VM Wealth Management Limited

Sovereign Bond Analysis: Government of Colombia 7.357% 2037

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- **Bond Recommendation:**

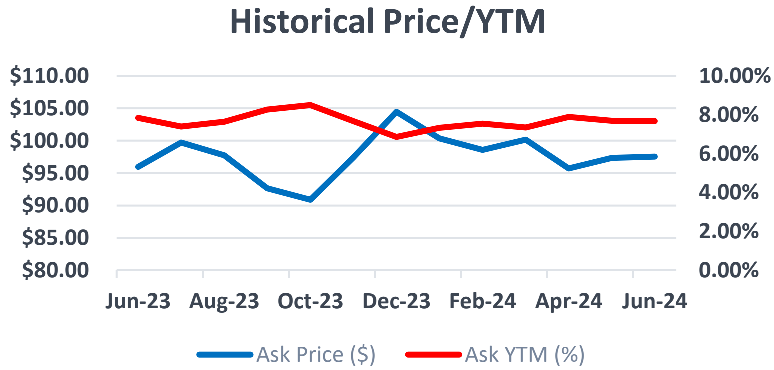
Conservative Risk Appetite: UNDERWEIGHT
Moderate Risk Appetite: MARKETWEIGHT
Aggressive Risk Appetite: OVERWEIGHT

About Colombia

Colombia, located in the northwest region of South America, is the fourth largest economy on the continent, driven by sectors such as oil and mining, agriculture, manufacturing, and services. It is a major producer of coffee, emeralds, and flowers, with significant reserves of oil and natural gas. The country has made substantial progress in improving its business environment and political stability, attracting considerable foreign investment. Recent economic reforms have aimed at enhancing competitiveness and fostering sustainable growth. Colombia's strategic location provides access to both the Pacific and Atlantic Oceans, facilitating international trade.

Despite these advancements, Colombia faces challenges such as income, regional disparities, inequality and security concerns linked to illicit activities. The government's efforts to address these issues include peace agreements and social programmes.

Government of Colombia (COLOM): Bond Term Summary	
Issuer	Government of Colombia
Currency	USD
Credit Rating/Outlook (S&P)	BB+/Negative
Day Count Basis	30/360
Maturity	9/18/2037
Price	98.273
Coupon Rate	7.375
Issue Date	9/19/2006
Tenor	13 Years
Maturity Type	Bullet
Amount Outstanding	1,818,400 (M)
Indicative Ask Yield (June 30, 2024)	7.582

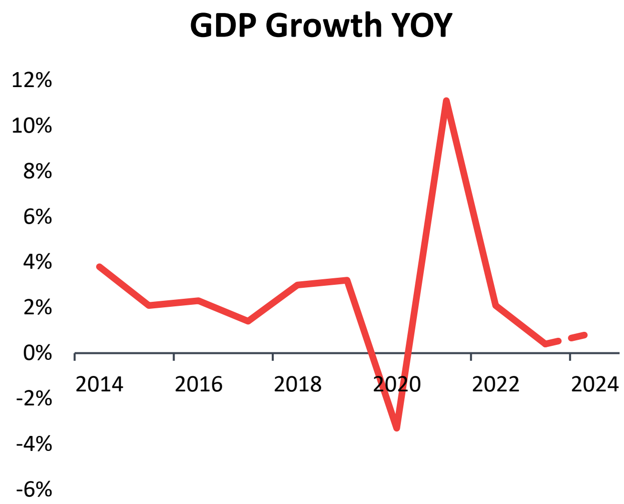


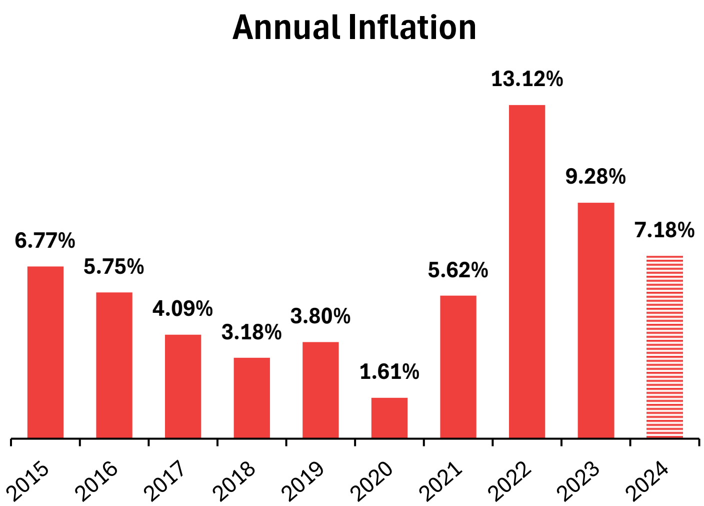
Recommendation: In comparison to bonds of a similar S&P credit rating of BB+ with a similar maturity (2034 to 2042), the coupon rate and yield on COLOM 37's are higher than the peer average and the price is lower than peer average. However, COLOM 37's bond is a bullet maturity type, which puts it at a higher risk of defaulting on its principal repayment, unlike COLOM's 35, PARAG's 36, and T&T's 34, which come with callable and/or sink features. These factors likely justify the lower price and higher coupon rate of the COLOM 37's bond. We therefore view Colombia bonds as fairly priced given the risk relative to comparables. Due to high yield-to-maturity (YTM) and relatively cheap bond price but low speculative grade S&P credit rating with a negative economic outlook, heavy debt burden, and fiscal deficit, we believe the Colombia 37 bond is suitable **OVERWEIGHT** investment option for persons with an **AGGRESSIVE** risk appetite and a **MARKETWEIGHT** investment option for persons with a **MODERATE** risk appetite.

ECONOMIC OVERVIEW & OUTLOOK: COLOMBIA

The Colombian Economy Experienced an Unexpected Fall in GDP Growth but Is Projected to Recover in The Medium-Term

In 2023, Colombia's economy grew modestly by 0.6%, a sharp slowdown from 7.3% in 2022, due to declines in net external demand, gross fixed capital formation, and public consumption, partially offset by private consumption. Tight monetary policies reduced inflation from 13.3% in March 2023 to 7.4% in March 2024. For 2024, Colombia's central bank projects GDP growth at 1.4%, revised up from 0.8%, while the International Monetary Fund (IMF) estimates a slightly lower 1.1%, driven mainly by private consumption despite weak investment. Risks remain high, with potential impacts from global geopolitical tensions, financial conditions, and commodity price fluctuations. Fiscal policies remain contractionary, reducing deficits and debt, and the central bank continues to utilize the Flexible Credit Line (FCL), a line of credit facilitated by the IMF, as a buffer against external risks. The medium-term outlook expects GDP growth to reach 3.2% by 2025, with inflation meeting the 3% target by end-2025, and a stable current account deficit at around 3% of GDP in 2024, supported by robust foreign direct investment.



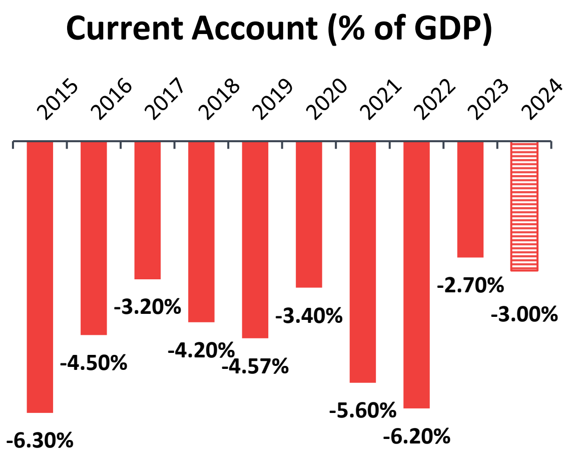


Inflation Has Fallen Faster Than Anticipated But Is Yet To Fall to the Target

In the first quarter of 2024, Colombia saw a continued decline in both headline and core inflation rates, which stood at 7.4% and 6.8% in March, respectively, reflecting a faster-than-anticipated descent (Central Bank of Colombia). Contributing factors included an appreciating peso, ample food supply, lower international costs, and reduced public service price adjustments. The central bank projects headline and core inflation to further decrease to 5.1% and 5.5% by the end of 2024, respectively, and to stabilize around the 3.0% target by 2025, although these forecasts carry significant uncertainties. The IMF supports this outlook, noting that tight monetary policies have effectively lowered inflation from 13.3% in March 2023 to 7.4% in March 2024. The IMF projects inflation to fall to 5% by the end of 2024 and reach the 3% target by the end of 2025.

Notable Decrease in Current Account Deficit but A Slight Increase Is Expected

Despite challenges like weaker terms of trade and appreciation of the real exchange rate, Colombia's current account deficit narrowed significantly in 2023 to 2.7% of GDP, down from 6.2% in 2022, according to the IMF. This improvement was primarily due to import compression resulting from tight monetary and fiscal policies. However, the Colombian central bank projects a widening of the deficit to 3.1% in 2024, driven by anticipated increases in imports and lower export prices for commodities like coffee and coal. According to the IMF, expectations are for the deficit to gradually converge to its medium-term average of around 3.75% of GDP, supported by robust foreign direct investment.

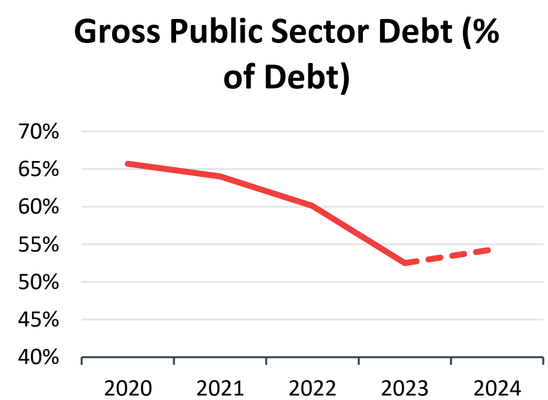


High Levels of Gross International Reserves have been Accumulated, Well Above the FCL Threshold

As of the end of 2023, Colombia’s Gross International Reserves (GIR) were reported at US$59.1 billion, up from US$56.7 billion at the end of 2022, comfortably meeting standard reserve coverage indicators and aligning with the median of Flexible Credit Line (FCL) peers, according to the IMF's May 2024 Country Report on Colombia. Over the period from 2021 to 2023, Colombia’s GIR holdings averaged 127%% of the ARA metric excluding the commodity buffer and 113% including it, both well above the FCL threshold of 100%. As of March 15, 2024, reserve accumulation under a central bank plan to gradually accumulate reserves reached US$424 million, with a target of up to US$1.5 billion over the next two years. In response to combined shocks to the current and financial accounts, the IMF projects that GIR could fall by US$13.7 billion, covering almost two-thirds of the balance of payments shock, and settling at around 100% of the ARA metric, the lower bound of adequacy.

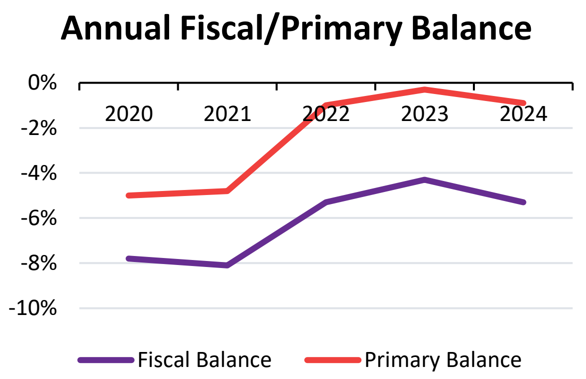
Stable Outlook for Colombia's Public Sector Debt

According to the IMF’s May 2024 Country Report on Colombia, public sector debt is projected to stabilize around 55%% of GDP over the medium-term. This outlook is supported by Colombia's sound and strong fiscal framework, which includes a structural balance rule, a medium-term debt anchor, and a debt ceiling. In 2023, the central government (CG) deficit slightly over-performed relative to the fiscal rule limit for the second consecutive year. The debt-to-GDP ratio, which peaked at 66.6%% in 2020, declined to 57.5%% in 2023 and is expected to remain around 56-58%% from 2024 onwards. The IMF assesses that Colombia's public debt is sustainable with a high probability under a wide range of plausible shock scenarios, and the country's favourable debt maturity structure and currency composition help mitigate sustainability risks.



Fiscal Balance Has Improved but At Threat of Slippage

According to the IMF's May 2024 Country Report, Colombia has seen significant improvements in its fiscal balance, with the Combined Public Sector (CPS) overall deficit narrowing to 2.6% of GDP in 2023 from 6.1% in 2022, driven by tax reforms and the elimination of gasoline subsidies. The CG deficit also decreased from 5.3% of GDP in 2022 to 4.3% in 2023, while the primary deficit dropped to 0.3% of GDP in 2023 from 1% in 2022. However, for 2024, the CG deficit is projected to rise to 5.3% and the primary deficit to 0.9%, reflecting economic slowdown and lower oil revenues, but these are consistent with the fiscal rule allowing temporary deficit increases. S&P's outlook indicates concerns over low economic growth potentially leading to fiscal slippage, though the overall fiscal policy stance remains contractionary with a commitment to the fiscal rule. Public debt, which stood at 52.8% of GDP in 2023, is expected to increase to 57% of GDP in 2024 but is projected to resume its downward trend by 2025.



CREDIT RATING

Standard & Poor's (S&P): BB+/Negative

S&P Global Ratings has revised Colombia's outlook from stable to negative while affirming its 'BB+/B' foreign currency sovereign credit ratings. Despite a rapid recovery from the pandemic recession, private investment in Colombia remains low, potentially hindering long-term economic growth. The negative outlook reflects concerns that weak investor confidence could prevent GDP growth from returning to the expected rate of just above 3%, posing risks of fiscal slippage and higher external vulnerabilities. The government anticipates slow GDP growth due to weak domestic demand and ongoing political challenges. However, Colombia's stable democracy and predictable economic policies, alongside efforts to manage inflation and maintain fiscal stability, support the current ratings. The country's high external debt limited fiscal flexibility, and reliance on hydrocarbon exports remain constraints. Future rating actions will depend on economic growth, fiscal measures, and the ability to reduce external vulnerabilities.

COMPARABLES ANALYSIS

When contrasted with peers possessing a similar S&P credit rating, the coupon and yield of Colombia 37 bond was found to be higher than the average of those peers. Additionally, Colombia historically has not defaulted on any of its debts, however it should be noted that this is primarily because the government was able to reschedule its debt on four different occasions during the Latin American debt crisis of the 1980s. Also, the Republic of Colombia bond has a bullet feature, potentially increasing risks associated with principal repayment, unlike Paraguay's 36's and Trinidad & Tobago's 34's, which follow a callable and/or sink structure.

Issuer	Indicative Yld to Mty (Ask)	Price	Coupon	S&P Rating	Maturity	Currency	Maturity Type
Colombia	7.582	98.273	7.375	BB+	9/18/2037	USD	Bullet
Colombia	7.481	103.909	8.000	BB+	11/14/2035	USD	Callable
Paraguay	5.810	101.579	6.00	BB+	02/09/2036	USD	Call/Sink
Trinidad & Tobago	6.404	99.968	6.40	BB+	06/36/2034	USD	Callable
Morrocco	6.541	88.943	5.500	BB+	12/11/2042	USD	Bullet
Average	**6.7636**	**98.53**	**6.655**				

Source: Bloomberg (As of July 9, 2024)

INVESTMENT POSITIVES

1. The coupon and yield of the Colombia 37 bond are higher than the average of its peers with a similar S&P credit rating.
2. The price of the Colombia bond is cheaper than most of its comparables.
3. Colombia's GDP growth is expected to reach the target rate of 3% by 2025.
4. The country benefits from a stable democracy and predictable economic policies.
5. High levels of gross international reserves comfortably meet standard reserve coverage indicators.
6. High inflation rates have fallen significantly, and although still outside the target range, are projected to reach the target range in the medium-term.
7. The medium–term outlook for public debt levels is stable.
8. There has been an improvement in fiscal balance levels.

INVESTMENT NEGATIVES

1. Colombia experienced a sharp slowdown in GDP growth in 2023, with the economy growing modestly by only 0.6%.
2. The central government deficit is projected to rise in 2024, reflecting economic slowdown and lower oil revenues.
3. Weak investor sentiment and global tensions threaten GDP growth and fiscal stability.
4. High external debt limits fiscal flexibility and increases vulnerabilities.
5. Heavy reliance on hydrocarbon exports makes the economy vulnerable to price fluctuations.
6. Low levels of private investment in the Colombian economy could hinder long-term growth.

Conclusion

Over the past two years, Colombia has achieved notable recovery in its macroeconomic environment from the severe impact of the Covid-19 pandemic through the utilization of tight monetary policies, resulting in stabilized public debt, inflation slowing at a quicker rate than anticipated, high levels of gross international reserves and improved fiscal balance levels. Additionally, the country has maintained a stable democracy and monetary policies. These are all factors which reflect positively on the country's ability to manage its debt obligations. Despite these positive achievements, Colombia's economy is still at risk of regressing due to low private investment, weak investor sentiment, increased global tensions, and high external debt levels, hindering financial flexibility and the government's ability to respond effectively to exogenous shocks, natural disasters, and economic challenges. Notwithstanding, we view the risks as being more balanced since the days of the Covid-19 pandemic (2020 – 2022).

In comparison to bonds of a similar S&P credit rating of BB+ with a similar maturity (2034 to 2042), the coupon rate and yield on COLOM 37's are higher than the peer average and the price is lower than peer average. However, COLOM 37's bond is a bullet maturity type, which puts it at a higher risk of defaulting on its principal repayment, unlike COLOM's 35, PARAG's 36, and T&T's 34, which come with callable and/or sink features. These factors likely justify the lower price and higher coupon rate of the COLOM 37's bond. We therefore view Colombia bonds as fairly priced given the risk relative to comparable. Due to high YTM and relatively cheap bond price but low speculative grade S&P credit rating with a negative economic outlook, heavy debt burden, and fiscal deficit, we believe the Colombia 37 bond is suitable OVERWEIGHT investment option for persons with an AGGRESSIVE risk appetite and a MARKETWEIGHT investment option for persons with a MODERATE risk appetite.

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SOURCES

Bloomberg, IMF, World Bank, Bank of the Republic, Standard & Poor's (S&P).

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DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.