Forest Products & Packaging	BB	B-	▼ -1
Metals & Mining	BBB-	B+	▼ -1
Oil & Gas	BB	BB	▶ 0
Utilities	BB	BB	▶ 0
Consumers	BB+	BB+	▶ 0
Telecom & Cable	BB-	BB-	▶ 0
Capital Goods & Building Materials	BB	BB	▶ 0
Power Generation	BB-	BB-	▶ 0
Real Estate & Homebuilders	BB-	BB-	▶ 0
Radio & TV Broadcasting	BBB	BBB	▶ 0
Conglomerates & Investment Holdings	BB+	BB+	▶ 0
Health Services	-	BB-	▶ 0
Technology Services	-	BB+	▶ 0
Engineering & Construction	CCC	CCC	▶ 0
Consumers - Protein	BB-	BB	▲ 1
Infrastructure	B+	BB-	▲ 1
Agribusiness	B	B+	▲ 1
Automotive	BB-	BB	▲ 1
Chemicals	BB-	BB	▲ 1

*Current versus pre-pandemic levels. Source: S&P Global Ratings calculations.

Chart 5

Outlook Distribution By Sectors



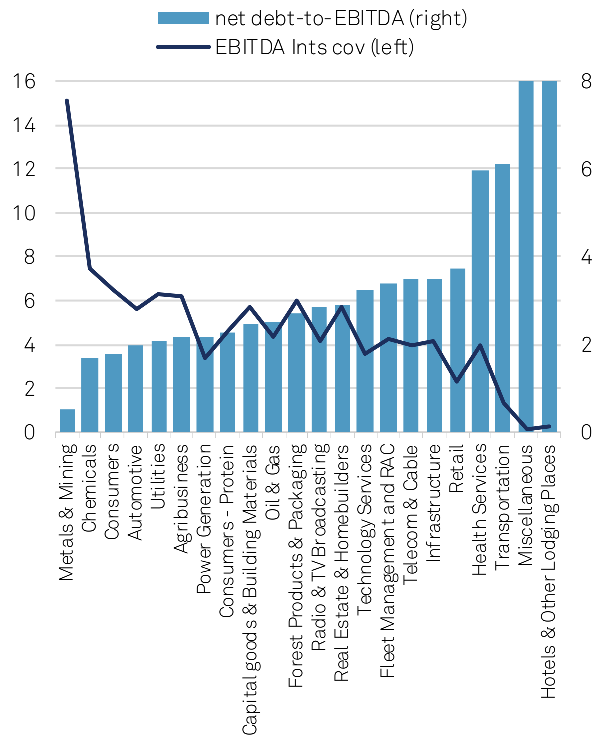
Source: S&P Global Ratings calculations.

In contrast, protein producers, and the agribusiness and chemicals companies have on average improved their credit profiles above pre-pandemic levels due to better prices. This occurred despite median ratings in the agribusiness sector falling due to assignment of 'B' category ratings on several new issuers in 2021. Automotive is another sector that has the potential for upgrades due to the large share of positive outlooks among Brazilian and Mexican auto suppliers. If it weren't for supply-chain problems, their performance would have been even stronger in 2021. Brazilian steel producers have also made tremendous progress, because they enjoy vertical integration in iron ore, prices of which have reached all-time highs in 2021 and remain very attractive. Demand for steel in Brazil, particularly for long steel, was robust in 2021 driven mainly by homebuilding construction. However, demand for new homes and project launches in Brazil have stalled recently, which may weigh on steelmakers' performances in 2022.

Chart 6 shows that leverage is fairly contained across most of the sectors, with net debt-to-EBITDA ratios at or below 3.5x, while EBITDA interest coverages are largely clustered at or above 4x.

Chart 6

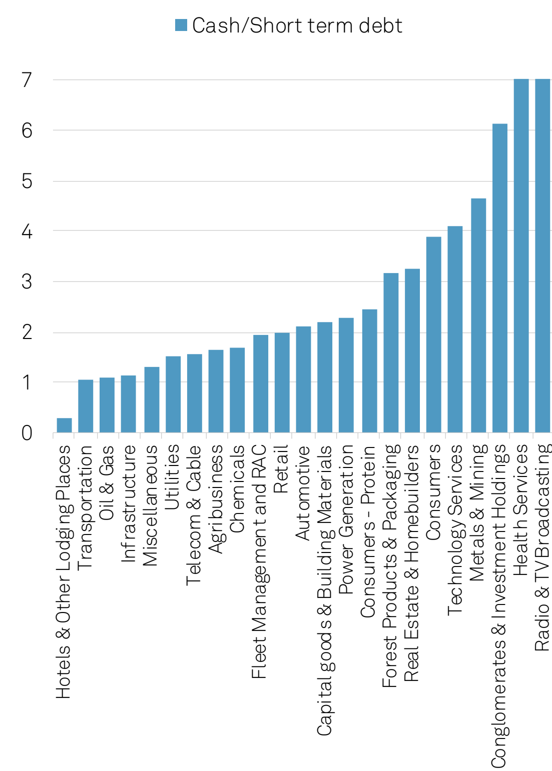
Median Net Debt-To-EBITDA And EBITDA Interest Coverages*



*For main sectors, for the 12 months ended September 2021. Source; S&P Global Market Intelligence and S&P Global Ratings calculations.

Chart 7

Median Cash To Short-Term Debt Ratios*



*As of September 2021. Source: S&P Global Market Intelligence and S&P Global Ratings calculations.

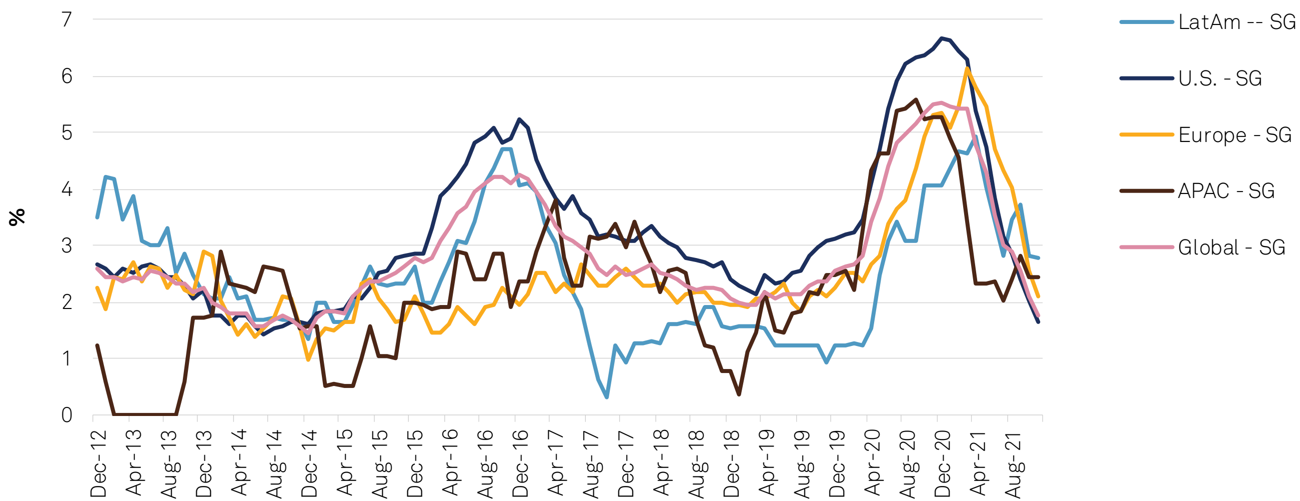
Financial flexibility on aggregate is also solid, although some sectors such as infrastructure, oil and gas, and transportation would need to roll over their short-term debts (see Chart 7). Hotels would struggle to meet their short-term obligations, absent a stronger recovery.

Default Rate Dropped To 2.8% In November 2021 From 4.9% In April 2021

The default rate has fallen considerably, arguably, to normal levels. But even more impressive was that at the peak of the pandemic-induced credit crunch, Latin America's default rate remained below that of the rest of the globe, except for Asia-Pacific (see Chart 8).

Chart 8

Trailing 12-Month Speculative-Grade Default Rates By Region

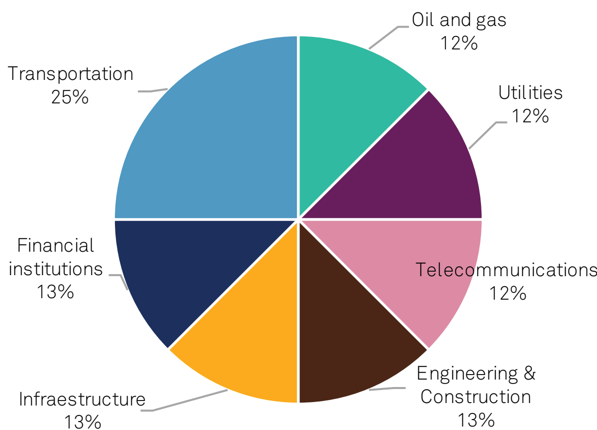


SG--speculative grade. Source: S&P Global Ratings.

Transportation accounted for 25% of 2021 defaults (see Chart 9). Argentine oil and gas, utilities, and engineering and construction companies with 2021 maturities were forced by the country's lack of funding options to launch debt exchanges, which we viewed as tantamount of default, even if creditors might have actually found them attractive. Therefore, Argentine entities comprised 37% of the sample, while the biggest share consisted of Mexican companies (50%) followed by Brazilian ones (13%; see Chart 10).

Chart 9

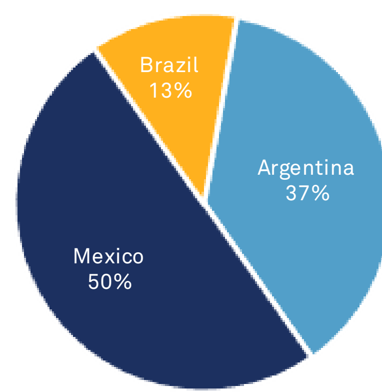
Defaults In Latin America By Sector In 2021



Source: S&P Global Ratings.

Chart 10

Defaults In Latin America By Companies In Individual Countries In 2021



Source: S&P Global Ratings.

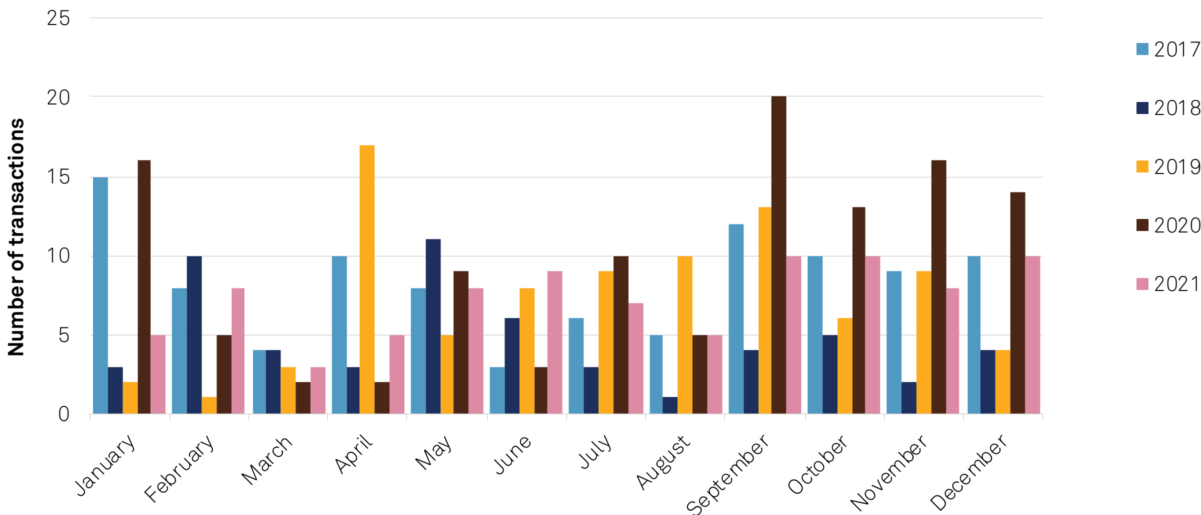
Access to external and domestic debt markets has played a vital role in keeping default rates low in each country. Banks' willingness to lend has shrunk or at least the pace of lending growth didn't match tapping the credit markets, which was evident in Brazil.

Access To Market Remains Fluid For Issuers With Better Credit Qualities

Access to international debt markets among Latin American corporations 2021 could be viewed as one of a kind. In the first place, the access was fluid and fairly evenly distributed across the entire year (see Chart 11). That usually isn't the case because the so called “market windows” usually show more activity in the second half of the year with emphasis in the last four months. Moreover, interest rates remained low as central banks insulated money to accelerate recovery from the pandemic effects. That fostered market activity as companies took advantage of cheap credit in anticipation of future rate hikes. Finally, the Brazilian domestic capital market rebounded in 2021, but other domestic markets shrank, which is a worrying sign for the future.

Chart 11

Amount Of International Bond Issuances Among Latin American Corporations



Source: S&P Global Ratings calculations based on Thompson Reuters.
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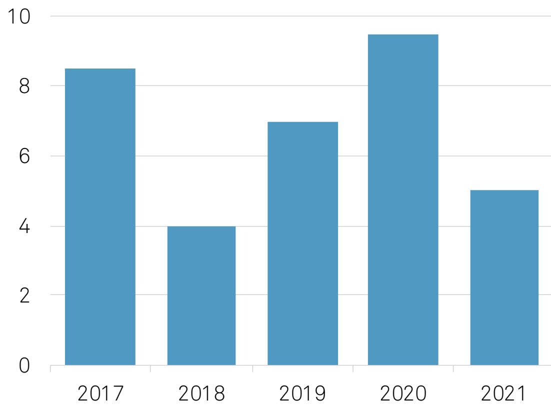
Charts 12 and 13 show that volumes issued were consistent with pre-pandemic standards--roughly $60 billion and that issuance amounts were a bit above 2019 levels, as there were less issuances in total with almost the same total amount issued as in 2019. That reflects a market concentration among most appealing issuers which according to Chart 13 continue to be Brazilian and Mexican corporations. The pick-up in Argentine issuances doesn’t respond to that trend, and is basically a consequence of the central bank's restrictions on cross-border payments in early 2021, which forced some domestic companies to make debt exchanges.

Chart 12

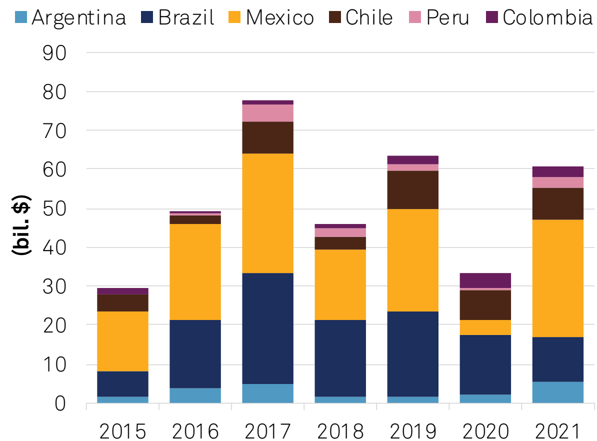
Median Amount Of Debt Issuances In International Markets



Source: S&P Global Ratings calculations based on Thompson Reuters.

Chart 13

International Corporate Bond Issuances, Selected Latin American Countries

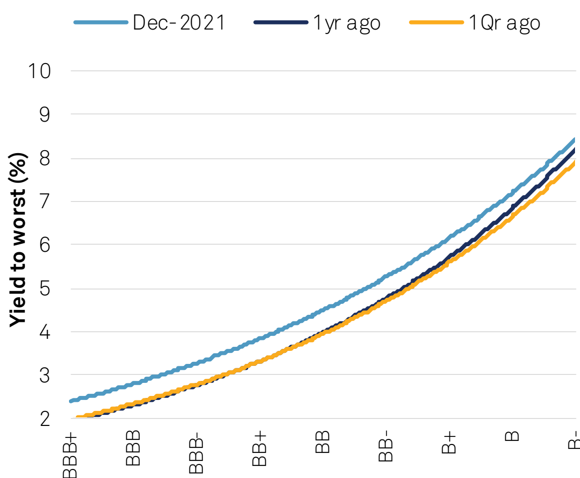


Source: S&P Global Ratings calculations based on Thompson Reuters.

Mexican and Chilean issuers preferred to issue debt in international markets in 2021 at the expense of domestic markets. That might have been due to the favorable conditions we mentioned, but if the trend continues, it could be worrisome amid lower macroeconomic growth and currencies depreciating against the dollar, especially if issuers need to refinance dollar-denominated debts.

Chart 14

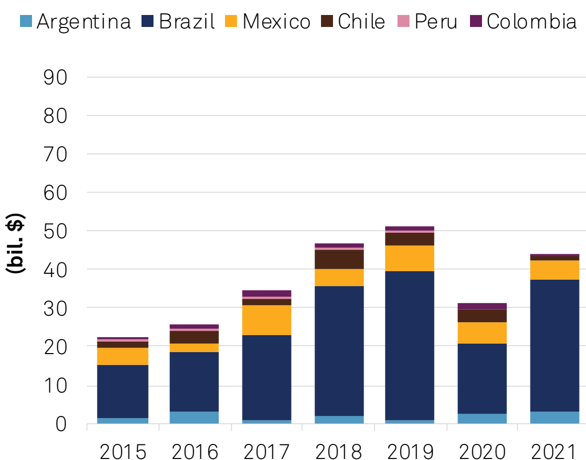
Yield Curves For Rated Latin American Corporations



Source: S&P Global Ratings calculations based on CapIQ Pro.

Chart 15

Domestic Corporate And Bond Issuances, Selected Latin American Countries

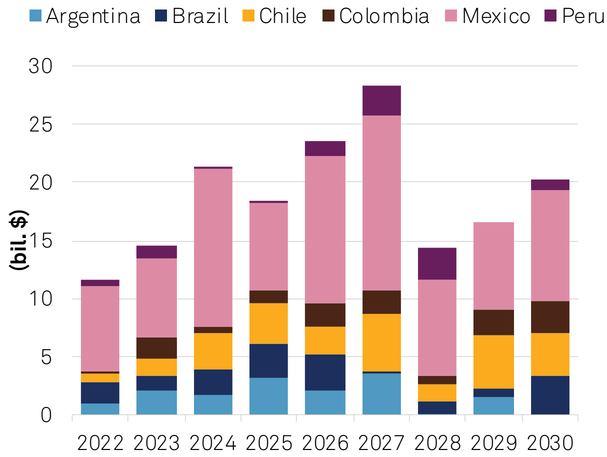


Source: S&P Global Ratings calculations based on CapIQ Pro.

Finally, Chart 16 shows that maturities of international bonds are manageable in 2022, but Colombian and Argentine issuers would need to seek other sources of refinancing in 2023 if international markets aren't more receptive than in the past. This is because their average issuance levels in the past two years would barely cover debt maturities in 2023 (see Chart 17).

Chart 16

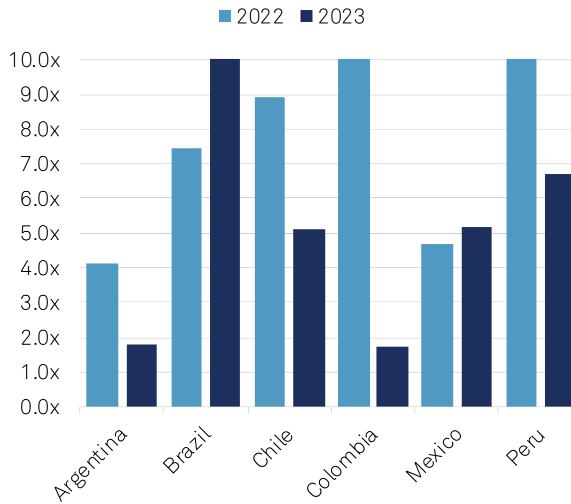
Maturities Of International Bonds, Selected Latin American Countries



Source: S&P Global Ratings calculations based on Thompson Reuters.

Chart 17

Average Corporate Debt Issuance In The Past Two Years/Bond Maturities Ratio (International Issuances Only)



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