MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes Guatemala's outlook to negative, affirms Ba1 ratings

10 Nov 2020

New York, November 10, 2020 -- Moody's Investors Service, ("Moody's") has today changed the outlook on the Government of Guatemala's ratings to negative from stable. Moody's has affirmed Guatemala's Ba1 issuer and senior unsecured bond ratings.

The key drivers for the change in outlook are:

1. The credit impact of the pandemic-related deterioration in debt metrics which is exacerbated by Guatemala's limited revenue base

2. The authorities' limited ability to reverse the deterioration in Guatemala's credit profile and bring government debt metrics in line with peers

The Ba1 rating affirmation reflects the balance between the country's track record of conservative fiscal management and resiliency to domestic and external shocks and credit pressures derived from low per-capita income and weak institutions, evidenced by low overall government effectiveness and rule of law scores.

Guatemala's long-term foreign-currency bond ceiling remains unchanged at Baa3. The foreign-currency deposit ceiling remains at Ba2, while the local-currency bond and deposit ceilings remain at Baa1. The short-term foreign-currency bond ceiling remains at P-3, while the short-term foreign-currency deposit ceiling remains unchanged at NP.

RATINGS RATIONALE

RATIONALE FOR CHANGING THE OUTLOOK TO NEGATIVE FROM STABLE

PANDEMIC-RELATED DETERIORATION IN DEBT METRICS EXACERBATED BY GUATEMALA'S LIMITED REVENUE BASE

The coronavirus pandemic has led to wider fiscal deficits and a recession that, while moderate by regional standards, has pushed government debt metrics higher. Moody's estimates the fiscal deficit will reach 5.6% of GDP this year, a result of both increased pandemic-related spending and lower revenue intake amid an economic slowdown, with GDP set to shrink 2% this year. In 2021, Moody's expects the economy to recover and post 4% annual growth, which is above Guatemala's historical trend growth of 3.5%. Still, the fiscal deficit will narrow only modestly to 4.8% of GDP next year.

Moody's projects that the wider fiscal deficits will push government debt from 27% of GDP in 2019 to 32% in 2020 and 34% in 2021. Given Guatemala's very low revenue intake, one of the lowest among Moody's universe of rated sovereigns, the anticipated increase in government debt and interest payments relative to revenue will cause metrics to compare unfavorably to peers. The government's interest burden is set to rise with interest payments representing 17.4% of revenue in 2021, much higher than the 12.8% median for Ba1 and Ba2-rated peers.

Low government revenue, a long standing feature of Guatemala's credit profile, restricts fiscal flexibility. Government revenue averaged 11.4 % of GDP in 2016-19, substantially below the 28.2% of GDP average for Ba1 and Ba2-rated peers. Moody's expects it to decline to 10.6% of GDP in 2020 and rise only modestly to 10.9% of GDP in 2021.

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LIMITED ABILITY TO REVERSE DETERIORATION IN CREDIT METRICS AND TO BRING THEM IN LINE WITH PEERS

Reducing debt metrics will pose significant challenges for Guatemala. Absent a substantial fiscal consolidation program, higher government debt and interest burdens will become a permanent feature of the sovereign credit profile, undermining Guatemala's standing relative to peers.

The authorities face the challenge of adopting a fiscal consolidation strategy that proves effective in reversing the deterioration in government debt metrics. This task will require combining spending restraint with a sustained and material increase in the tax intake, an area where major shortcomings have been observed over the years.

Guatemala's revenue base is among the lowest in Moody's sovereign rated universe as a result of low tax rates, weak tax enforcement, and a large informal sector. Given the authorities' limited ability to bolster government revenue, the country's performance on this front will be critical to determining the direction in which sovereign credit prospects will move.

RATIONALE FOR AFFIRMING THE RATINGS AT Ba1

The Ba1 rating affirmation reflects the balance between a track record of conservative fiscal management and the relative resilience of the economy to domestic and external shocks, against underlying credit pressures derived from a low per-capita income level and weak institutions.

Low income per-capita undercuts the sovereign credit profile with weak development metrics placing important structural constraints on credit prospects. Even though Guatemala's $77 billion economy is larger than the $43 billion peer median, the country's per-capita GDP (PPP basis) of $8,487 in 2019 was 46% lower than the median for similarly rated peers. Moreover, with one of the highest Gini coefficients (a standard measure of income inequality), Guatemala's income distribution is highly unequal, a condition that introduces potential political and policy risks.

A weak institutional framework is another factor that restricts Guatemala's credit standing. The country's Worldwide Governance Indicators, which are incorporated in Moody's assessment of 'institutions and governance strength', are lower than those of most of its peers particularly with regards to government effectiveness and rule of law.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Environmental risks are material to Guatemala's credit profile. Guatemala's sovereign credit profile is exposed to climate change risks from recurring droughts and hurricanes, which can deplete agricultural production and thus harm Guatemalan exports.

Social risks are also material and stem from long-standing levels of poverty, economic inequality, and social exclusion. The fiscal impact of the coronavirus pandemic, which Moody's considers a social risk, will result in a higher fiscal deficit and a larger debt burden.

Governance considerations are material credit risks and include issues such as the rule of law and control of corruption, which limit policy effectiveness and reduce investment and growth. Despite these credit constraints the government maintains a strong track record of effective fiscal and monetary policymaking.

GDP per capita (PPP basis, US$): 8,487 (2019 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 3.8% (2019 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.4% (2019 Actual)

Gen. Gov. Financial Balance/GDP: -2.2% (2019 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 2.4% (2019 Actual) (also known as External Balance)

External debt/GDP: 24.5 (2019 Actual)

Economic resiliency: ba2

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 05 November 2020, a rating committee was called to discuss the rating of the Guatemala, Government of. The main points raised during the discussion were: The issuer's institutions and governance strength, have not materially changed. The issuer's governance and/or management, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has materially decreased.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of Guatemala's rating is unlikely in the near to medium term. A change in the outlook to stable from negative would require evidence that the government has managed to stabilize debt metrics and has a credible plan to bring them more in line with those of its peers.

The rating could be lowered if (1) worse-than-expected economic and fiscal performances result in persistently high government debt and interest burdens, or (2) weak social development indicators and domestic security challenges begin to pose a threat to political stability.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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