

**Sovereigns
Latin America
Special Report**

Latin American Sovereign Outlook 2009

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Challenging Times Ahead

- Latin American economies have recoupled with the crisis in the developed economies. Since September 2008, Latin American countries have been buffeted by stronger external headwinds, as evident from the fall in regional currencies and stock markets and from widening bond spreads.
- Three simultaneous shocks of global recession, lower commodity prices and a reduction in private capital inflows will adversely affect macroeconomic performance in 2009. Fitch expects that Latin America's real GDP will contract by 0.9% in 2009 from an estimated 3.8% growth in 2008, with Brazil's economy stagnating at best and Mexico contracting by over 2%.
- Despite the magnitude of these shocks, Latin America's starting point is perhaps the best it has been in recent decades. Five years of current account surpluses, combined with rapid capital inflows, have led to a substantial increase in the region's external buffers. Many countries in the region have strengthened their policy frameworks by adopting inflation-targeting regimes and implementing flexible exchange rates, improving their ability to confront external shocks.
- Fitch believes that countries' vulnerability will vary, as will their capacity to absorb the above-mentioned shocks. The extent of financial and economic dislocation in Latin American countries will depend on their level of trade openness, commodity dependence and financial integration with the rest of the world while the degree of policy discipline and flexibility will play an important role in sovereigns' ability to weather the storm.
- Policy makers in Latin America will be challenged to cushion the blow of external shocks on their economies. Most central banks have embarked on easing cycles, although policies may require fine-tuning if the pass-through from weaker exchange rates complicates inflation dynamics. Moreover, credible counter-cyclical fiscal policies can be employed in only a few countries. Authorities in these countries must execute fiscal stimulus packages efficiently to maximize the multiplier effect on their economies.
- Fitch believes that the credit cycle has turned in Latin America. After taking three positive rating actions during the first months of 2008, the agency has taken a number of negative rating actions since September 2008. Fitch has three sovereigns with a Negative Outlook – Mexico, El Salvador and Jamaica – suggesting that credit pressures are on the rise in the region. Weaker economic growth, rising fiscal and balance of payments (BoP) pressures and limited access to international capital markets will continue to challenge the region's credit outlook. The degree to which Latin American countries and their policy frameworks remain resilient in these uncertain times will determine the ratings trajectory in the region.
- The main risks for Latin America's credit outlook continue to be: a sharp and a prolonged global recession; continued decline in commodity prices; sustained closure of the private sector to international markets and/or a re-emergence of the intense global financial instability observed in the final months of 2008; and a rise in political and social instability in the region due to worsening growth and rising unemployment, with this risk even higher in countries with weaker institutions, greater corruption, and centralized power.

Latin American Sovereign Review Ratings (LFTC)

Country	Rating	Outlook
Bermuda	AA+	Stable
Chile	A	Stable
Mexico	BBB+	Negative
Aruba	BBB	Stable
Brazil	BBB-	Stable
Peru	BBB-	Stable
Guatemala	BB+	Stable
El Salvador	BB+	Negative
Colombia	BB+	Stable
Panama	BB+	Positive
Costa Rica	BB	Stable
Uruguay	BB-	Stable
Venezuela	B+	Stable
Jamaica	B	Negative
Suriname	B	Stable
Dominican Republic	B	Stable
Bolivia	B-	Stable
Ecuador	RD	
Argentina	RD	

N.A. - not applicable. Source: Fitch

Macro Indicators

	2002	2003	2004	2005	2006	2007	2008e	2009f	2010f
Real GDP Growth (%)	0.4	1.7	6.0	4.3	5.3	5.2	3.8	-0.9	1.8
Inflation (%)	8.4	10.1	6.6	6.0	5.0	5.1	7.3	7.2	6.1
Gov Balance (% of GDP)	-3.4	-3.0	-1.7	-0.9	-1.3	-0.7	-1.2	-2.6	-2.8
Gov Debt (% of GDP)	60.0	56.7	52.9	49.4	46.8	46.0	45.2	46.9	47.7
Nominal GDP (USDbn)	1,694	1,820	2,104	2,561	3,016	3,527	4,086	3,559	3,732
GDP per head (USD)	3,452	3,661	4,180	5,024	5,839	6,750	7,721	6,638	6,869

Source: Fitch estimates and forecasts

Current Account Balance

(USDbn)	2002	2003	2004	2005	2006	2007	2008e	2009f	2010f
Current External Receipts	440	482	589	709	847	960	1,102	952	981
-o/w Merchandise Exports	345	377	466	562	668	751	879	738	755
Current External Payments	454	473	568	673	798	940	1,127	1,046	1,074
-o/w Merchandise Imports	321	331	404	478	568	676	822	771	790
Current Acc Balance	-14	9	21	36	49	20	-25	-94	-93
% of GDP	-0.8	0.5	1.0	1.4	1.6	0.6	-0.6	-2.6	-2.5
Interest Services	50.3	49.0	49.0	49.4	50.0	51.5	60.6	61.4	64.4
% of CXR	11.4	10.2	8.3	7.0	5.9	5.4	5.5	6.4	6.6

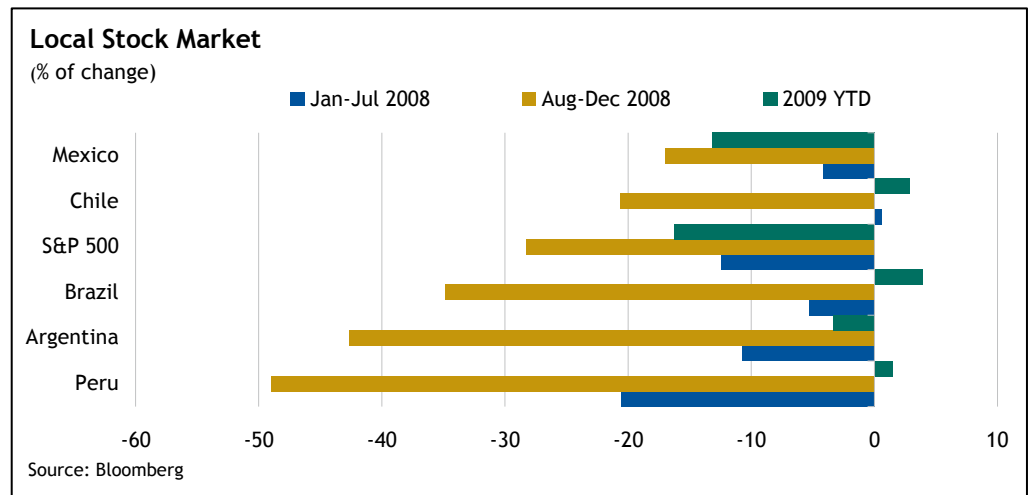
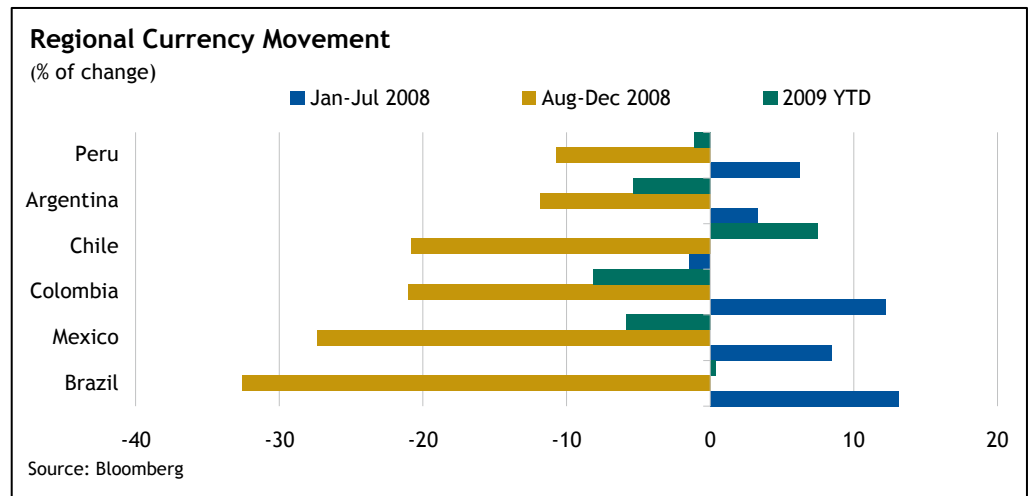
Source: Fitch estimates and forecasts

External Debt (USDbn)	2002	2003	2004	2005	2006	2007	2008e	2009f	2010f
Gross External Debt	803	843	851	770	796	920	979	966	983
% of CXR	182.4	175.1	144.3	108.6	93.9	95.8	88.9	101.4	100.2
Gross Public External Debt	373	407	430	358	345	367	365	380	392
% of CXR	84.7	84.4	72.9	50.5	40.7	38.2	33.2	39.9	40.0
Short-term debt	102	107	104	106	120	160	166	170	175
Net External Debt	354	331	282	139	54	-54	-52	-9	20
% of CXR	80.3	68.6	47.8	19.6	6.4	-5.6	-4.7	-0.9	2.1
Net Public External Debt	202	205	206	103	31	-96	-157	-62	-20
% of CXR	45.8	42.5	34.9	14.6	3.7	-10.0	-14.2	-6.5	-2.1
Reserves Incl Gold	159	193	218	247	306	441	493	415	386
Debt Service	150	171	177	181	178	154	165	164	156
% of CXR	34.2	35.4	30.0	25.6	21.0	16.1	15.0	17.2	15.9
Liquidity Ratio (%)	84.2	77.9	89.8	99.2	110.8	135.1	150.6	164.3	143.9

Source: Fitch estimates and forecasts

Latin America Recouples with the Crisis in Developed World

After displaying resilience in the first half of 2008, the Latin American countries have been buffeted by stronger external headwinds following the Lehman Brothers collapse in September. This was evident from the sharp fall in regional currencies and stock markets and from widening bond spreads. The increased volatility of regional currencies led several central banks in the region to intervene in the FX market. To some extent, the exchange rate weakening is part of the adjustment process to the new economic realities facing Latin American countries: lower commodity prices, global recession and reduced capital inflows. In some cases (primarily Mexico and Brazil) currency volatility increased further due to “homegrown” problems stemming from the losses related to corporate derivatives.



Three Simultaneous Shocks

More generally, the rigor of financial recoupling reflects the changing perception that Latin American countries will feel the heat from the three simultaneous shocks of a sharp downward adjustment in commodity prices, reduced flow of international credit and global recession. Below, Fitch discusses the vulnerability of Latin American countries to these shocks.

Vulnerability to Lower Commodity Prices

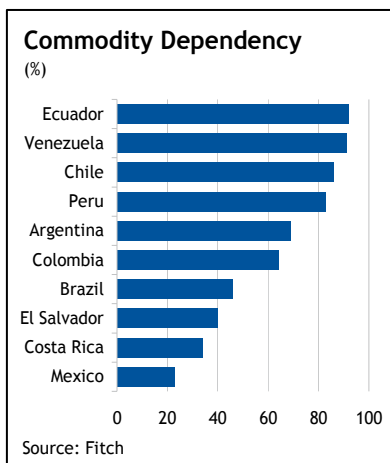
Higher commodity prices in 1H08 cushioned the impact on Latin America’s commodity exporters from the slowing economic activity in the developed world.

However, a strong decline in commodity prices in recent months and the expectation that most commodity prices will remain substantially below 2008 peaks this year imply that the outlook for GDP growth and the fiscal and external accounts has worsened considerably for the region.

Impact of USD10 Drop in Oil Prices

	Net oil exports (% of GDP)	Impact of USD10/b decline in oil prices		2009 Budget oil price (USD/b)
		Exports (USDm)	Fiscal impact (% of GDP)	
Latin America				
Colombia	4.5	900	0.7	50
Ecuador	15.8	1,200	1.1	40
México	1.9	4,500	0.2	70
Venezuela	24.0	8,800	1.3	60

Source: Fitch



As the chart illustrates, with the exception of Mexico and countries in Central America and the Caribbean, most countries in the region are heavy exporters of commodities. Ecuador and Venezuela will be most exposed to the commodity price shock, as they primarily export oil.

Chile will also be greatly exposed due to the importance of copper exports. However, Chile has sufficient fiscal and external cushion to withstand the dramatic correction in copper prices.

Although minerals account for around 60% of merchandise exports, Peru has a well-diversified mineral base of which close to 30% is accounted for by gold, a mineral with a low price correlation to copper and zinc, which comprise half of the country's mineral exports. Furthermore, Peru's fiscal accounts are better cushioned from the fall in commodity prices, as only 16% of revenues are derived from commodity-related activities.

Colombia will also be exposed to the fall in commodity prices – primarily oil, coal and nickel – although the extent of the related fiscal deterioration will be mitigated by the expected fall in fuel subsidies in 2009.

Argentina and Uruguay will be affected by the fall in agricultural prices. Besides falling commodity prices, commodity exports from these countries will be hit by poor weather this year. Argentina will be more vulnerable, as it has largely spent its commodity windfall in recent years and discouraged investment through continued government intervention.

Brazil will feel the pinch of falling commodity prices as well, although its commodities are better diversified and its mining companies are some of the most cost-efficient ones.

While the fall in commodity prices will not have a significant impact on Mexico's external accounts, they will adversely affect the country's public finances.

Vulnerability to Tighter International Credit

As the graph below shows, capital inflows to Latin America have increased in recent years, although they rose less spectacularly than in other regions of the world (especially emerging markets in Europe). Higher risk aversion and greater competition for resources in an environment of dwindling international credit will reduce capital inflows to the region. While the global de-leveraging process is likely to hit all the countries to a certain degree, Mexico and Brazil may feel the biggest pinch because of the higher foreign participation and greater liquidity in their equity and fixed-income markets. The re-emergence of current account deficits amid declining capital inflows will lead to a hard landing for some countries in the

Total Financing Need for 2009

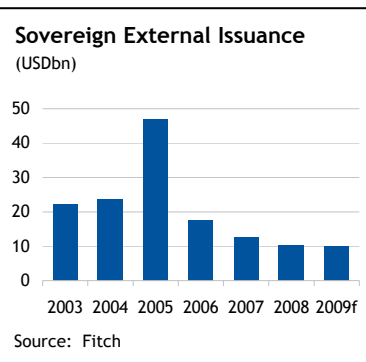
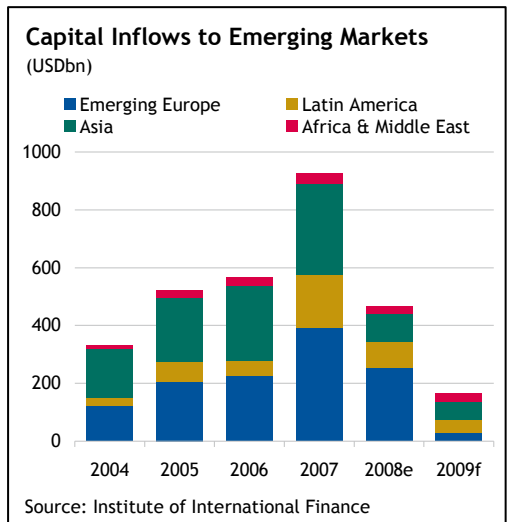
		% of 2008 Reserves
1	Jamaica	98.9
2	Chile	57.5
3	Costa Rica	56.6
4	Guatemala	54.2
5	El Salvador	52.6
6	Mexico	51.3
7	Colombia	43.8
8	Uruguay	24.7
9	Brazil	23.5
10	Argentina	19.5
11	Peru	19.3
12	Venezuela	18.0

Note: Total financing need equals CAB plus maturing bond and commercial loan only, the latter based on data from Dealogic.

Source: Dealogic; Fitch projections

region. Depending on the exchange rate regime of a country, lower capital inflows will require a weaker currency, loss of international reserves or a sharper economic adjustment, particularly in dollarized economies.

The table in the column ranks countries on gross external financing needs (% reserves) and shows that the most vulnerable are countries in the Caribbean and Central America. Chile also appears quite exposed on this indicator, although this vulnerability is mitigated by the fact that Chile has sizable resources in its Fiscal Stabilization Fund. Moreover, the country has not accumulated international reserves at the same pace as some other Latin American countries due to its commitment to a free-floating exchange rate regime. Among the bigger countries Mexico appears more exposed due to its relatively modest external cushion while Brazil's strong international reserves position renders it less vulnerable.



The tightening of international liquidity will also manifest itself through lower issuance in the international capital markets and restricted trade financing. On the positive side, as the graph in the column shows, external sovereign issuance has been declining in recent years due to reduced funding needs and local market development. In fact, some sovereigns and quasi-sovereign entities have accessed international capital markets since December 2008. However, access to these markets continues to be challenging for Latin America's private sector. Mexico and Brazil – the region's two most financially integrated economies – will face the brunt of the near closure of international capital markets to their private-sector borrowers. As the table below demonstrates, both countries face sizable external bond and loan amortization this year (predominantly in the private sector).

Bonds and Loan Amortization

Country	2009 Maturing Bonds (USD mil)	2009 Maturing Loans (USD mil)	Total (USD mil)
1 Mexico	9,337.5	13,902.2	23,239.7
2 Brazil	5,700.4	14,436.9	20,137.4
3 Chile	2,034.7	4,537.4	6,572.1
4 Argentina	4,344.5	1,195.5	5,540.0
5 Venezuela	1,237.2	2,167.0	3,404.2
6 Colombia	1,102.4	1,294.5	2,396.9
7 Peru	50.0	832.5	882.5
8 Uruguay	565.4	0.0	565.4
9 Costa Rica	300.0	33.0	333.0
10 Jamaica	251.4	48.3	299.6
11 El Salvador	75.0	48.5	123.5
12 Guatemala	50.0	9.3	59.3

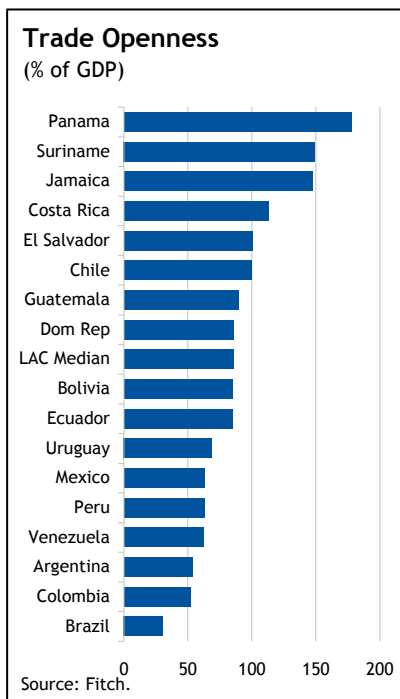
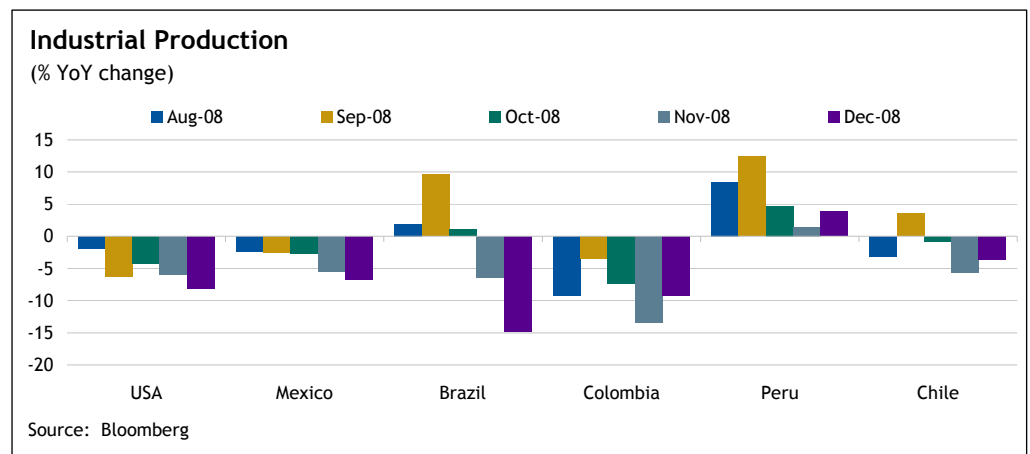
Dealogic data that is based on the nationality (rather than residence) of the issuer and does not capture repayments prior to final maturity and hence may over-state the volume of maturing debt.
Source: Dealogic, Fitch

In the absence of greater access to funding abroad, private-sector issuers are likely to fund themselves through local banks and/or local capital markets. However, in light of the region's relatively low savings rate and higher fiscal deficits (which will be largely funded domestically as well), the private sector could get crowded out by the public sector. This could result in higher corporate defaults or higher domestic yields on private-sector issuances, both of which would be detrimental for

investment and growth for the region. A prolonged loss of private sector access to external funding could aggravate external pressures and result in further depletion of international reserves.¹ To mitigate this risk, sovereigns are increasing borrowing from multilaterals to reduce their reliance on local capital markets and/or increase the supply of credit by on-lending these funds to the private sector through commercial and development banks.

Vulnerability to Global Recession

Latin American countries will be affected by global recession as reduced external demand weakens exports from the region notwithstanding the sustained depreciation of regional currencies. The effect of global recession will be felt through trade, financial, overseas worker's remittances and FDI channels. While Latin America's trade openness is not as high as seen among Asian countries, the region's vulnerability to global recession has, at the margin, increased due to the growing trade openness in recent years. In fact, the sharp downturn in the global economy has already been manifested in either fast deceleration or in some cases outright contraction in non-commodity exports. The simultaneous fall in industrial production in all major Latin American countries (with the exception of Peru) in the final quarter of 2008 was synchronized with the collapse seen in developed markets and reflects the region's links with the rest of the world.



As the chart to the right shows, smaller, open economies of Central America and the Caribbean appear most vulnerable to the global recession. On the other hand, Brazil appears the most insulated due to the closed nature of its economy. Even though Mexico is not a very open economy, it will be disproportionately affected by the US contraction, as over 80% of the country's exports are destined for that market. While domestic demand growth can mitigate the impact of faltering external demand, it will not be able to serve as an independent engine of growth given higher unemployment, restricted credit growth and faltering consumer and business confidence in the region. The domestic demand outlook for the larger economies of Brazil and Mexico (where arguably it can be a bigger driver of growth) is weak due to the domestic credit crunch and faltering confidence indicators.

The deteriorating domestic demand outlook could be somewhat supported by counter-cyclical policies in the region. Unlike in the past, the central banks in the region have been able to follow the developed countries in cutting interest rates. Most central banks have delivered deeper interest rate cuts than expected as they have attempted to front-load the easing cycle to maximize the impact on the fast

¹ As an example, the central bank of Brazil has committed USD20bn of its international reserves to aid the private sector in meeting its 2009 external amortizations due to the decline in the roll-over rate on private-sector debt.

decelerating growth. However, still limited (albeit increased) financial intermediation and the risk of an eventual pass-through of weaker currencies to inflation could limit the impact of counter-cyclical monetary policies in the region. In this regard, Banxico recently reduced the pace of monetary easing due to its growing concerns about the MXN volatility and its impact on inflation.

The scope for counter-cyclical fiscal policies is limited in Latin America, as most countries are still saddled with relatively high debt burdens. Chile, Mexico and Peru, with debt burdens of below 35% of GDP, have some flexibility in implementing counter-cyclical fiscal packages. Indeed, all three countries have announced such packages in recent months of varying sizes: Chile (2.8% of GDP), Mexico (1.4% of GDP) and Peru (2% of GDP). However, timely and efficient execution of these fiscal packages is essential to maximize the multiplier effect on their economies. This is particularly pertinent for Peru and Mexico, as they have faced execution difficulties (especially related to capital expenditure) in the past.

But the Starting Point Matters...

While Latin America is poised to be buffeted by the three simultaneous shocks, the region's starting point is perhaps the best it has been in recent decades. Five years of current account surpluses, combined with rapid capital inflows, have led to a substantial increase in the region's external buffers. International reserves (including gold) stood at USD493bn at the end of 2008, triple the levels observed in 2001. At the same time, several Latin American countries have taken advantage of the good years to prepay external liabilities. Among the major markets, Brazil, Chile, Mexico and Peru have turned into net sovereign external creditors. Fiscal balance sheets have improved in recent years as fiscal consolidation, debt buybacks and currency appreciation reduced debt burdens across the region.

Many countries in the region have strengthened their policy frameworks by adopting inflation-targeting regimes and implementing flexible exchange rates, improving the ability of these countries to confront external shocks. While FX intervention has increased by central banks, in most cases this is aimed at reducing exchange rate volatility rather than setting the level of the exchange rate. Barring Peru, Costa Rica and Uruguay, most financial systems have low or non-existent dollarization, which has given the region's central banks greater leeway in letting the exchange rates depreciate significantly without worrying about the consequences of weaker currencies on the banks' balance sheets. Moreover, most banking systems in the region have relied on deposit and local funding rather than external funding to expand their balance sheets (in sharp contrast to the emerging Europe economies). To some extent, this will limit the extent of dislocation from the on-going global tightening of lending by foreign banks.

In summary, if the current external shocks had appeared a few years ago, the region's macro and credit outlook would have been far worse than it is now.

...And Risks Are Not Evenly Spread Across Countries

Fitch believes that the vulnerability and the capacity of absorbing the above-mentioned shocks will differ across countries, and to a great degree will depend on their policy discipline and flexibility. Fitch believes that three broad camps are emerging in Latin America.

1. Investment Grade or Near-Investment Grade Countries

This camp comprises investment-grade sovereigns of Chile, Mexico, Brazil, Peru and speculative-grade countries like Colombia, Panama and Uruguay. All these countries will experience a marked economic slowdown (if not economic contraction), and deterioration in their fiscal and external accounts. However, Fitch expects these countries to display greater resilience due to their better policy frameworks and

external cushions². Finally the agency believes that these countries will have ample support from the multilaterals should external pressures lead to greater contagion than expected. In this regard, Brazil and Mexico already benefit from the USD30bn swap line with the US Fed, while IMF's new liquidity facility could also be accessed by some of these countries should it be required.

2. Small and Open Economies

This camp comprises smaller countries of Central America and the Caribbean such as Costa Rica, El Salvador, Guatemala, the Dominican Republic and Jamaica. These countries could experience greater distress because they will be severely impacted by the US recession. Besides their tight trade links with the US, they also receive significant tourism and remittances flows from that country. Moreover, these countries continue to run higher current account deficits and, barring Guatemala, these countries also have weak external liquidity. Moreover, in some cases, policy frameworks are weaker, which could compromise their flexibility in dealing with external shocks. For example, Costa Rica's exchange rate regime (with limited FX flexibility) will be challenged in 2009 due to lower capital inflows and higher risk aversion. Two of the five countries (El Salvador and Jamaica) in this camp are already on Negative Outlook, reflecting the higher probability of credit deterioration in these countries. However, greater multilateral support has been forthcoming for some of these countries, which is likely to contain the extent of credit deterioration.

3. Populist Countries

This camp comprises populist countries of Argentina, Bolivia, Ecuador and Venezuela. These countries have handsomely spent the commodity windfall they have enjoyed in recent years. Greater state intervention, an unfriendly investment environment and implementation of inconsistent macroeconomic policies, including price controls and exchange rate regimes with little flexibility, will complicate their adjustment to the external shocks they face this year. From a credit perspective, these countries are quite low on the rating scale and their ratings largely capture the difficulty they will face in adjusting to the new economic realities. Last December, Ecuador joined Argentina in Restricted Default, while Bolivia's Foreign Currency (FC) Issuer Default Rating (IDR) remains quite low at 'B-'. Fitch also downgraded Venezuela to 'B+' last year.

Prospects for Latin America in 2009

Real GDP to Contract

Economic growth decelerated in 2008 due to slower external and domestic demand growth. During the first three quarters of the year, Latin American countries continued to enjoy a good level of dynamism due to soaring commodity prices and the lack of a significant contagion from the external credit turmoil, although tightening monetary policy conditions dampened domestic demand. However, growth dynamics changed dramatically after September 2008, when the international credit crisis began to worsen with the Lehman collapse. A sharp downward correction in commodity prices, greater volatility of regional currencies, and a significant deterioration in consumer and investor confidence in 2008, led to a marked slowdown in the fourth quarter of 2008 for Latin American countries.

Fitch estimates regional growth to have reached 3.8% in 2008, down from 5.2% in 2007. Mexico and Brazil – the two largest economies in the region – showed divergent growth trends. Mexico's growth decelerated further to 1.3% in 2009 from 3.2% in 2007. Mexico suffered from the US slowdown, which hurt its manufacturing production, remittances and exports, while tighter monetary policy and stricter lending criteria dampened credit and domestic demand growth. In contrast,

² In this camp, only Mexico's ratings are on Negative Outlook highlighting that some credit deterioration is possible in this camp as well.

Real GDP growth (%)

	2008e	2009f
Argentina	7.1	-1.4
Aruba	0.8	-1.5
Bolivia	5.6	1.0
Brazil	5.1	0.0
Chile	3.5	0.5
Colombia	3.2	1.4
Costa Rica	2.9	-0.3
Dominican Republic	4.5	0.5
Ecuador	5.2	-1.6
El Salvador	2.8	-0.5
Guatemala	4.0	1.0
Jamaica	-0.5	-2.0
Mexico	1.3	-2.5
Panama	9.2	3.0
Peru	9.3	4.0
Suriname	4.2	-0.6
Uruguay	10.1	2.0
Venezuela	4.9	-1.7

Source: Fitch

notwithstanding the poor growth performance in the fourth quarter, Brazil grew by 5.1%, with domestic demand growing strongly on the back of real wage growth, higher employment and relatively easy credit conditions (at least till Q408).

Peru, Panama and Uruguay were the fastest-growing economies, each recording over 8% growth. Peru's growth was supported by its rapid domestic demand growth, with investment getting an important boost from FDI flows in the mining and other sectors. Panama's growth was supported by strong investment growth, which was underpinned by the expansion of Panama Canal and other services.

Argentina and Venezuela's growth could not keep up in 2008, as falling commodity prices combined with their heterodox policies led to deterioration in consumer and investor confidence, dampening domestic demand.

Prospects for 2009 appear to be considerably weaker for Latin America's growth. Consistent with global assumptions of falling commodity prices (oil prices averaging USD 40 pb) and global recession (with the U.S. contracting by approximately 3%, according to the latest Consensus Forecasts), Fitch is projecting that Latin America's real GDP will contract by 0.9% this year. Underpinning the regional growth forecast is the expected contraction in Mexico (-2.5%) and stagnation in Brazil, with clear downside risk. Mexico is the most exposed to the US in the region and its limited ability to execute a large counter-cyclical fiscal response implies that the country will face a contraction this year. Falling commodity prices, tightening external liquidity and deteriorating domestic confidence indicators will have a negative impact on Brazil's growth dynamics.

Notwithstanding Chile's efforts to implement a sizable fiscal package in 2009, Fitch expects the country's growth to remain subdued as its economy is buffeted by falling commodity prices and the slowdown in global trade. The Colombian economy will also be affected by deteriorating external demand, more so due to the sharp deceleration in Ecuador and Venezuela, with which it has extensive trade ties. In contrast, Peru and Panama are likely to record respectable growth north of 4%, on the back of ongoing sizable investment projects and domestic consumption.

Growth will be particularly weak in Central America and the Caribbean due to the region's relatively high trade openness and close ties with the US through exports of goods and remittances. Fitch expects Jamaica, Costa Rica and El Salvador to contract in 2009, while the Dominican Republic and Guatemala to record meager growth. The extent of economic dislocation to this region will depend on the degree to which US tourism and remittances are affected by the recession.

Growth will deteriorate significantly in the "populist camp" countries of Argentina, Bolivia, Ecuador and Venezuela as well. The sharp correction in commodity prices and reduced funding options would stretch the limits of fiscal expansion (geared towards boosting growth) these countries have seen in recent years. At the same time, political compulsions are unlikely to result in improved macroeconomic policies to help reverse dwindling consumer and investor confidence in these countries.

Inflationary Pressures to Ease

Fitch expects inflationary pressures to decline from the elevated levels in 2008 for most Latin American countries. Last year, the central banks were challenged by the rise in commodity prices, which in turn increased overall inflation in the region. While most central banks raised interest rates to curb the second-round effects of higher commodity prices, average inflation reached 7.3% for the region in 2008 compared with 5.1% in 2007.

Most inflation-targeting central banks missed their inflation targets, some missing by a wide margin, such as Chile (7.1% compared with a target of 3.0%, Mexico (6.4% compared to the ceiling of 4%), and Colombia (7.7% compared with a target of

(4%+/-0.5%). Inflation in Brazil reached 5.9%, which was within the tolerance band of the inflation target of 4.5%+/-2% but well above the middle of the band.

Even the dollarized economies of El Salvador and Panama observed higher inflation of 8.1% and 8.8% respectively, in part due to the weaker dollar during the first half of 2008. Price controls (which in turn produced shortages), and easy liquidity manifested by negative real rates led to the highest inflation rate of 31.9% in Venezuela. While Argentina's official inflation rate ended at 7.2% in 2008, private-sector estimates ranged from double to triple that level.

Inflation dynamics have changed due to the drastic fall in commodity prices in recent months and a sharp deceleration in the regional economies since the last quarter of 2008. These forces suggest that inflation should end the year lower than in 2008, and in many cases the central banks will be able to achieve their inflation targets. However, the degree of pass-through from weaker regional currencies is still unknown, which could limit the extent of disinflation in the region. The currencies of Mexico, Brazil, Chile and Colombia have weakened by over 30% from their peaks in mid-2008. While weaker economic activity could limit the pass-through, Fitch believes that the regional central banks would have to fine-tune their monetary policies should the pass-through effect be higher than expected. Many central banks in the region have embarked on the easing cycle with aggressive moves, suggesting their concern over the slump in the growth outlook.

Fiscal Pressures on the Rise

Most Latin American countries are likely to see higher fiscal deficits in 2009 due to slower GDP growth, a fall in commodity prices and the rigidity in their spending profiles. Political pressure to implement counter-cyclical fiscal policies to stimulate domestic demand is also rising in the region. Some Latin American governments are using development banks to provide financing for the private sector. Similarly, state-owned companies are also being employed to provide a counter-cyclical boost through higher investment. Fitch expects a reversal in the trend of improving public finances observed in recent years as a result of higher growth and a strong rise in commodity prices as well as disciplined spending. Fitch projects that the region's weighted average general government deficit could rise to 2.6% of GDP from 1.2% in 2008. In Fitch's opinion, significant and sustained deterioration in public finances could present a risk to sovereign creditworthiness in the region.

On a general government basis, Argentina, Chile and Peru were the only countries in the region that ran fiscal surpluses in 2008, benefiting from higher commodity prices. However, in 2009 Fitch expects Chile and Peru to incur deficits, while Argentina will see a further deterioration in its fiscal surplus. Fiscal deterioration in Chile, Mexico and Peru will partly be a reflection of their counter-cyclical fiscal packages, although all three will face greater revenue pressures due to a slowing economy and falling commodity prices.

Brazil will find it challenging to meet its primary surplus target of 3.8% of GDP, as its budget is based on an optimistic growth assumption, necessitating spending cuts. It remains to be seen if the government uses the resources in its Sovereign Wealth Fund and the PPI to meet the primary surplus target.

Colombia will see a noticeable deterioration in its fiscal deficit owing to slower revenue growth and the government's inability to cut spending due to heavy earmarking of revenues.

The countries in Central America will benefit from the decline in their subsidy bill (owing to falling commodity prices), but the economic downturn will increase the pressure on their fiscal accounts.

From a fiscal perspective, the populist countries will be most at risk, as they have increased spending at a fast pace in recent years, which may be difficult to rein in

as commodity prices slump. Also, substantive spending cuts are harder to implement in these countries owing to their political dynamics. Fitch expects Bolivia's fiscal surplus to turn into a deficit, although multilaterals are expected to provide adequate funding to cover it. While traditionally Venezuela has plugged its fiscal hole by devaluing its currency, that policy choice is increasingly becoming costly due to the country's already high inflation rate. However, Venezuela has amassed considerable financial assets, which it could dip into to alleviate part of the effect of lower oil prices.

Both Argentina and Ecuador could be more challenged in terms of financing options, as they lack access to international markets or substantial multilateral funding. Argentina's recent nationalization of the private pension system as well as debt swaps in the local markets could partly ease its financing needs for 2009, but a strong deceleration in revenue growth would eventually necessitate a re-assessment of spending growth. In Ecuador, the elimination of oil saving funds will compound the impact of low prices on public finances and preclude counter-cyclical spending, especially public investment.

Fiscal deterioration, slower growth and weaker regional currencies are likely to reverse recent years' favorable debt dynamics. However, the extent of deterioration in debt dynamics will be mitigated by the substantial improvement in the debt composition of countries in the region, as most have used good years to pay down foreign-currency debt and increased their reliance on the local markets. This should limit the knock-on effects on the debt dynamics from weaker currencies.

In some countries, such as Peru and Panama, debt dynamics will continue to be favorable due to positive growth momentum and sufficiently high primary surpluses. Despite the substantive counter-cyclical fiscal package and a deceleration in growth, Chile's debt dynamics will not be hurt significantly as the government will fund its deficit by using resources from its stabilization fund. Furthermore, Chile's government debt to GDP ratio is already well below that of most peers in its rating category.

On the other hand, Fitch projects that Mexico's debt burden would begin to increase as its economy contracts and the government incurs a higher deficit. Similarly, while the net public debt/GDP ratio (a key target for the Brazilian government that the market monitors) will broadly remain stable in 2009, the gross general government debt is likely to increase as the economy stagnates and the government grapples with revenue pressures. At the same time, the Treasury is likely to borrow to fund the transfer of BRL 100 bn to the BNDES during 2009-10. Fitch forecasts Ecuador and Venezuela will see the largest increase in their debt burden as their fiscal imbalances deteriorate sharply along with a significant deceleration in their economies.

Current account balance (% of GDP)

	2008e	2009f
Argentina	2.5	-1.3
Bolivia	13.2	7.0
Brazil	-1.8	-2.0
Chile	-2.4	-4.4
Colombia	-2.9	-4.3
Costa Rica	-9.0	-6.0
Dominican Republic	-9.0	-6.1
Ecuador	1.4	-5.0
El Salvador	-7.3	-5.2
Guatemala	-5.0	-6.2
Jamaica	-18.8	-9.9
Mexico	-1.5	-2.8
Panama	-10.8	-8.5
Peru	-3.6	-3.8
Suriname	4.3	-8.0
Uruguay	-4.6	-3.9
Venezuela	11.9	-1.5

Source: Fitch

External Finances to Remain under Pressure

After recording five years of current account surpluses, the region posted a current account deficit of 0.6% of GDP in 2008. The regional aggregate was weighed down by the re-emergence of a current account deficit in Brazil owing to its robust domestic demand growth and higher profit remittances. Moreover, Mexico's current account deficit deteriorated, due to weaker export growth and a decline in overseas workers' remittances. Peru and Chile's current account surpluses vanished in 2008 as well reflecting deteriorating terms of trade. The countries in Central America and the Caribbean experienced the sharpest deterioration in their external accounts, as they were adversely affected by the significant increase in international commodity prices and faltering overseas remittances reflecting the effect of the US downturn. On the other hand, commodity-dependent Argentina, Bolivia, Ecuador and Venezuela continued to record surpluses, albeit shrinking ones with the exception of Venezuela.

External accounts are likely to deteriorate further in 2009 as the region's current accounts are adversely affected by global recession and falling commodity prices. Fitch is projecting that the region's current account deficit will deteriorate further to 2.6% of GDP this year. Brazil's current account deficit may stabilize around 2% of GDP with the decline in trade balance offset by a fall in the services deficit and profit remittances. Mexico's current account deficit is likely to worsen due to the fall in oil and manufactured exports and a possible decline in overseas workers' remittances. On the back of falling commodity prices, current account deficits in Chile and Peru will widen, while Argentina, Bolivia, Venezuela and Ecuador will likely begin to incur deficits. Notwithstanding the fall in tourism and remittances flows, countries in Central America and the Caribbean could see a decline in their current account deficits from last year's peak on the back of a sharp downward correction in commodity prices.

BoP pressures are also likely to increase in Latin America due to reduced capital inflows. Foreign direct investment (FDI) flows to the region are likely to be hit due to global recession and falling commodity prices. Brazil, Colombia, Uruguay and Peru have received hefty FDI flows in commodity sectors, which will decline in 2009 given the more sanguine view on commodities. At the same time, higher risk aversion towards the region could make it harder for countries to receive substantial portfolio flows. Fixed-income flows to the region will fall from the peaks seen in recent years as the volatility in regional currencies and the higher cost of hedging will make "carry trade" flows less attractive. Finally, Fitch believes that international market access for corporates and banks will be significantly constrained in 2009 due to higher risk aversion and the dwindling pool of international credit, which will add to capital account pressures. Consequently, Fitch is projecting the region's stock of international reserves to decline by USD78bn in 2009 but still remain at a hefty level of USD415 bn. As a result of both falling current external receipts and a decline in the region's international reserves, further improvement in external solvency ratios is unlikely in 2009.

Political Calendar Heating up Amid a Deteriorating Reform Outlook

Reform outlook in the region is bleak, as most countries face tough economic conditions and will be focused on minimizing the impact of external shocks on their respective economies. At the same time, structural reforms to improve competitiveness and the business climate and to increase the relatively low tax base are likely to remain on the back-burner over the next 12 months as elections draw closer and the political appetite to pass such reforms is limited. This is unfortunate, as the need for such reforms has arguably increased in light of slower growth and the need to compete for the fast-dwindling pool of international capital.

There are eight presidential and several Congressional elections in the region over the next 18 months in the region as shown on the table. Political and social risks could increase in some countries as election time coincides with unfavorable economic conditions. Countries with weaker institutions and governance, greater centralization of power, and a high level of policy unpredictability are most at risk. Venezuela, Ecuador, Argentina and Bolivia belong to this category.

After his success in removing terms limits for public elected officials in the recent referendum, President Hugo Chavez has already publicly expressed his desire to seek re-election in 2012. In addition, elections for the National Assembly are scheduled for 2010. Hence, political considerations will continue to guide the government's policy response to declining oil prices. In Ecuador, President Rafael Correa is expected to obtain a fresh term in office this April due to his high popularity levels and a divided opposition. Although the new constitution increases the power of the President vis-à-vis other institutions, political polarization and the impact of the external shock on the economy could increase political and social instability in a country which has seen 7 presidents over the last 13 years. Finally, Argentines' will likely go to the polls in June to renew half of the lower house and a

Elections 2009-2010

Presidential

El Salvador	March 2009
Ecuador	April 2009
Panama	May 2009
Bolivia	December 2009
Chile	December 2009
Costa Rica	Feb 2010
Colombia	May 2010
Brazil	October 2010
Uruguay	October 2010

Parliamentary

El Salvador	January 2009
Bolivia*	January 2009
Venezuela*	February 2009
Mexico	July 2009
Argentina	October 2009
Colombia	March 2010
Dom. Rep.	May 2010
Venezuela	December 2010

* Constitutional reform referendum.

Source: www.electionguide.org

third of the senate seats. In the event of a poor showing of the “Kirchnerista” faction of the Peronist party, President Christina Fernandez risks turning into a “lame duck” administration. Hence, Fitch believes political calculations are likely to continue guiding economic policy decisions, thus, further weakening the country’s fiscal and external position.

Bolivia’s presidential and congressional elections will be held in December and there is considerable risk of a further escalation in political and social tensions in the coming months, especially in the context of worsening domestic economic conditions. Moreover, the recently approved constitution does not resolve one of the primary issues of social, political and ethnic cleavage: the extent to which lower levels of government retain revenues generated locally.

While Peru’s political institutions remain relatively weak and President Garcia’s popularity remains low, Fitch is less concerned about political and social risks in this country, as Peru is likely to grow at a faster pace than most of its regional peers, and expansion in investment will likely provide some employment opportunities for Peruvians. Finally, Peru has previously demonstrated its ability to manage its fiscal accounts prudently, even at times of higher spending pressures. No major reforms are expected in Peru, although the country has implemented a free-trade agreement with the US. The Garcia administration is likely to focus on executing the counter-cyclical fiscal package it has announced, as budget execution has traditionally been an issue in Peru.

While Colombia has stronger political institutions, the uncertainty related to President Uribe’s decision to re-run for office in May 2010 could cloud the political environment in that country as well. Fitch believes that irrespective of whether President Uribe chooses to run, the main tenets of the Uribe administration, both in terms of security and economic policy, are likely to remain in place. Given the importance of the security issue for investor and consumer confidence, the next president of Colombia will likely continue to prioritize security.

Among the larger countries, such as Mexico and Brazil, where democratic institutions are stronger, risk of policy slippage is not insignificant, given that both countries will face elections over the next 18 months amid slowing (contracting in the case of Mexico) economic growth. Mexico will face mid-term congressional elections in July and the composition of Congress after this contest will determine the likelihood of any reform during the remainder of President Calderon’s term. In light of the economic contraction, a sharp decline in oil prices in recent months (and dim prospects of a fast recovery) as well as the drop in oil production, the Mexican government may need to rekindle its efforts to pass a revenue-enhancing tax base reform and/or energy reform to address weaknesses in public finances.

Brazil’s presidential elections in October 2010 are likely to be less eventful, although the race remains relatively open. Fiscal reform to make the tax system simpler and more efficient, which has been in discussion for many months, is unlikely to be passed. Similarly, prospects for labor, social security and other reforms to limit the increases in personnel costs appear dim during the remainder of the Lula administration.

Chile and Uruguay will be going to polls in 2009. Alianza, Chile’s opposition coalition stands to gain from the current weakness in economic activity. The December 2009 presidential elections will be neutral for Chile’s ratings, as Fitch expects broad policy continuity regardless of who wins the elections. Over the next 12 months, Fitch does not expect any significant passage of structural reforms in Chile, as the focus of the authorities will be to implement efficiently the already announced counter-cyclical fiscal package to support a fast faltering growth outlook. In Uruguay, candidates for October’s presidential elections from the governing Broad Front or the opposition National Party are yet to be nominated. Fitch believes, though, that the benefits harvested by Uruguay in recent years in the

form of higher growth and investment will support the continuity of coherent macroeconomic policies. However, the reform outlook is not promising as the new President is likely to face a divided congress with no clear majority for the governing party.

In Central America, Mauricio Funes from the FMLN won the March presidential race in El Salvador. While this represents an important landmark in El Salvador's political history, it remains to be seen whether the new president departs from the current policy framework. Before the elections, Mr. Funes made encouraging statements regarding his commitment to maintain dollarization and respect previous privatizations and continue with fiscal discipline. The new government will take office amidst what appears to be an increasingly harsh period of economic adjustment for El Salvador's dollarized economy. The focus of the new government will be to minimize the fallout from the global recession and tightening external liquidity on the Salvadoran economy. Unfortunately, the government lacks fiscal reserves and its funding options are still limited, both of which will limit its capacity to implement counter-cyclical policies. Panama will hold presidential elections in May, and Fitch does not expect this to affect the country's credit outlook. The leading candidate, Ricardo Martinelli, remains committed to fiscal discipline and prudent management of the Panama Canal expansion plan.

Costa Rica will go to polls in early 2010 and Fitch does not expect any significant policy departure in that country either. After a long, drawn-out approval process in Congress, Costa Rica is now a party to the DR-CAFTA. While that the legislative pipeline is more open, tax-enhancing legislation is no longer in the cards. However, the government may be able to garner congressional support to capitalize the central bank in a gradual manner before its term in office is over.

Credit Cycle in Latin America Has Turned

In 2008, Fitch took three positive rating actions, all of which were in the first half of the year. Peru and Brazil were upgraded to 'BBB-' (investment grade) in March and June respectively. Peru's upgrade reflected the country's improving fiscal and external balance sheet and its growth dynamism. Brazil's upgrade reflected the dramatic improvement in its external and public-sector balance sheet that has greatly reduced the country's vulnerability to external and exchange rate shocks, entrenched macroeconomic stability, and enhanced medium-term growth prospects.

During the last quarter of the year, as the external environment took a turn for the worse and commodity prices began their precipitous decline, Fitch took a series of negative rating actions.

- In September, the rating Outlook on the Dominican Republic ('B') was revised to Stable from Positive to reflect increased concerns regarding the country's weak external liquidity position, which could hinder its flexibility in the current external environment.
- In October, the rating Outlook on El Salvador ('BB+') was revised to Negative owing to increasing downside risks stemming from growing fiscal and economic pressures against a backdrop of tighter external and domestic liquidity as well as rising political uncertainty.
- In November, as part of Fitch's global review of emerging markets, the rating Outlook on Mexico ('BBB+') was revised to Negative, reflecting concerns over the capacity of the economy and policy framework to absorb three simultaneous external shocks, which include the worst US recession in 25 years, reduced capital and financial market flows, and lower oil prices, given the country's relatively limited fiscal and external cushions. At the same time, Fitch revised the rating Outlook on Chile to Stable from Positive reflecting the lower likelihood of an upgrade against current external backdrop.
- In November, Jamaica's IDRs were downgraded to 'B' with a Negative Outlook

to reflect Fitch's view that shocks from global financial turbulence and the US recession had heightened downside credit risks given Jamaica's modest and deteriorating international liquidity, large current account deficit and comparatively high public debt burden.

- In December, Ecuador's Long-Term FC IDR was downgraded to 'RD' from 'CCC' following the expiration of the grace period for the coupon payment on the 2012 global bonds that was due on November 15 and the government's announcement that it will selectively default on the 2012 and 2030 global bonds.
- In December, Venezuela's foreign and local currency IDRs were downgraded to 'B' from 'BB-' to reflect an increased risk of financial and economic crisis in Venezuela due to its weak macroeconomic policy framework and Fitch's concerns that a timely adjustment to the collapse in oil prices may not be forthcoming, particularly within the context of elections in 2009.
- Finally, in December Argentina's LC IDR was downgraded to 'B-' from 'B' to reflect Fitch's concerns about the mounting challenges for Argentina's fiscal and external financing requirements in light of falling commodity prices, the country's slowing economy and limited funding options.

Currently, Fitch has three sovereigns on a Negative Outlook, Mexico, El Salvador and Jamaica, and only Panama on a Positive Outlook, suggesting that credit pressures are on the rise in the region. Weaker economic growth, rising fiscal and BoP pressures and limited access to international capital markets will continually challenge Latin American policy makers in 2009. The degree to which Latin American countries and their policy frameworks remain resilient to the three simultaneous shocks of global recession, falling commodity prices and tighter external liquidity will determine the trajectory of the ratings in the region.

The main risks to the Latin American credit outlook continue to be a sharper and a prolonged global recession, continued sharp decline in commodity prices, sustained closure of the private sector to the international market and/or a re-emergence of the financial instability observed in the final months of 2008 and a rise in political and social instability in the region due to worsening growth and rising unemployment, with this risk even higher in countries with weaker institutions, greater corruption, and centralization of power. A deeper and longer global downturn could potentially increase the scope for policy slippage in the region.

Selected Country Updates

Argentina ('RD')

Fitch downgraded Argentina's local currency IDR to 'B-' from 'B' in December 2008, since lower economic growth, falling commodity prices and limited funding sources have increased the risk of the sovereign facing difficulties in meeting significant fiscal and external financing needs. Moreover, decelerating consumption and investment are expected to take a toll on domestic demand and compound the negative shock of lower export taxes for public finances. On the external front, the erosion of the country's trade surplus, limited capital inflows and continued pressure on the ARS are likely to erode the country's external liquidity.

Although Argentina is expected to have the capacity to service its debt commitments over the next 12 to 18 months, the electoral calendar creates political incentives for the government to continue the pace of expenditure growth, thus complicating the government's financing picture. Moreover, challenges for policy makers could increase in the event of sharper than anticipated economic slowdown or capital flight. Fitch would remove the 'RD' on the sovereign's foreign currency IDR, if Argentina were to open a new exchange offer for holdouts that was broadly accepted without incurring the risk that proceeds or debt service would be attached by foreign courts. Downward pressures on Argentina's local currency IDR could intensify if fiscal slippage is greater than anticipated.

Bolivia ('B-')

Fitch affirmed Bolivia's ratings and Stable Outlooks in July 2008. Bolivia's manageable external debt burden following sizeable write-offs under the Multilateral Debt Relief Initiative and the country's abundant natural resources support the sovereign's creditworthiness. At the same time, severe social, regional, and political fragmentation as well as widespread poverty and poor social indicators will constrain Bolivia's ratings to the 'B' category for some time.

Owing to a favorable external environment, Bolivia's overall macroeconomic performance remained relatively strong in 2008 although domestic and external price shocks kept inflation in double-digits. Hydrocarbons and extractive sector exports continued to support fiscal and current account surpluses as well as moderate GDP growth. International reserves excluding gold increased to US\$7.7bn in 2008, boosting liquidity indicators and net external debt ratios. Nevertheless, Bolivia's commodity dependence renders it vulnerable to external shocks which should increase macroeconomic pressures in 2009. At the same time, institutional weakness leave Bolivia vulnerable to instability as issues including the direction of macroeconomic policy and regional autonomy have not been resolved despite the approval of a new constitution in early 2009. Social and political pressures could also increase as the economic environment deteriorates and general elections approach.

An easing of social tensions which results in improved governability could benefit creditworthiness. Similarly, an adequate policy response to growing economic pressures and the decline in commodity prices could boost Bolivia's ratings. On the other hand, broader civil unrest resulting from further intensification of regional and social divisions could put downward pressure on the sovereign's ratings. Significant fiscal slippage could also undermine creditworthiness if it jeopardizes the maintenance of macroeconomic stability and a sustainable debt burden.

Brazil ('BBB-')

Brazil's investment-grade ratings were affirmed in November 2008. Brazil's ratings continue to be supported by its strong external balance sheet, its net public-sector creditor status and a prudent policy framework, which has buttressed investor and consumer confidence. Brazil will be affected by the falling commodity prices and lower international credit, while it will be more protected from the global recession due to the closed nature of its economy. Between 50% and 60% of Brazilian exports are either commodities or linked to commodities. In recent years, Brazil has benefited tremendously from larger capital inflows (both equity and fixed income); however, higher risk aversion and tighter external liquidity imply that Brazilian economy will have to adjust to a lower level of capital inflows. The effects of these shocks are already evident, with the Brazilian economy decelerating sharply in the fourth quarter of last year amid tightening external and domestic credit conditions and worsening consumer and investor confidence indicators. Fitch expects the Brazilian economy to stagnate in 2009 at best, losing the dynamism it displayed in 2008 when it grew at 5.1%. While monetary policy easing underway should provide some support to the faltering domestic demand, Brazil can not afford to implement a large-scale counter-cyclical fiscal package due to its heavy government debt burden.

Brazil's strong international reserves cushion provides the policy makers greater maneuverability in dealing with the external shocks. The Bacen (central bank) has already intervened in the foreign-exchange market through spot sales, FX repos, foreign-currency trade lines and FX swaps. Yet, to preserve its international liquidity, the central bank has been judicious in limiting its reserves sale in the spot market. Similarly, policy makers have been swift in their response to address the liquidity issues that have emerged in the small and medium-sized banks as well.

Maintaining a credible monetary and exchange rate policy framework as well as fiscal prudence will be critical for Brazil to weather the unfavorable external environment. On the other hand, Fitch would view negatively a significant deterioration in Brazil's international reserves position or macro policy management or a more severe worsening of debt composition than expected.

Chile ('A')

Fitch revised the Outlooks on Chile's Long-term Foreign and Local Currency IDR's of 'A' and 'A+', respectively, to 'Stable' from 'Positive' in November 2008, reflecting Fitch's view that an upgrade was less likely given the disproportionate impact of global recession on Chile's small open economy as well as the impact of declining commodity prices on exports, fiscal accounts and the sovereign's external liquidity position. Nevertheless, Chile's credible macroeconomic framework, underpinned by strong fiscal management, flexible exchange rate and an overall net external creditor position, support the sovereign's capacity to absorb the ongoing external shocks without materially weakening its credit profile.

The central bank has begun an aggressive monetary easing cycle, cutting interest rates by 350bp in the first two months of 2009, but must remain vigilant against inflation risks stemming from a weaker peso. The authorities are also implementing countercyclical fiscal policy with a US\$4.0bn (2.8% of GDP) package which will be funded with fiscal saving accumulated in its Fund for Economic and Social Stabilization. Although lower copper revenues and increased expenditure mean that Chile will run a fiscal deficit in 2009, its general government balance will remain in line with the A category median. At the same time, the sovereign's debt levels are low enough that borrowing even the full US\$4.0bn would not compromise debt dynamics or comparisons with the category medians.

Evidence that Chile is weathering the storm well relative to peers and that inflation is returning to target levels could boost creditworthiness. On the other hand, eroding credibility of the fiscal or monetary policy framework, evidenced by inappropriate policy response, could put downward pressure on Chile's sovereign ratings. Fitch will also monitor the private sector's capacity to serve its relatively high foreign currency obligations and appropriately hedge currency and refinancing risks.

Colombia ('BB+')

Fitch affirmed Colombia's foreign currency IDR at 'BB+' in August due to the sovereign's macroeconomic stability, much-improved growth performance, as well as its disciplined fiscal policies and debt liability management. Nevertheless, a less robust monetary and exchange rate policy framework and relatively high fiscal and external solvency ratios continue to represent credit weaknesses. As shown by the current crisis, Colombia remains vulnerable to external shocks due to limited trade integration, high commodity dependence, and considerable trade exposure to Venezuela.

A responsible easing of monetary policy that is consistent with medium-term inflation objectives will be important to maintain the country's medium- and long-term growth prospects and to retain investors' confidence. Although the benefits of diversification can be blurred under the present global conditions, Fitch still believes that greater trade institutional trade links do not only improve the resilience of export flows, but also push forward reforms to advance the competitiveness and efficiency of the economy. Continued improvement in external and fiscal solvency ratios relative to peers would be positive for Colombia's creditworthiness. Conversely, a sharper than anticipated fiscal deterioration in the absence of adjustments to lower economic growth could put pressure on Colombia's ratings. Similarly, greater than expected financial and economic dislocation as well as increased balance of payments pressures due to lower FDI flows could undermine creditworthiness.

Costa Rica ('BB')

Fitch affirmed Costa Rica's Long-Term Foreign and Local currency IDR's at 'BB' and 'BB+', respectively, with Stable Outlooks in February 2008. Costa Rica's ratings are supported by its high per capita income, strong governance indicators, modest external debt burden and improved public finances. On the other hand, the monetary and exchange rate policy framework represents a key credit weakness, particularly in light of comparatively high levels of inflation and financial dollarization, a relatively large current account deficit, financial sector weaknesses and fragile albeit improved international liquidity.

Although Fitch expects FDI inflows to weaken in 2009, Costa Rica's broad multilateral backing through emergency liquidity support, which could amount to US\$2 billion, could help bolster liquidity and meet external financing needs in 2009. However, despite improved regulation and reduced offshore activities, Costa Rica's financial system remains comparatively weak due to high and increasing financial dollarization and lower capital adequacy. In this context, economic slowdown and continued currency pressure could negatively impact the financial system, potentially leading to contingent liabilities for the sovereign in light of considerable state participation in the banking system.

Strengthening of the monetary and exchange rate policy framework could benefit Costa Rica's ability to cope with external shocks and in turn, its creditworthiness. Passage of revenue-enhancing legislation along with continued fiscal discipline is also critical to supporting Costa Rica's ratings by sustaining positive debt dynamics as economic growth decelerates. Alternatively, given concerns about Costa Rica's relatively weak exchange rate framework, current account deficit and liquidity indicators, significant erosion of international reserves could put downward pressure on ratings. An inappropriate policy response to the ongoing economic slowdown or greater currency pressures could also be negative for creditworthiness, particularly in light of important public participation in the financial system.

Dominican Republic ('B')

Fitch revised the Rating Outlooks on the Dominican Republic's foreign and local currency IDR of 'B' to Stable from Positive last September. This outlook revision reflected increased concern that the Dominican Republic's comparatively weak liquidity position relative to similarly rated peers could render the country more vulnerable to external shocks in an environment of lower global growth and tighter international liquidity conditions. The Dominican Republic's need for foreign financing rapidly increased at a time of worsening global financial conditions last year. However, lower international food and oil prices will reduce the country's current account deficit by an estimated 3% of GDP in 2009, which combined with anticipated multilateral disbursements will ease this pressure somewhat.

Looking ahead, the Dominican Republic's ratings would benefit from stronger external liquidity. Maintenance of an appropriate policy response which resolves near-term challenges such as increasing inflation, as well as fiscal and external financing pressures would be supportive of the sovereign's ratings to the extent that it bolsters confidence. Though not Fitch's base case scenario, marked downward pressure on the peso or an erosion of international reserves would be negative for the ratings. These pressures could materialize from a continued widening of the current account deficit, as well as a sharp decline in non-debt creating capital inflows or a return of capital flight.

Ecuador ('RD')

Although record-high oil prices, the incorporation of the oil savings funds into the central government budget and the government's under-execution of capital spending bolstered Ecuador's public finances in recent years, and thus its capacity to service debt, the sovereign's willingness constrained its sovereigns ratings. In December 2008, the government of President Rafael Correa decided to halt

payments on a portion of its external bond debt alleging that these obligations were both “illegal and illegitimate” based on the assessment of government-appointed commission. As a result, Fitch downgraded the sovereign’s foreign currency IDR to ‘RD.’

The government’s debt moratorium will constrain the country’s already limited access to international capital and financial markets and reduce prospects for non-debt creating capital inflows. Dependence on oil export revenues, a weaker fiscal stimulus and reduced private investment as a result of government policies also reduce the domestic economy’s resilience in a low oil price environment. As a dollarized economy facing an adverse terms of trade shock, reduced capital inflows will magnify an eventual contraction of the monetary supply with downside risks for both growth and the government’s ability to access domestic markets as well. Ecuador’s rating will remain in ‘RD’ until the government successfully renegotiates new repayment terms with bondholders.

El Salvador (‘BB+’)

Fitch revised the Outlooks on El Salvador’s Long-term Foreign and Local Currency IDR’s of ‘BB+’ to ‘Negative’ from ‘Stable’ in October 2008 due to increasing downside risks stemming from growing fiscal and economic pressures against a backdrop of tighter external and domestic liquidity. However, a stable monetary and economic environment, a good track record on structural reforms, and stronger governance indicators than rating peers support the ‘BB+’ ratings. Additionally, a large IMF precautionary liquidity support package and key multilateral loans, worth a combined total of US\$2.15bn or almost 10% of GDP, which have served to partially mitigate the negative impact of domestic politics on public and external finances by encouraging roll-over of short-term domestic liabilities (Letes) at maturities beyond the March election.

Nevertheless, the next government will face significant economic challenges. El Salvador’s exposure to the US recession is really starting to bite via weaker external demand and lower remittance flows. While Fitch expects El Salvador’s current account deficit to narrow in 2009 due to declining commodity imports and economic weakening, dwindling capital inflows imply that the dollarized economy must decelerate sharply or contract to cover the external financing gap. El Salvador does not have additional buffers, such as fiscal reserve assets, to ease the blow of the deeper economic correction required in the absence of exchange rate flexibility and independent monetary policy. Moreover, public finances could remain tight if already low fiscal revenues take a hit as the economy contracts and pressure to provide fiscal stimulus rises. Fitch will look for signs of easier domestic financing conditions and also continue to monitor how El Salvador’s financial system copes with the worsening external situation.

Measures which improve fiscal flexibility and easing of financing constraints as well as resilience of the economy to the challenging external and domestic environment could help uphold creditworthiness. On the other hand, a worsening macroeconomic outlook, sustained fiscal financing challenges, capital flight continued political gridlock and an inadequate policy response to fiscal pressures could result in downward pressure on sovereign ratings.

Guatemala (‘BB+’)

The government’s track record of macroeconomic stability, low public and external debt burdens, as well as a solid commercial debt repayment history continue to support Guatemala’s long-term foreign currency IDR of ‘BB+’.

The country’s key credit weaknesses include its low tax take, high level of poverty and inequality, as well as its weak social and governance indicators, factors which will take time to address and are likely to constrain Guatemala’s ratings to sub-investment grade over Fitch’s rating horizon. Fitch believes the current policy

framework could be vulnerable to erosion of public support over the medium-term if notable progress on these fronts is not forthcoming. Despite a more challenging external environment, the country's sound macroeconomic fundamentals and the authorities' commitment to managing downside risks should help Guatemala's resilience in facing the global crisis. Given the depth of the ongoing recession in the US, Fitch expects economic growth to decelerate sharply this year to around 1% compared to 4% in 2008. In light of growth challenges, the government announced a package of measures to jump start the economy last month, including strengthening Guatemala's social safety net with targeted conditional income transfer programs and investing in infrastructure. Nevertheless, the fiscal deficit is not expected to exceed 2% of GDP this year.

Easing of Guatemala's rating constraints, including a low tax take, high poverty and poor social indicators, through the implementation of reforms which strengthen public finances and sustain higher rates of economic growth would be viewed positively. Conversely, political gridlock which hinders the implementation of needed structural reforms or a marked deterioration in fiscal and external solvency, as well as liquidity indicators could negatively affect Guatemala's ratings

Jamaica ('B')

Jamaica's FC and LC IDRs were downgraded to 'B' in November 2008 with a Negative Outlook. The downgrade reflected Jamaica's limited capacity to absorb external shocks emanating from a US recession and tightening external credit conditions in light of its high current account deficit, weak and declining external reserves position and a heavy debt burden.

While Jamaica has secured multilateral funds and paid down the maturing foreign bond in February, policy makers will be continually challenged in navigating the economy with limited fiscal and external buffers. Currency depreciation has prompted the central bank to increase interest rates significantly and to intervene in the FX spot market despite the already weakened international reserves cushion. Although falling commodity prices will provide some relief to the external accounts and inflation, Fitch still expects the Jamaican economy to face a hard landing this year due to the global recession, which will adversely affect tourism, remittances and FDI flows to the country. Fitch expects fiscal pressures to remain high due to the economic contraction, higher debt servicing costs and increased wage demands by public-sector employees, thereby increasing the already existing wide gap between Jamaica's fiscal solvency indicators and the 'B' median.

A significant erosion of the country's external liquidity position and an inappropriate response to rising economic and financial pressures would be negative for sovereign creditworthiness. On the other hand, easing of external financing constraints and resilience of the policy framework in the face of the deteriorating external environment could help stabilize the ratings.

Mexico ('BBB+')

Mexico's sovereign ratings were placed on a Negative Outlook in November 2008 to reflect Fitch's concerns over the capacity of the economy and policy framework to absorb smoothly three simultaneous external shocks: the worst US recession for 25 years; reduced capital and financial market flows; and lower oil prices. The fiscal and external cushions that Mexico has to absorb these shocks are modest in comparison with many of its rating peers: the Oil Stabilization Fund is equivalent to approximately 1% of GDP and gross external financing needs (% reserves) are relatively high as well. The large-scale FX intervention by the central bank also represented a marked policy departure from the past given Banxico's commitment to maintaining a free-float exchange rate regime. Moreover, the financial stress experienced by some Mexican corporations in recent months has raised concerns about the robustness of the Mexican corporate sector in the face of the coming economic downturn.

Mexico's policy makers will be challenged this year to manage the country's fast-deteriorating economy prudently and soften the blow from the US recession. Fitch expects the country to contract by over 2% in 2008. While counter-cyclical fiscal policies have been announced by the government, the execution of the infrastructure plan will determine the extent of fiscal impulse in 2009. Moreover, the capacity to loosen fiscal policy further is limited, as Mexico's general government debt (both as a percentage of GDP and revenues) is above the 'BBB' median, and public finances remain quite vulnerable to lower oil income, while Fitch does not expect a tax reform to expand the non-oil tax base in the short term. Fiscal pressures are likely to be higher in 2010 as oil prices remain low (and in the absence of an oil hedge that has protected fiscal oil income this year) and the effects of the economic contraction in 2009 are felt on income taxes next year. While Banxico is easing monetary policy, the continued weakening (and volatility) of the MXN is constraining its ability to deliver faster interest rate cuts.

The resilience of Mexico's economy and its policy framework to the external shocks will help in stabilizing the country's ratings at the current level. On the other hand, signs of further financial distress and dislocations in the economy, further weakening of policy framework and inappropriate handling of fiscal pressures ahead will be viewed negatively.

Panama ('BB+')

Fitch recently affirmed Panama's ratings and Positive Outlook due to the sovereign's resilience to withstand the international financial crisis, even though it will experience a cyclical downturn and downside risks are present. Although both economic growth and the fiscal balance are expected to deteriorate in 2009, Panama's macroeconomic and structural strengths will continue to set it apart from 'BB' peers. Official dollarization, a stable financial system, low public sector debt service needs as well as the government's considerable financial and land assets support the sovereign's IDR of 'BB+'. Furthermore, dollarization underpins an established track record of macroeconomic stability unrivalled by sub-investment grade emerging markets, as illustrated by an extended period of high growth in conjunction with low to moderate inflation.

Higher savings and investment, partly due to the ongoing Canal widening project, should help Panama maintain stronger economic growth this year relative to the global slowdown in 2001/02 and also compared to regional peers. As such, Fitch believes that Panama should be able to absorb future increases in public debt related to the expansion of the canal without precipitating downward pressure on the ratings given its growth prospects and the expectation that fiscal discipline will be maintained even during an election year.

Peru ('BBB-')

Peru's investment grade ratings were affirmed in January 2009. The ratings affirmation recognized that Peru's solid macroeconomic framework, which resulted in record accumulation of foreign assets, as well as its strong fiscal and external solvency indicators, has increased the economy's capacity to withstand a commodity price collapse, a recession in the world's advanced economies, and a reversal of capital and financial flows.

Of the challenges facing all emerging markets, Fitch believes the collapse in commodity prices will affect Peru most significantly, contributing to a deterioration of the current account balance, currency weakness and reduced fiscal revenues. However, Even with the anti-crisis measures announced by the government late last year, which include a \$3 billion economic stimulus package (about 2.2% of GDP), Peru's debt dynamics will remain on a positive trajectory and continue to outperform peers over our rating horizon

Venezuela ('B+')

Fitch downgraded the Bolivarian Republic of Venezuela's Long-term Foreign and Local currency Issuer Default Ratings (IDRs) to 'B+' from 'BB-' in December 2008, as the risk of financial and economic crisis in Venezuela have increased due to the sovereign's tenuous macroeconomic policy framework. Moreover, Fitch is concerned that timely adjustments may not be forthcoming due to political considerations, thus eroding Venezuela's strengths of comparatively low debt maturities and an important level of accumulated reserves. Failure to amend policies will most likely jeopardize fiscal and external accounts.

The economy's dependence on oil revenues, high inflation and an overvalued fixed exchange rate increase the challenges for authorities to adjust to a low oil price environment. Mounting macroeconomic pressures, if not addressed, could result in a severe and disorderly economic adjustment, thus, adversely affecting the sovereign's capacity to service debt. A greater than anticipated deterioration of the country's fiscal and balance of payments position could also put downward pressure on Venezuela's ratings. Conversely, Venezuela's creditworthiness could strengthen if a sustainable and coherent policy response were implemented to reduce its vulnerability to oil price fluctuations and thus the volatility of overall macroeconomic performance.

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