FITCH DOWNGRADES BOLIVIA'S IDRS TO 'BB-'; OUTLOOK STABLE

Fitch Ratings-New York-13 July 2016: Fitch Ratings has downgraded Bolivia's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BB-' from 'BB'. The Rating Outlook is Stable. The issue ratings on Bolivia's senior unsecured Foreign and Local Currency bonds have also been downgraded to 'BB-' from 'BB'. The Country Ceiling has been downgraded to 'BB-' from 'BB' and the Short-Term Foreign Currency IDR is affirmed at 'B'.

KEY RATING DRIVERS

The downgrade of Bolivia's IDRs reflects the following key rating drivers:

The weaker gas price outlook and the government's policy response have resulted in large "twin deficits" in Bolivia. Sizeable fiscal and external buffers offer policy flexibility to accommodate the external shock, but they are likely to continue to decline at a rapid pace, as an ambitious state-led development plan focusing on sustaining growth and diversifying the economy unveiled this year envisions fiscal and external deficits rising further.

Public finances face a revenue shock as gas prices have fallen below levels expected a year ago. The non-financial public sector deficit jumped to 6.9% of GDP in 2015 from 3.4% in 2014, above the official mid-year forecast of 4.1%. The general government deficit rose to 4.5% of GDP in 2015, above Fitch's previous estimates. Current spending also increased (driven by salaries) but was partly offset by lower capital spending. In line with official projections, Fitch expects the general government deficit will rise further to an average 6% of GDP in 2016-2018, significantly above the 'BB' median of 3.8%, as capital spending on development projects ramps up and current spending pressures persist.

Fitch expects deficits will be financed in part by drawdown of sizeable deposit holdings, as observed in 2015, but projects higher borrowing needs will lift general government debt from 35% of GDP in 2015 to 46% of GDP by 2018, converging with the 'BB' median and around 10pp higher than forecast last year. These projections include government guarantees on loans to state-owned companies, which totalled 4.7% of GDP at end-2015.

The current account balance swung sharply negative in 2015 (6.6% of GDP) after 12 years of surpluses. Fitch projects the CAD will average 7.5% of GDP in 2016-2018, well above the 'BB' median of 1.6%, partly reflecting higher capital imports related to public development projects. Foreign direct investment flows have fallen to relatively low levels as weaker profits among energy companies have cut into reinvested earnings. The authorities have remained committed to the stable XR regime as an anchor for containing inflation and advancing de-dollarization. The boliviano is estimated to be materially stronger than its 10-year average in real effective terms, posing a challenge to competitiveness and external adjustment.

Reserve levels remain the highest in the 'BB' category at 33% of GDP (USD11.6 billion) as of mid-2016, but are declining at a rapid pace on reduced FX inflows and expansive fiscal policy. Reserves fell by USD2 billion in 2015 and by nearly USD1.5 billion in the first half of 2016. The sovereign's strong net external creditor position (73% of CXR in 2015) is expected to deteriorate in the forecast period as reserves fall and external indebtedness rises.

The state-led growth model sustained firm growth of 4.8% in 2015, above regional and 'BB' peers, but has not prompted crowding-in of private investment, which fell in nominal terms in 2015. Expansive policies (fiscal, monetary and quasi-fiscal central bank lending to SOEs) and the stable exchange-rate regime could become more difficult to sustain given the current pace of erosion of buffers. In Fitch's view, it is likely that a second referendum to allow President Evo Morales to seek re-election for a fourth term may be introduced after such a referendum failed in February, which could increase political incentives to use buffers in support of growth.

The Stable Outlook on Bolivia's 'BB-' ratings reflects its strong fiscal and external balance sheets, which are projected to deteriorate during the forecast period but will likely remain within the tolerance range of the 'BB-' rating. Favourable and stable growth rates also support the current rating. The ratings are constrained by Bolivia's low GDP per capita, weak institutional quality and a poor business environment relative to 'BB'-rated sovereigns. High export commodity dependence of 70% of current external receipts is above the 'BB' median of 20%, exposing credit metrics to terms of trade shocks and gas supply shortages.

Gas production should remain stable in the coming years as production at the new Incahuasi field offsets declines at mature fields, fulfilling local demand and export contracts with Brazil and Argentina (notwithstanding some supply cuts to the latter during periods thus far in 2016). The outlook beyond 2019 is less clear in the absence of large new discoveries. To stimulate exploration and production, the authorities passed a hydrocarbon incentives law in late-2015 and have outlined a large USD7.3 billion upstream investment plan for 2016-2020 (21% of GDP).

Macroeconomic stability has been preserved in the context of policy stimulus. Inflation has remained around 3%-5% since early-2015. Lending growth has remained high, fuelled by expansive monetary policies and a 2013 law establishing lending quotas to certain sectors. Fitch's Macro-Prudential Indicator of '3' for Bolivia indicates a potential for financial stress given rapid credit growth and real exchange rate appreciation, but the agency notes that indicators of bank solvency, asset quality and profitability have remained healthy.

SOVEREIGN RATING MODEL (SRM) and QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Bolivia a score equivalent to a rating of 'BB' on the Long-Term Foreign Currency IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final Long-Term Foreign Currency IDR by applying its QO, relative to rated peers, as follows:

--Macroeconomic Performance and Policy Management: -1 notch, to reflect risks to consistency of expansive policies (fiscal, monetary, quasi-fiscal central bank lending) and the stabilised exchange rate amid eroding policy buffers.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three year centred averages, including one year of forecasts, to produce a score equivalent to a Long-Term Foreign Currency IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

RATING SENSITIVITIES
The following risk factors individually, or collectively, could trigger a negative rating action:

--Greater-than-expected deterioration of fiscal and external balance sheets;
--Signs of increased macroeconomic instability or stress in the financial system;
--Evidence of external financing constraints.

The following risk factors individually, or collectively, could trigger a positive rating action:

--Sustained fiscal deficit reduction that improves public debt dynamics;
--Reduction in the current account deficit and improvement in external solvency and liquidity metrics;
--Evidence of improvement in governance and the business climate that supports stronger investment and growth prospects.

KEY ASSUMPTIONS
--Fitch assumes Bolivia will be able to maintain natural gas production around present levels and meet requirements for the local market and export contracts with Argentina and Brazil in 2016-2018.
--Fitch's latest forecasts project Brent oil prices (a benchmark for Bolivia's energy contracts) will average USD35/barrel in 2016, USD45 in 2017, and USD55 in 2018.

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Applicable Criteria
Country Ceilings (pub. 20 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869287
Sovereign Rating Criteria (pub. 26 May 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=881782

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