Colombia: Fitch downgrades sovereign credit rating as fiscal challenges could persist beyond 2026 elections

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Yesterday, Fitch Ratings downgraded Colombia's sovereign credit rating. The Long-Term Foreign Currency rating was lowered from **BB+ to BB**, while the Outlook improved from **"Negative" to "Stable."** Fitch views Colombia's debt dynamics as challenging, given that the economy continues to run large fiscal deficits. At the same time, Fitch believes that the difficulties in increasing fiscal revenues will persist even after the 2026 elections.

Fitch is the second of the three main credit rating agencies to downgrade Colombia's rating to BB, joining the level set by S&P in June 2025. The difference is that Fitch's outlook is "Stable," whereas S&P's remains "Negative." At DAVIbank Economics, this move was somewhat expected, as Fitch's last statement came before the release of the Medium-Term Fiscal Framework (MTFF-2025). In various forums, Fitch had expressed concerns about the suspension of the fiscal rule and the forecast of high fiscal deficits presented in the MTFF-2025.

Changing the outlook to "Stable" is relatively positive news, as it reduces the likelihood of further downgrades in the coming months and could help avoid additional uncertainty during the electoral period. However, the current rating assessment is a wake-up call for the next government and Congress, as the deterioration of public finances—especially the primary deficit—has resulted in persistently high debt costs, which are harmful to the country. Fitch emphasizes that factors that could move Colombia's rating up or down include debt dynamics, which strongly depend on policies aimed at reducing the deficit.

All in all, yesterday's downgrade pushes even further away the possibility of regaining the investment grade lost in 2021. Today, market reaction was negative, with the COLTES curve widening between 8 and 14 bps. However, we cannot attribute the full impact to the downgrade, as there were also announcements from government officials suggesting that the increase in the minimum wage could exceed 12%. In the FX market**, the USDCOP depreciated to 3,867 pesos (+0.638%).** In our opinion, recent market movements are also related to clearer pricing of fiscal risk, as the Ministry of Finance shifts from its role as a net buyer in the COLTES curve to one focused on reducing next year's maturities, while facing strong liquidity requirements compared to the market's capacity to provide during this time of year.

Key Highlights from Fitch's Statement

1. **Temporary Impact of Liability Management Operations**
   Fitch recognizes that liability management operations have only a temporary effect, while the structural outlook remains challenging. For 2025, **Fitch projects a deficit of 6.5% of GDP**, which includes a reduction in **interest payments from 4.7% to 3.6% of GDP**. However, this also reflects a **wider primary deficit of 2.9% of GDP**, compared to the previous estimate of **2.4% of GDP**. At DAVIbank Economics, we agree that although liability management operations achieve some efficiencies, the structural issues of inflexible spending and insufficient revenues must be addressed through agreements with Congress. Our projection for 2025 is a fiscal deficit of 6,5% of GDP with a primary deficit of 2.9% of GDP.

2. **Fiscal Adjustment: Neither Predictable nor Credible**
   Fitch highlighted that the suspension of the fiscal rule is inconsistent with fiscal adjustment and macroeconomic stability. Additionally, the rejection of the Fiscal Reform for 2026 opens a new funding gap that could push next year's deficit to **7.5% of GDP**, raising the debt burden to **62.8% of GDP**. This is a strong warning signal, indicating that future policies should focus on restoring credibility in Colombia's public finances. Let's see if we can have more clear policy proposals in that front during the presidential campaign.

3. **Economic Activity and Inflation**
   Fitch projects a modest acceleration in GDP growth—from **2.7% in 2025 to 2.9% in 2026**—driven by improved consumption. However, investment remains at historically low levels (**17% of GDP**). On the inflation front, Fitch expects persistent price pressures, with inflation closing at **4.5% in 2026**, prompting the central bank to hike the policy rate by **100 bps** next year. **At DAVIbank Economics, we do not favor the possibility of rate hikes, as this scenario would require a significant structural shift in the inflation trend, something that requires shocks that currently can't be fully anticipated.**

4. **External Sector**
   Fitch is not significantly concerned about external accounts, noting that

financing of the current account deficit still relies mainly on FDI. They project a deficit of **2.9% of GDP** by the end of 2026. Regarding international reserves, Fitch highlighted that current levels of **USD 64 billion** cover nearly seven months of current account payments. At DAVIbank Economics, however, we are concerned that the relatively small current account deficit is increasingly being financed through public indebtedness.

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