Markit Recap – Fed boosts Latam credit

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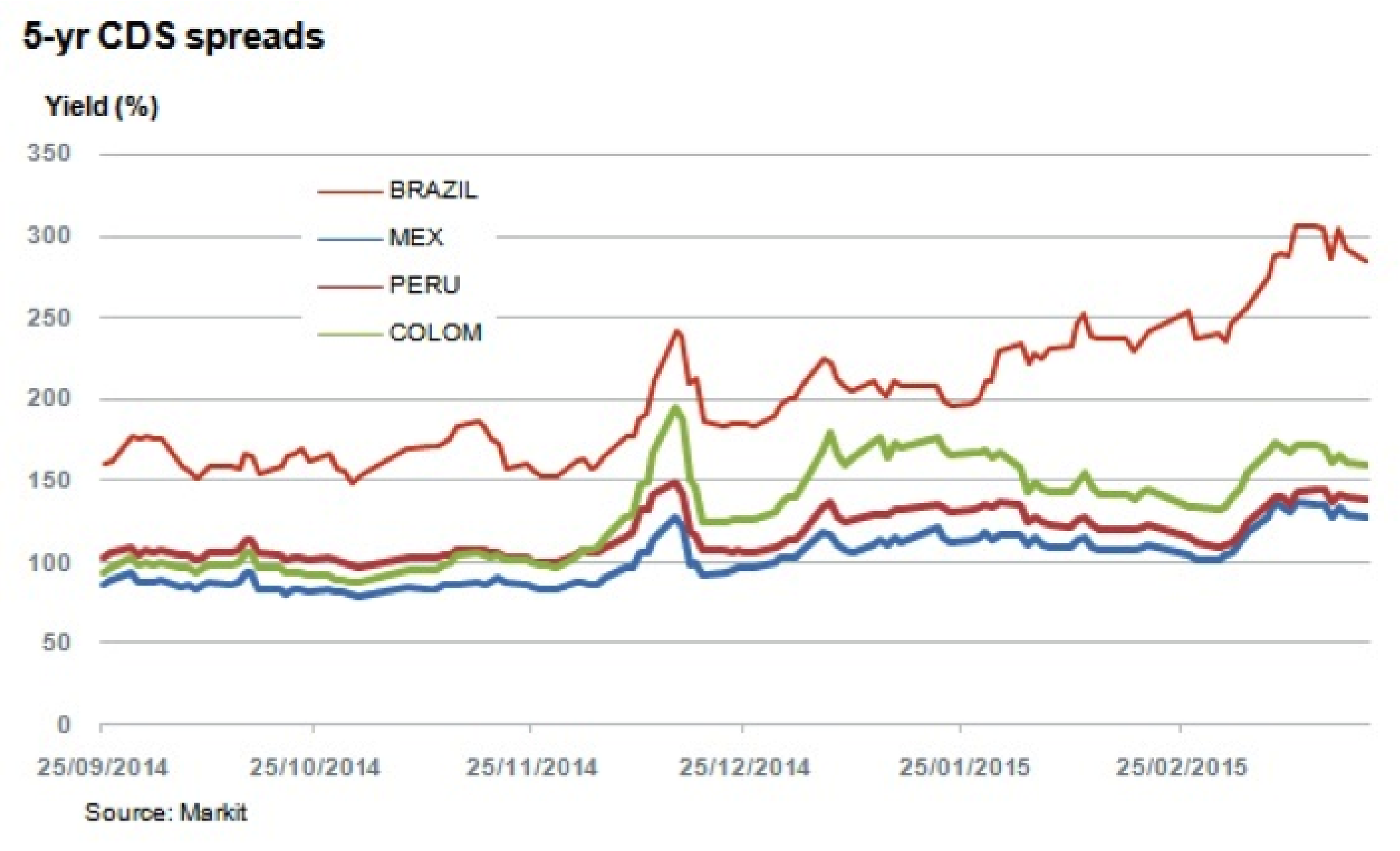
The bearish sentiment around Latin American credits was reversed last week as the US Federal Reserve signalled a more cautious economic outlook and subsequent slower path for monetary tightening. Vast quantities of emerging market debt, like that in Latin America, are denominated in US dollar. The dovish tone emanating from the Fed was welcomed by market participants' heightened expectations of a prolonged environment of low borrowing costs.



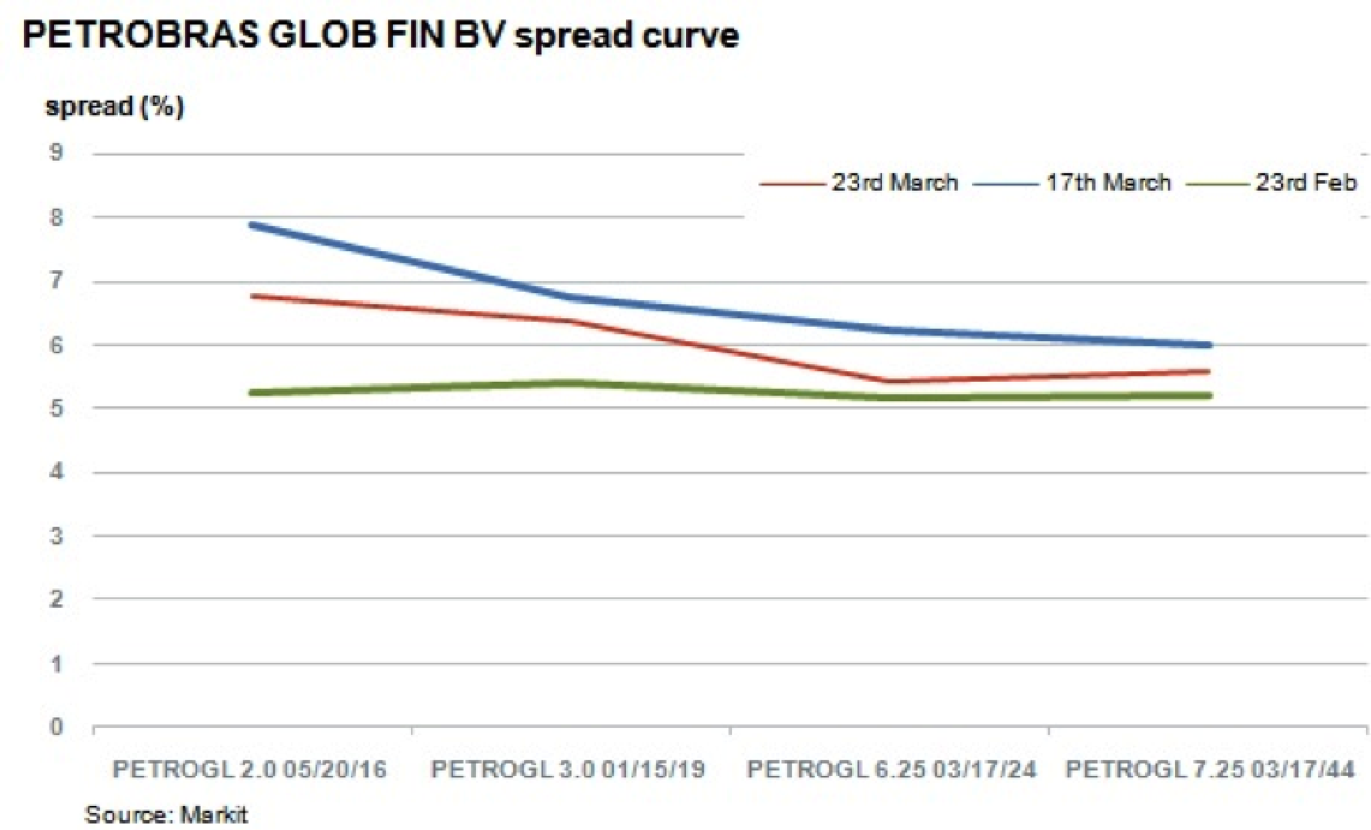
Credit markets were first to react positively to these developments, as evidenced by the falling cost of insuring Latam government bonds against default.

Over the last couple of months, Brazilian bonds CDSs were initially set apart from the rest of the Latam sovereign pack. This was the back on the increasingly negative fallout from the Petrobras corruption scandal. In fact Colombian and Mexican CDS spreads tightened 25bps and 15bps in February while Brazil traded 4bps wider. But the continuing weakness in oil prices and the strengthening of the US dollar saw the entire Latin American universe trade wider in early March.

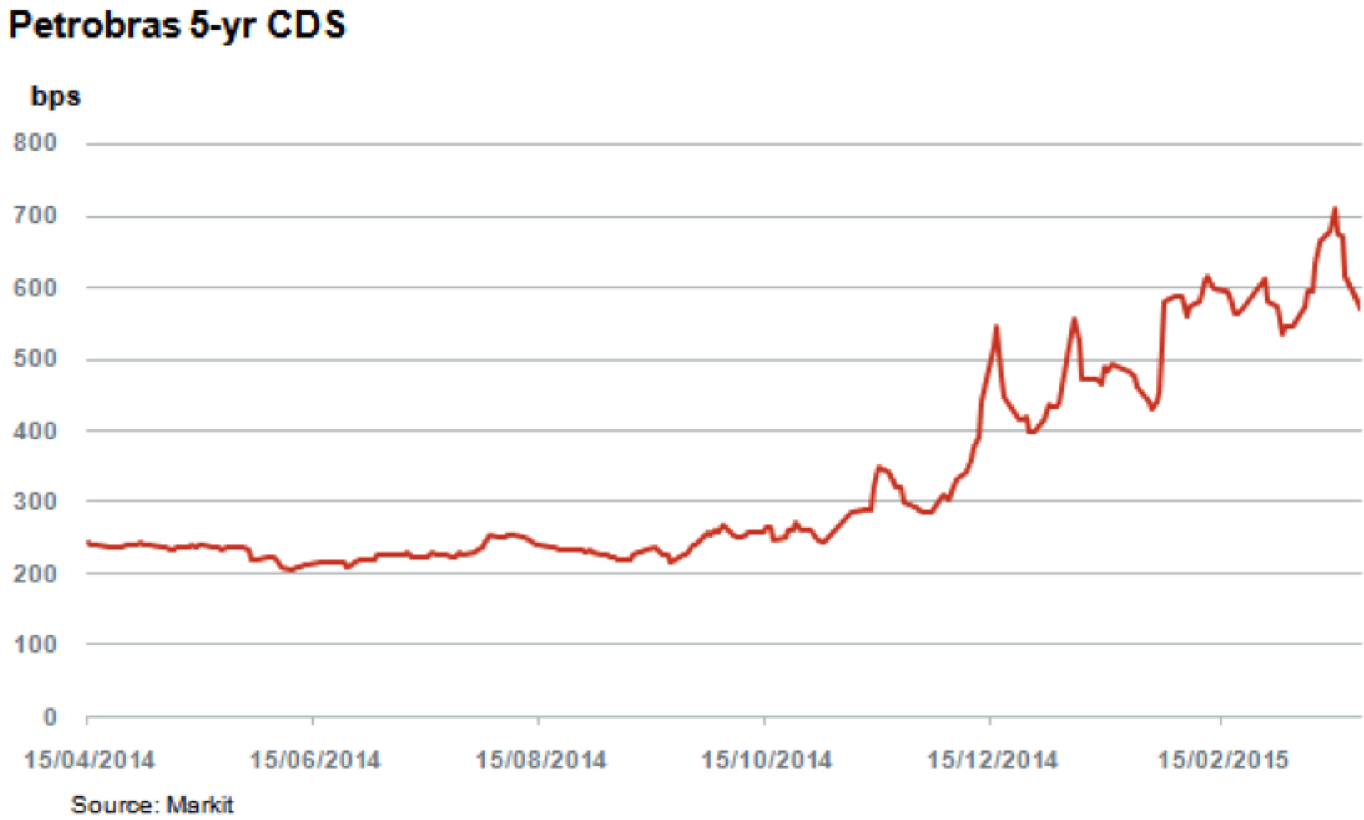
Following the FOMC meeting, Brazilian 5-yr CDS spreads tightened 18bps to 286bps, accompanied by Mexican and Colombian sovereign spreads which tightened by 15bps and 7bps respectively.

The cash markets also reacted positively to the FOMC developments. Peru's recently tapped 2050 bond, gained 3.75 points on the back of the Fed's comments, according to Markit bond pricing. It is worth noting that Peru's 5-Yr CDS spread remains near a 52 week high.

The improved credit outlook off the back of the FOMC meeting has also lifted the mood in corporate credit.



The Fed's actions allowed Petrobras to regain some lost ground following the recent corruption as the company saw spreads on its US dollar denominated bonds recover. The short end of the yield curve tightened over 100bps; the long end, as gauged by the 7.25% 2044 bond, saw its spread over treasuries decrease by 40bps. However, the curve remains inverted – a sign of distress.



It was a similar story in CDS with 5-yr spreads tightening just under 100bps last week, from all-time highs of 711bps. The knock on effects were also felt by other Latam state owned oil companies, with Pemex in Mexico, which saw its CDS spread fall from 202bps to 190bps and even non related credits such as Food & Beverages company BRF, and steel firm Gerdau.

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