

# REPORT ON THE LATIN AMERICAN ECONOMY

Inflation slowing, monetary tightening on hold and fiscal  
vulnerabilities

International Economics and Euro Area  
Department

BANCO DE **ESPAÑA**  
Eurosistema

First half of  
2023



## Editorial

Economic activity in Latin America remains more buoyant than expected some months ago. This is despite monetary policy tightening, the withdrawal of some fiscal stimulus measures and the loss of purchasing power owing to persistently high inflation, although this loss has been partly mitigated by the good performance of the region's labour markets.

Despite this greater than expected resilience, economic growth forecasts for 2023 (which are significantly lower than for 2022) have been revised up just a few percentage points. This suggests that weak economic momentum is still expected for the second half of 2023 and for 2024. One of the reasons for this is that Latin America is expected to face a rather more adverse international environment, with slightly lower growth worldwide and a drop in energy and food commodity prices (which are, however, still above their historical average), considering that several of the region's economies are net exporters of these commodities. Moreover, the picture is also shrouded in uncertainty and the medium-term outlook is discouraging, given the potential growth rates calculated by various international institutions for the region.

Inflation in Latin America has continued to moderate overall, standing at 6% year-on-year in May, 4.2 percentage points off its June 2022 peak. Yet the pattern is uneven across the region and there are no clear signs of services inflation heading down. Inflation is expected to continue to decline gradually in the coming quarters, to reach the inflation target ranges of the region's main inflation-targeting central banks by end-2024. In addition, long-term inflation expectations remain anchored around the inflation targets and bear little relation to past inflation.

The region's clearly restrictive monetary policy stance appears to be warranted, according to standard monetary policy rules, in view of the present inflationary episode. Despite the high policy interest rates, the financial markets are factoring in a slow and feeble cycle of monetary easing in Latin America. Yet monetary policy developments in the region will largely depend on how monetary policy evolves in the main advanced economies, especially in the United States.

During the first half of 2023, financial conditions in Latin America held quite steady, despite the financial stress episodes witnessed in the US and Swiss banking systems. Indeed, the region's financial markets outperformed those of other emerging market economies, given the positive performance of factors that have historically had more impact on the Latin American markets, such as the reopening of China when it ended its zero-COVID policy, the better economic data in the United States, the favourable carry-trade<sup>1</sup> in the countries of the region and commodity prices that are still high in historical terms. However, the uncertainty surrounding economic policies and the social and political unrest in the region has remained high overall in recent quarters.

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<sup>1</sup> The difference between the cost of borrowing in a low-interest rate currency and investing in financial assets in a high-interest rate currency, in this case the Latin American currencies.

The public debt-to-GDP ratio fell slightly in 2022, owing to the strong economic growth, high inflation and the withdrawal of fiscal stimulus measures. But it is still high, in historical terms and compared with other emerging market economies. In this regard, the region's chief vulnerabilities remain concentrated in public finances. For instance, the likelihood of the public debt-to-GDP ratio remaining above its pre-pandemic level over a ten-year horizon has increased significantly for some countries, such as Colombia.

This report includes two boxes. Box 1, in collaboration with the SECMCA,<sup>2</sup> offers an overview of the key monetary policy developments in Central America and the Dominican Republic (where some countries have embarked on policy rate cuts) and of the banking system (where lending has remained strong, despite both local and global financial conditions having tightened in previous quarters). Box 2 sets out the recent developments in the Latin American banking systems that are of material significance to the Spanish banking system. In this respect it highlights that the profitability indicators of the region's banking systems show no significant signs of worsening (despite the widespread slowdown in lending to the private sector and the increase in non-performing loans) and that capital levels have held steady above the regulatory minimum. In addition to the common risks analysed in this report, the box also highlights the main country-specific risks to financial stability in Latin America, according to the regular financial stability reports published by the region's central banks for the first half of 2023. Compared with the previous half-year, two points stand out: the increase in credit risk, associated with the worsening of the financial position of households and some firms; and the decrease in exchange rate risk.

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2 Secretaría Ejecutiva del Consejo Monetario Centroamericano.

## Report

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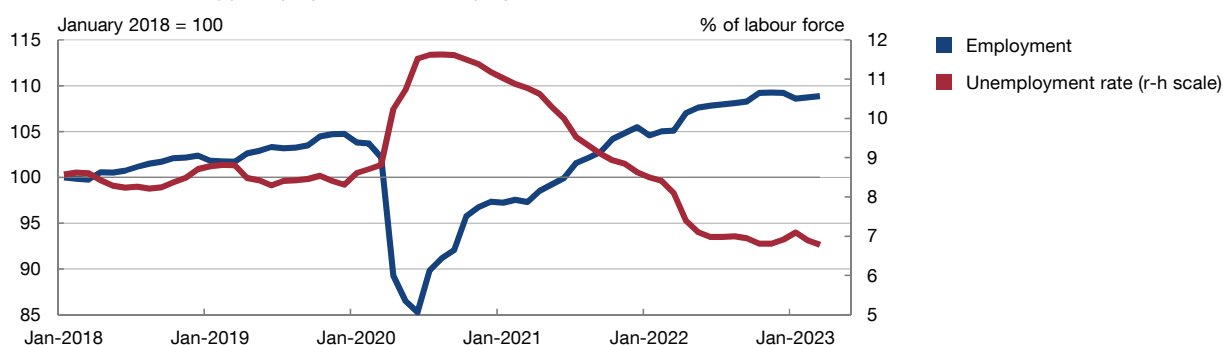
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## 1 Economic activity in Latin America remains more buoyant than expected...

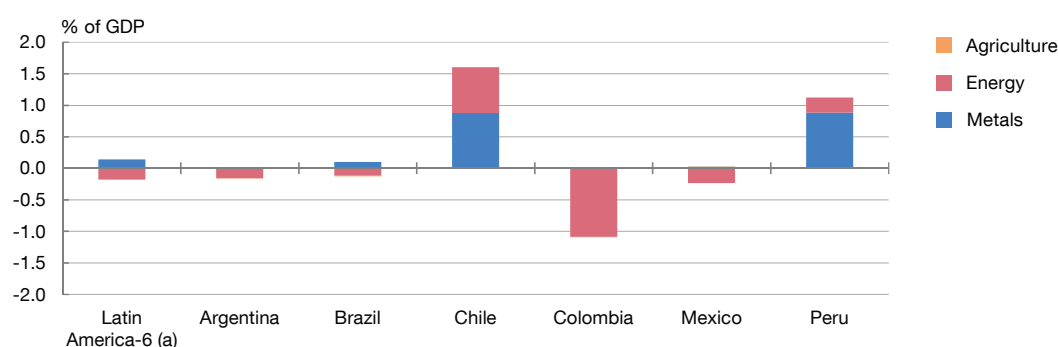
- As in 2022, GDP growth in the main Latin American economies surprised on the upside in 2023 Q1, with a quarterly growth rate in the period of 1.2%, compared with the analysts' forecast of 0% at the start of the year. Growth was uneven across the region (see Table 1), with strong momentum in Brazil, owing to the contribution of the agricultural sector, and economic contraction in Peru, temporarily weighed down by the disruption associated with the social unrest.
- One factor behind the resilience of economic activity in recent quarters is the good labour market performance. In March the number of persons employed was 5% higher than the pre-pandemic figure, while the unemployment rate continued to decline, down to 6.8% in March compared with an average of 8.5% in 2019 (see Chart 1.a).
- In the first half of 2023, commodity price developments compared with the previous half-year had a positive impact on the trade balances of countries that export metals and an adverse impact on the trade balances of those that export oil. This also partly explains the uneven growth observed across countries in the first half of the year (see Chart 1.b).

Chart 1

### 1.a Latin America-6 (a). Employment and unemployment rate



### 1.b Effects of commodity price developments on the trade balance in 2023 H1 (b)



SOURCES: Refinitiv and Consensus Forecasts.

- a Aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru, weighted by GDP in PPP (purchasing power parity) terms.
- b The shock depicted is calculated using average trade, for each of the three commodity aggregates, between 2015 and 2018. Two price indices are applied: one for 2022 H2 and another for 2023 H1 (up to 21 June). The difference is represented as a percentage of GDP. For the commodity prices: in the case of Argentina and Brazil, soybean prices are taken as the price for agriculture and aggregate prices (Dow Jones) for metals and energy; in the case of Chile and Peru, copper prices are taken as the price for metals and aggregate prices for agriculture and energy; and in the case of Colombia and Mexico, oil prices are taken as the price of energy and aggregate prices for agriculture and metals.

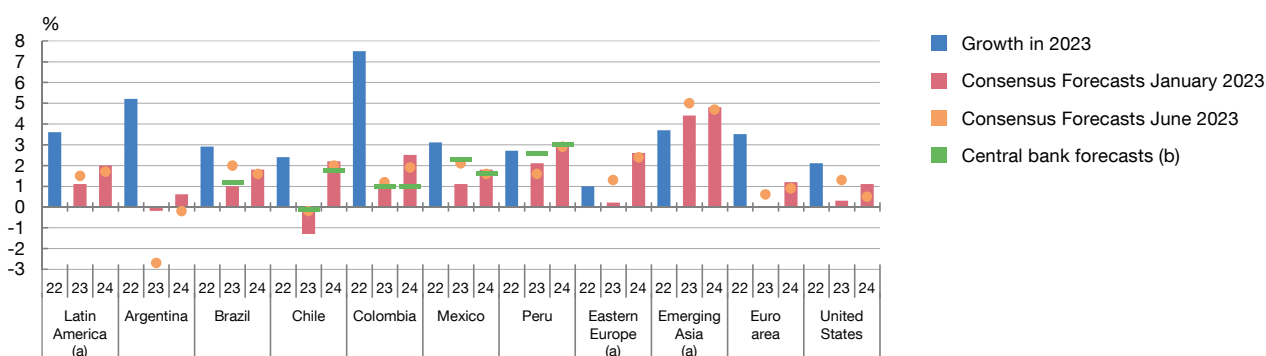


## 2 ... although a significant slowdown is anticipated in the coming quarters...

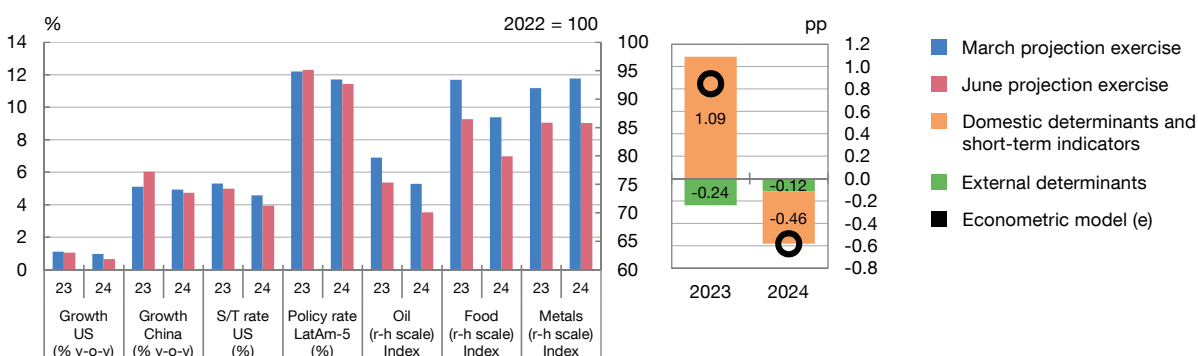
- The latest analyst consensus forecast for 2023 continues to expect a sharp slowdown in activity, with growth of 1.5% for Latin America overall, compared with 3.6% in 2022 (see Chart 2.a). This growth rate for the region is similar to that forecast for eastern Europe (1.5%), affected by the war in Ukraine, higher than that projected for the main developed countries (the United States and the euro area) but lower than the outlook for emerging Asia (4.4%). Growth is expected to accelerate slightly – to 1.7% – in 2024.
- Compared with the start of the year, the outlook for Latin America has been revised up for 2023, but down slightly for 2024. The less favourable global environment and lower expected prices (measured by futures) for key commodities on the international markets dilute the expected growth and are only partially offset by the somewhat less restrictive monetary policy now anticipated in the United States and across Latin America compared with the expectations six months ago (see Chart 2.b).

Chart 2

2.a GDP growth forecasts for 2023 and 2024



2.b Determinants of the revised growth outlook for Latin America-5 (c, d)



**SOURCES:** Refinitiv, LatinFocus Consensus and ECB.

**a** Consensus Forecasts, Latin America, eastern Europe and Asia (excl. Japan) aggregates.

**b** Brazil, March 2023; Chile, June 2023; Colombia, April 2023; Mexico, May 2023; Peru, March 2023.

**c** Brazil, Chile, Colombia, Mexico and Peru.

**d** The other values in the chart are those habitually used in the Eurosystem joint projection exercises.

**e** An autoregressive vector model is used for the Latin America-5 aggregate. This model includes GDP, inflation, the average policy rate, the EMBI, US and Chinese GDP, oil, food and metal prices and the US 3-month interest rate. The model is estimated using Bayesian methods and quarterly data for the period 2000-2019. Two projections are made, one for each cut-off date, and the difference in annual growth is reported, together with the contribution that the external and domestic variables make to that difference.

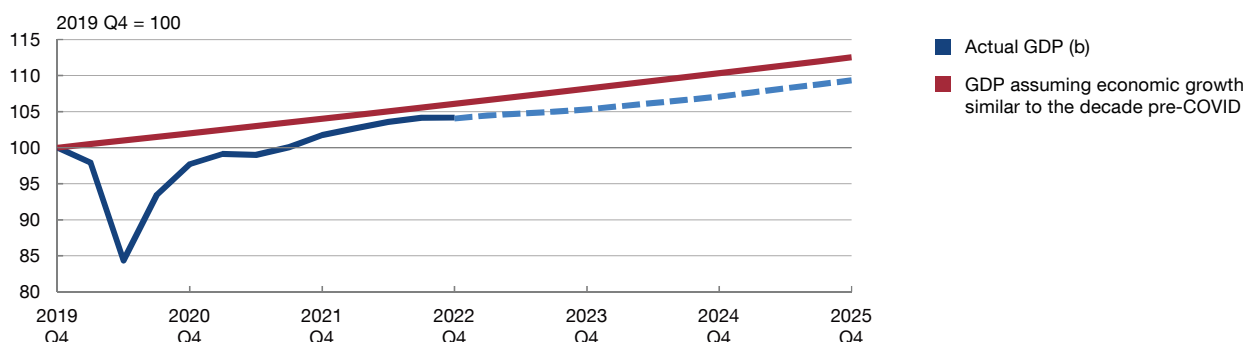


### 3 ... against a backdrop of low potential growth and high uncertainty

- At-end 2022, the aggregate GDP of the main economies of the region was 4% above its pre-pandemic level, although very uneven across countries. Further, it was 2% lower than would have been the case had economic growth in those three pandemic years equalled that observed in the decade 2010-2019, which was, moreover, low in historical terms (2%). If the forecasts are met, by end-2025 the gap between GDP and potential GDP will have widened to 3%, given the lacklustre economic activity expected for 2023 and 2024, followed by growth in line with the potential for the region<sup>1</sup> in 2025 (around 2.25%) (see Chart 3.a).
- A decomposition of GDP growth in Latin America over the last four decades shows that, when compared with other emerging regions: (i) capital makes a lower contribution, owing to lower investment rates; (ii) labour input makes a lower contribution, because the demographic dividend is coming to an end, public spending on education yields low returns and informal employment is high; and (iii) the contribution of total factor productivity has been negative on average since 1970 (low productivity is explained by a series of structural obstacles, such as low public expenditure on infrastructure, low institutional quality and limited regional integration).<sup>2</sup>
- However, the present setting of global geopolitical fragmentation could be beneficial for the potential GDP of some countries in the region, which could in some cases benefit from “friendshoring” (when countries invest in and trade with others with lower geopolitical risks), and also because the region’s geopolitically neutral stance and its abundant supply of strategic raw materials could help boost trade with the other main geopolitical blocs.

Chart 3

3.a Latin America-6 (a). GDP growth: actual versus simulated assuming economic growth similar to the decade pre-COVID



SOURCES: Refinitiv and IMF.

a Weighted aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru.

b The broken lines denote WEO estimates (IMF, April 2023) for the aggregate of the six countries considered.



1 Estimated, for instance, by the IMF. (2023). *World Economic Outlook. A Rocky Recovery*, April or *Latin American Consensus Forecasts*, April 2023.

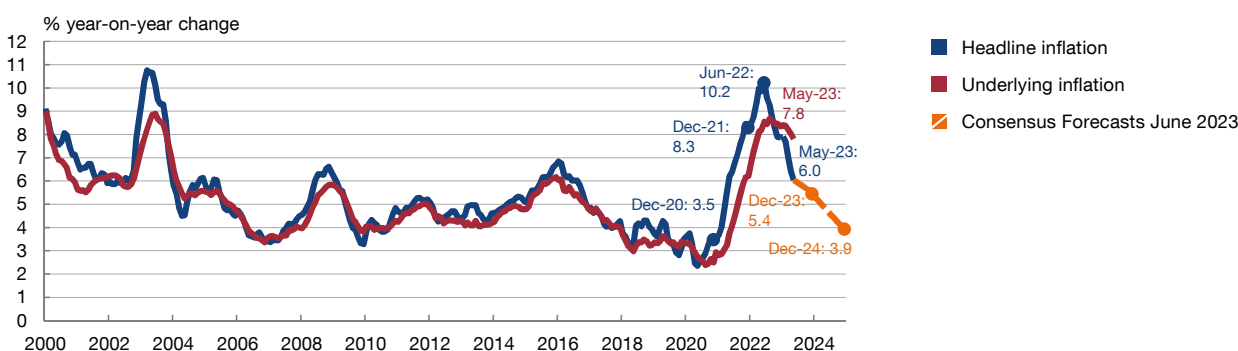
2 For instance, Center for Global Development (2023), “*Latin America’s hard-to-escape stagnation trap*”.

## 4 Inflation has continued to moderate across the region, albeit unevenly across countries and to a lesser extent in the case of underlying inflation

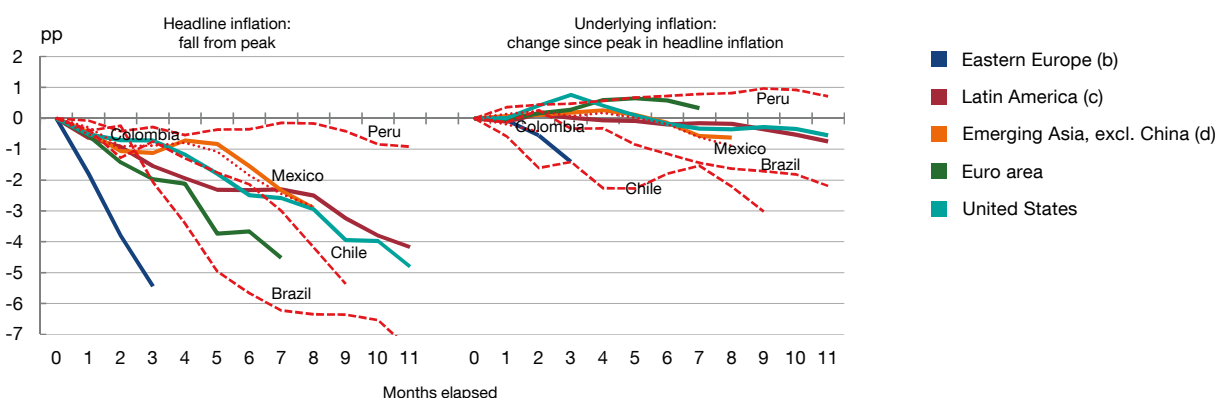
- Inflation has continued to decline in the main economies of Latin America in recent months, standing at 6% in May (see Chart 4.a). This is a cumulative drop of 4.2 percentage points (pp) from the June 2022 year-on-year peak and is broad-based across the region (see Chart 4.b). However, the slowdown in inflation has been considerably uneven across countries, both in terms of when it began (July 2022 in Brazil and Peru, September 2022 in Chile and Mexico and not until April 2023 in Colombia) and the scale of the decline (from 8 pp in Brazil to 0.8 pp in Colombia).
- Underlying inflation began to head down two months later than headline inflation in the region overall, standing at 7.9% in May, 0.8 pp off its August 2022 peak (see Charts 4.a and 4.b). The lag compared with headline inflation was uneven across countries (nine months in Peru and four months in Mexico, whereas there was no lag in Brazil, Chile and Colombia) and the decline has been smaller in all cases, all of which will have an impact on monetary policy normalisation in the coming quarters.

Chart 4

### 4.a Latin America-5. Headline and underlying inflation (a)



### 4.b Inflation: fall from peak



SOURCES: IMF, Refinitiv, Consensus Forecasts and national statistics.

a Aggregate of Brazil, Chile, Colombia, Mexico and Peru, weighted by GDP in PPP terms.

b Aggregate of Poland, Hungary, the Czech Republic, Bulgaria and Romania, weighted by GDP in PPP terms.

c Aggregate of Brazil, Chile, Colombia, Mexico and Peru, weighted by GDP in PPP terms.

d Aggregate of India, Indonesia, Thailand, Malaysia and the Philippines, weighted by GDP in PPP terms.



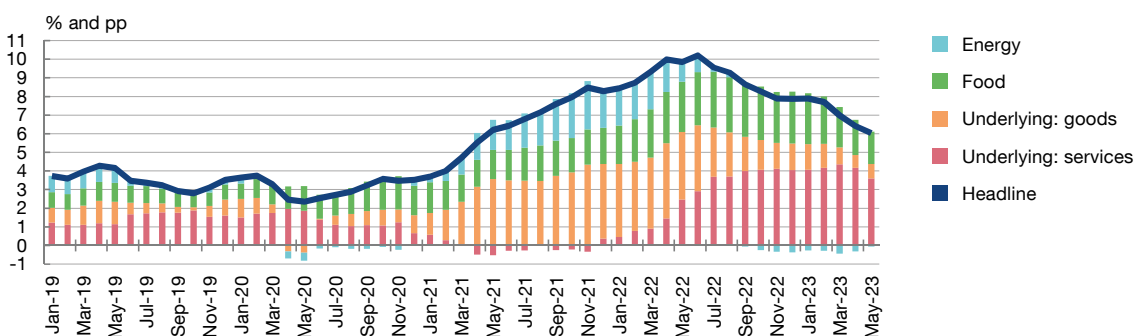


## 5 The downward stickiness of underlying inflation is mainly due to the services component...

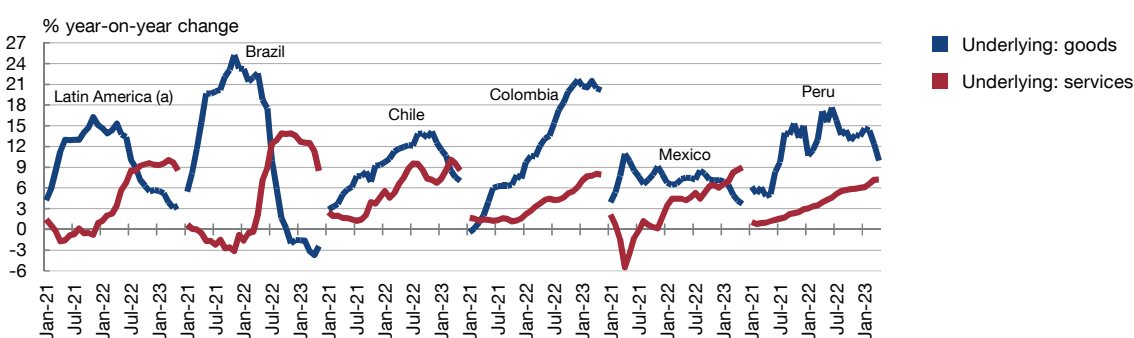
- The fall in the year-on-year inflation rate in the region's main economies from the June 2022 peak to May 2023 (-4.2 pp) can partially be explained by the non-underlying components: energy (-1 pp) and food (-1.1 pp). Nonetheless, these two components have performed very differently (see Chart 5.a): energy has made a negative contribution to headline inflation over the last nine months, whereas food continues to drive up inflation owing to its price momentum (a year-on-year rise of almost 9% in May)<sup>3</sup> and its heavy weighting in the consumption basket (around 25%).
- As regards the underlying inflation components, non-energy goods also saw a sharp decline (making a contribution of -2.8 pp to the fall in headline inflation from June 2022), attributable in part to the unwinding of bottlenecks and currency appreciation. By contrast, services continue to account for a sizeable contribution (60% of total inflation in May 2023) and, overall, there are no signs of any appreciable easing of the pressure on this component (see Chart 5.b).

Chart 5

5.a Latin America: contributions to inflation (a)



5.b Latin America: goods and services inflation (a) (b)



SOURCES: Refinitiv Eikon and national statistics.

- a Aggregate of Brazil, Chile, Colombia, Mexico and Peru.  
 b The services series excludes energy. The goods series excludes food.



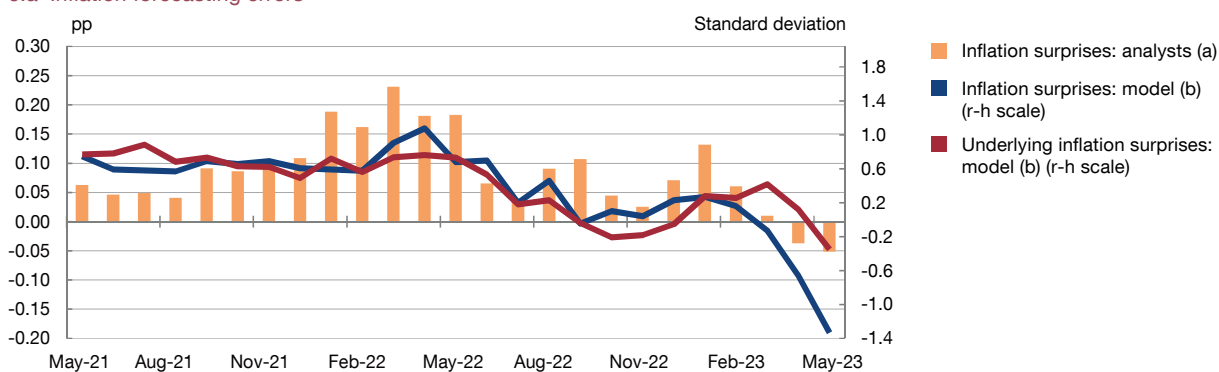
3 See Chart 5.b of the [Report on the Latin American economy. Second half of 2022](#), which details the specific composition of the food basket included in the CPI of several countries in the region.

## 6 ... which has continued to surprise on the upside in recent months

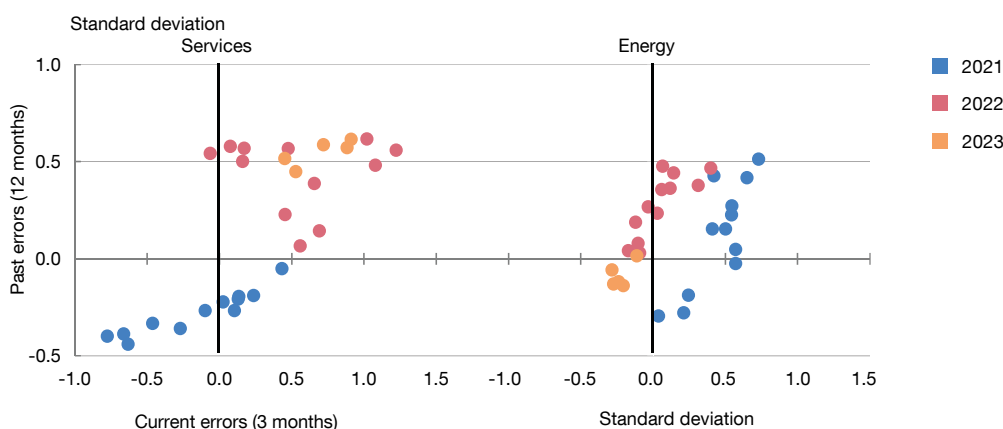
- Headline inflation has surprised analysts on the downside in recent months (see Chart 6.a). Nonetheless, based on an approach using time series models, the underlying inflation signal is less clear, with the year-to-date inflation rates tending to be higher than expected.
- This difference between the surprises in headline and underlying inflation is due mainly to services inflation, where figures have been consistently higher than projected and have not corrected in the most recent months (the forecasting errors over the last three months are higher than over the last 12) (see Chart 6.b, left-hand panel). Conversely, the downward correction of the forecasting errors for the energy component is very clear, with no notable deviations year-to-date (see Chart 6.b, right-hand panel).

Chart 6

### 6.a Inflation forecasting errors



### 6.b Forecasting errors by inflation component according to the model (c)



**SOURCES:** Refinitiv, Trading Economics and national statistics.

- The bars represent the 3-month moving average of the difference between the actual figure and the analysts' consensus forecast (Trading Economics) of monthly inflation (measured by the CPI), for the average of Brazil, Chile, Colombia and Mexico.
- Automatic ARIMA forecasting models are used for the monthly year-on-year inflation series. The lines depict the 3-month moving average for one-month-ahead forecasting errors. All errors have been re-scaled, dividing them by the corresponding standard deviation. Calculated as the average for Brazil, Chile, Mexico, Colombia and Peru.
- Automatic ARIMA forecasting models are used for the monthly year-on-year inflation series. The horizontal axis shows the 3-month moving average for one-month-ahead forecasting errors and the vertical axis shows the 12-month moving average for one-month-ahead forecasting errors. Calculated as the average for Brazil, Chile, Mexico, Colombia and Peru.

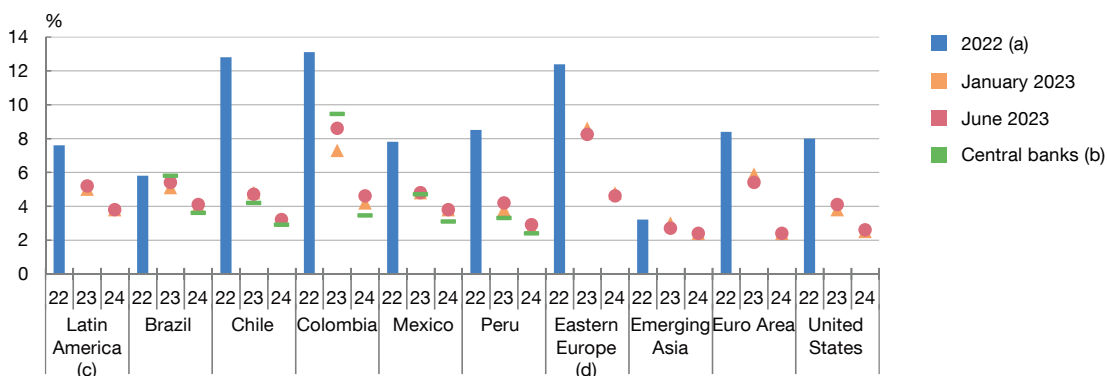


## 7 Inflation is expected to continue declining gradually

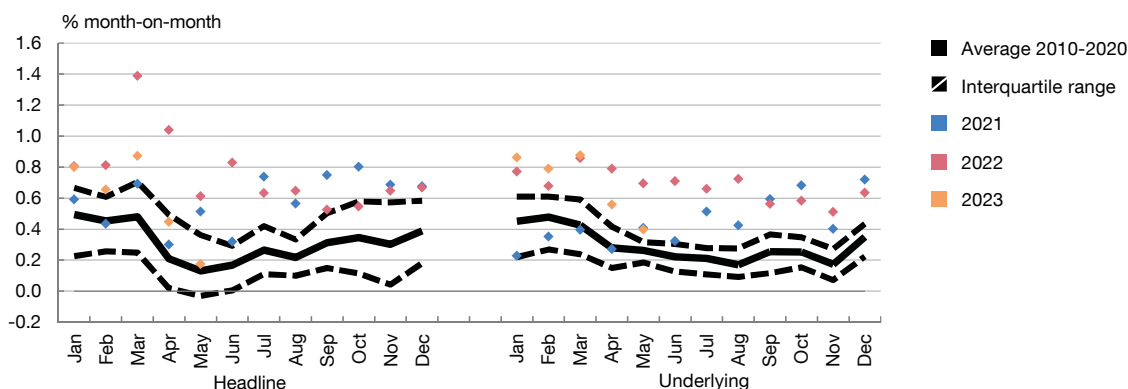
- Analysts expect inflation in the region to stand below 6% at end-2023 (see Chart 7.a). This means that monthly headline inflation rates are expected to be subdued for the remainder of 2023, in line with the historical average, such that a significant negative base effect will still be appreciable (see Chart 7.b).
- In their regular reports, the central banks of the region's main economies detail some of the factors that will lead to a gradual decline in inflation: the asymmetric fall in food inflation as international benchmark prices fall<sup>4</sup> and exchange rates appreciate; the extent to which nominal contracts are indexed; higher than anticipated wage growth; the slower expected pace of domestic demand adjustment; and the recovery in profit margins following the decline seen in previous years.<sup>5</sup>

Chart 7

### 7.a Inflation forecasts



### 7.b Inflation in historical perspective (e)



SOURCES: Consensus Forecasts and Refinitiv.

- Final inflation data for 2022.
- Central bank forecasts published in their latest monetary policy reports.
- Excluding Venezuela and Argentina.
- Includes Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Slovakia and Slovenia, weighted by GDP in PPP terms.
- Monthly rates of inflation (average and interquartile range) for each specific month in the period 2010-2020 and for each year shown, for the five inflation-targeting Latin American countries (Brazil, Mexico, Chile, Colombia and Peru).



4 See, for example, Box 4 “Efecto asimétrico de cambios en los precios internacionales de las materias primas alimenticias sobre los precios al consumidor en México”, in *Informe Trimestral. Julio-Septiembre 2022* of the Banco de México.

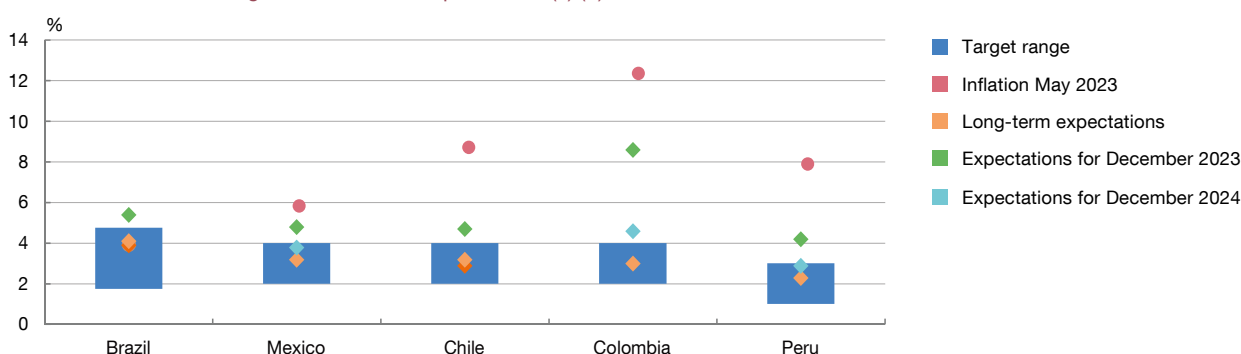
5 See Box I.3 of *Informe de Política Monetaria. Marzo 2023* of the Banco Central de Chile.

## 8 Long-term inflation expectations are still anchored around the inflation targets and bear little relation to past inflation

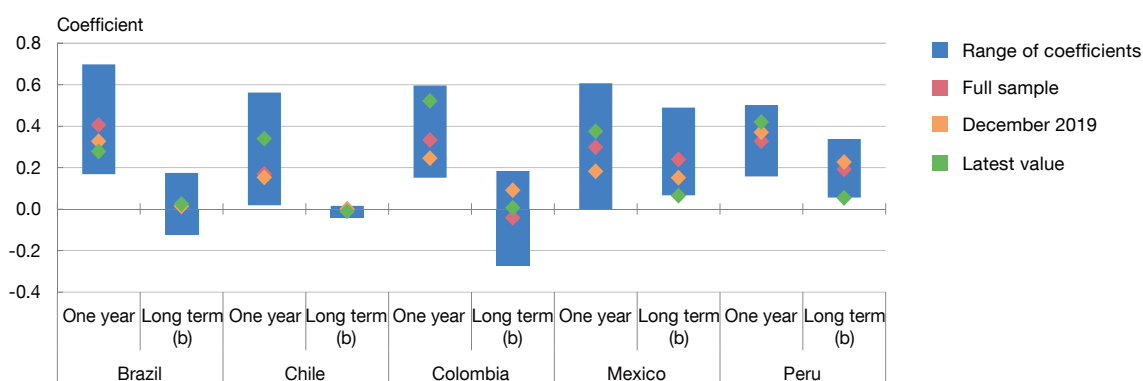
- Although the forecasts for 2023 and 2024 point to a slow convergence towards the central banks' inflation targets, long-term expectations generally remain anchored around these targets (see Chart 8.a).
- The higher sensitivity of short-term inflation expectations to past inflation seen in recent months<sup>6</sup> is not reflected in more backward-looking long-term expectations (see Chart 8.b).<sup>7</sup> This indicator allows for an optimistic view as regards the risk of significant indirect and second-round effects materialising and, therefore, of a “deanchoring” of inflation expectations.

Chart 8

8.a Inflation, inflation targets and inflation expectations (a) (b)



8.b Sensitivity of inflation expectations to past inflation (c)



SOURCES: Consensus Forecasts, Refinitiv and national statistics.

- a The inflation target for the central banks of Brazil (from 2024), Chile, Colombia and Mexico is 3%, while that for the central bank of Peru is 2%.
- b The inflation expectations are taken from Consensus Forecasts: the June forecast for December 2023 and December 2024, and the April forecast (latest publication; next publication in October) for long-term expectations (six to ten years ahead).
- c Coefficient  $\alpha$  of the regression equations:  $\pi_t^{exp} = \alpha\pi_{t-1} + (1 - \alpha)\pi_t^{elp} + \varepsilon_t$  y  $\pi_t^{elp} = \alpha\pi_{t-1} + (1 - \alpha)\pi^* + \varepsilon_t$ , estimated using five-year rolling windows; where  $\pi_t^{exp}$  is one-year-ahead inflation expectations,  $\pi_{t-1}$  is year-on-year inflation for the previous quarter,  $\pi_t^{elp}$  is long-term inflation expectations and  $\pi^*$  is the inflation target.



6 See Box 5, “Inflation expectations in episodes of high inflation”, in the *March 2023 Inflation Report* of the Banco Central de Perú.

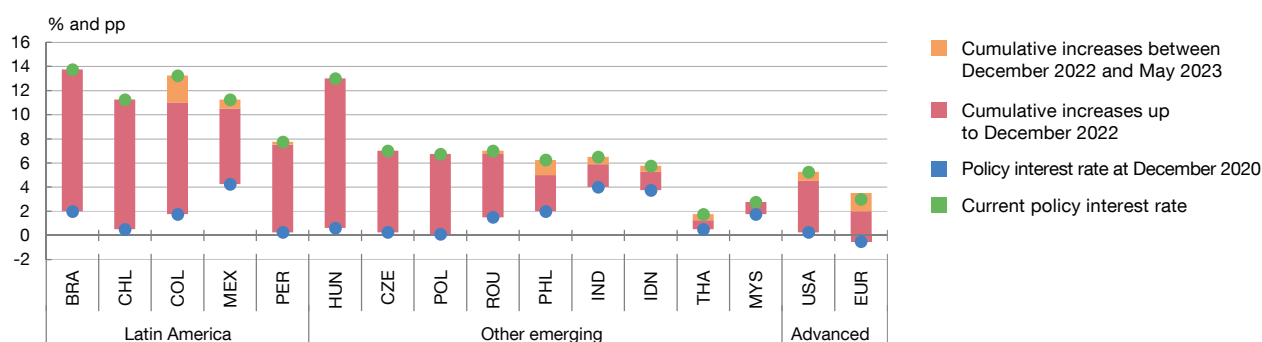
7 See Box 5, “Comportamiento de las expectativas de inflación de largo plazo en el contexto de presiones inflacionarias”, in *Informe Trimestral. Octubre-Diciembre 2022* of the Banco de México.

## 9 Against this backdrop, the region's central banks have gradually been pausing their interest rate hiking cycles

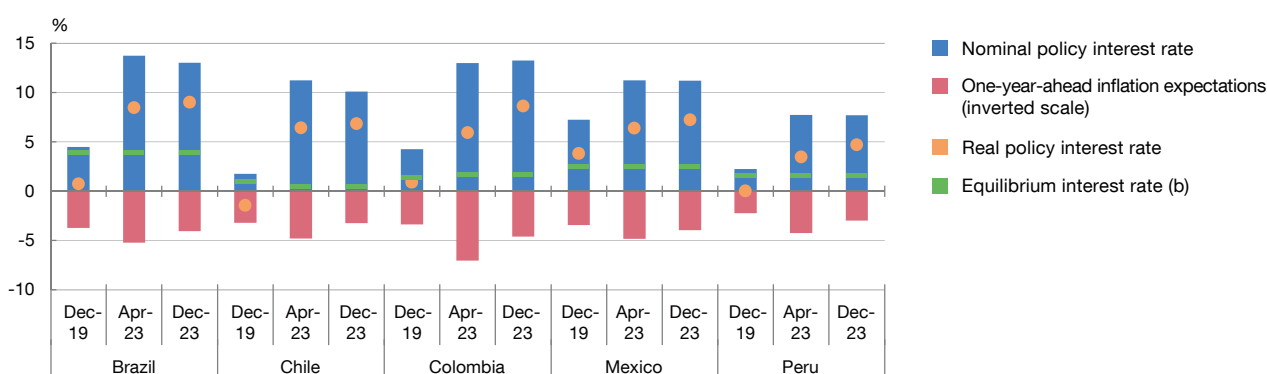
- Between 2022 Q3 and April 2023, the main inflation-targeting central banks in Latin America stopped raising their policy interest rates. Specifically, the last policy interest rate hikes were made in August 2022 (in Brazil), October 2022 (Chile), January 2023 (Peru), March 2023 (Mexico) and April 2023 (Colombia) (see Chart 9.a). Since then, the central banks have opted to keep their policy rates unchanged. Thus, an early, swift and very intense monetary tightening cycle, comparable only to those of some emerging economies in eastern Europe, has been paused.
- Real interest rates in Latin America's inflation-targeting economies point to a markedly restrictive monetary policy stance (see Chart 9.b). Moreover, in most countries this restrictive stance could be maintained or even intensified in the coming months if the expectations that policy interest rate cuts could be smaller than the decline in inflation are borne out.

Chart 9

9.a Cumulative policy interest rate rises since December 2020



9.b Real policy interest rates in the main Latin American economies (a)



SOURCES: National statistics and Refinitiv.

- a Real interest rates calculated as the difference between policy interest rates and one-year-ahead inflation expectations, drawn from central bank surveys, except for December 2023, which is the policy rate according to futures or interest rate swaps less the inflation expected for end-2024 according to Consensus Forecasts (June 2023).
- b Equilibrium interest rates, drawing on estimates by the region's various central banks.

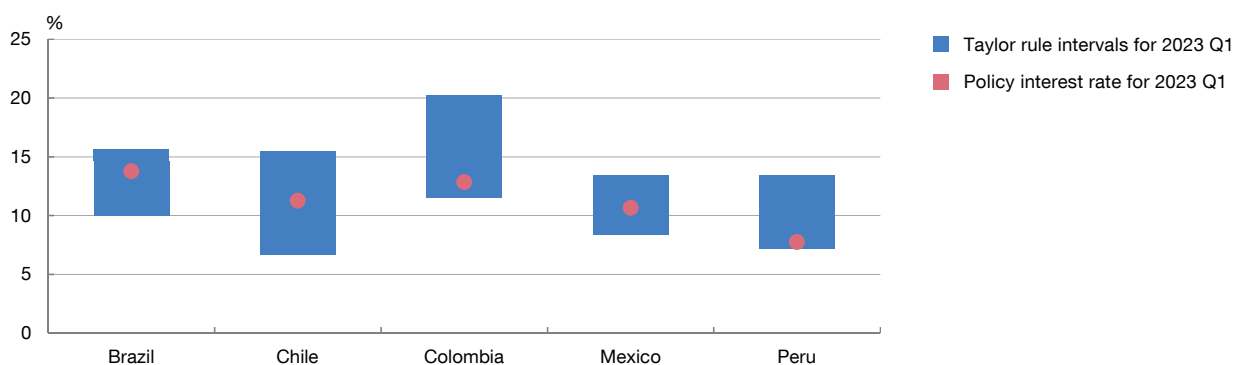


## 10 The restrictive monetary policy stance in the region's main economies appears well suited to tackling the current inflationary episode

- To analyse whether the restrictive nature of current monetary policy (see Chart 9.b) reflects the present needs of the region's main economies, this policy stance is compared with the standard monetary policy rules, such as the Taylor rule. These rules offer estimations as to the “right” policy interest rate, considering the inflation gap (the difference between inflation and the inflation target) and the output gap. Given the uncertainty surrounding measures of inflation, estimations of the neutral interest rate, the weights of the inflation and output gaps and the optimal speed at which central banks respond to such gaps, a wide range of Taylor rules tends to be used, offering a range with which to compare the current policy interest rates.<sup>8</sup>
- Chart 10.a shows the estimated ranges for the “right” policy interest rate based on these rules for different measures of inflation (headline, underlying and one-year inflation expectations), given the uncertainty over the persistence and duration of the inflationary process. Moreover, it is assumed that the neutral interest rate for each economy is that calculated by its central bank and that, given the severity of the inflationary episode, the central banks' response focuses on the inflation gap, with a lower weighting for the output gap, and that central banks respond instantaneously.
- These Taylor rules appear to suggest that the restrictive monetary policy in the region is appropriate in view of the observed and expected inflation developments. Certain countries at the lower end of the estimated range, such as Peru or Colombia, could have more leeway for raising their policy interest rates.

Chart 10

10.a Policy interest rates and uncertainty. Taylor rule. 2023 Q1



SOURCES: Refinitiv Eikon, central banks and own calculations.



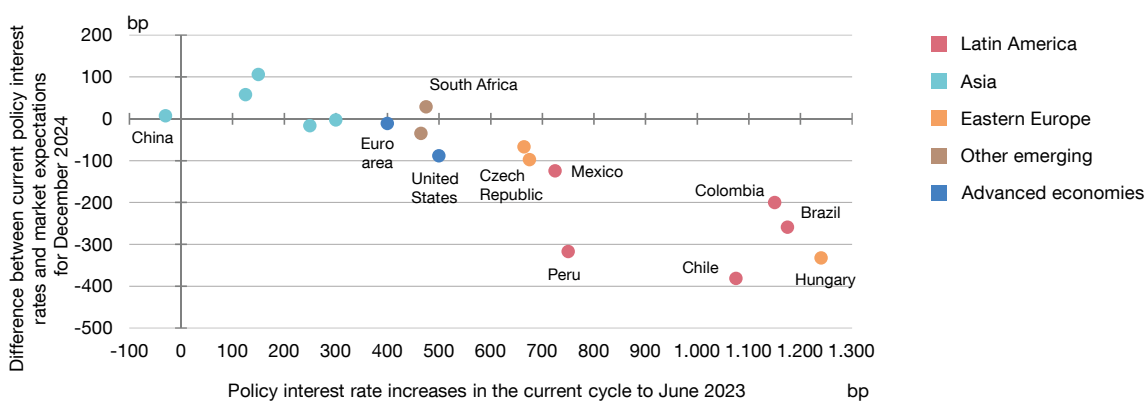
<sup>8</sup> See, for instance, <https://www.clevelandfed.org/publications/economic-commentary/2016/ec-201607-federal-funds-rates-from-simple-policy-rules>.

## 11 The financial markets are pricing in very gradual policy rate cuts

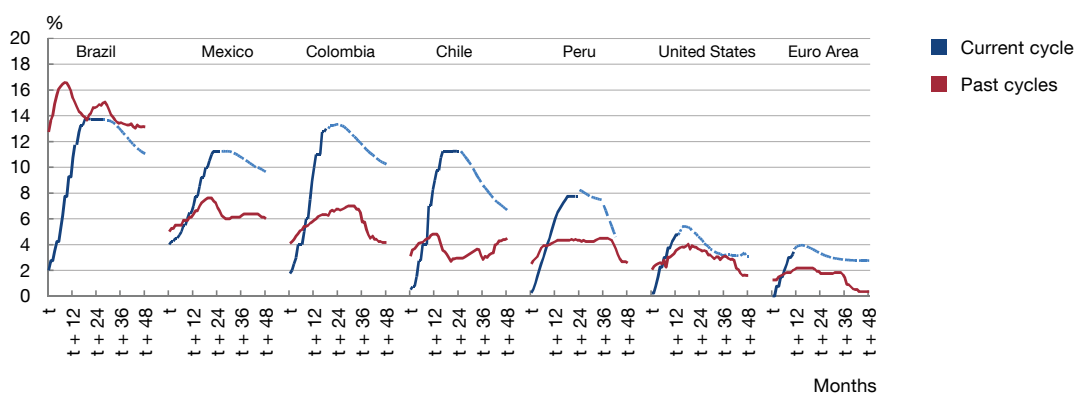
- The financial markets are factoring in the first policy interest rate cuts in countries such as Brazil, Chile and Peru for 2023 H2. The rate cuts are likely to be far smaller than the rate hikes seen since the current cycle began and are expected to be gradual (see Chart 11.a), even though, save in Brazil, the starting point is higher than in previous cycles (see Chart 11.b).<sup>9</sup>
- Meanwhile, expectations as regards monetary policy developments in Latin America are subject to considerable uncertainty, and will be heavily influenced by the also uncertain monetary policy developments in the advanced economies, particularly the United States.

Chart 11

11.a Policy interest rate increases and policy interest rates expected by financial markets (a)



11.b Policy interest rate cycles (b)



SOURCES: Refinitiv, Consensus and JP Morgan.

- End-2024 policy interest rates according to futures markets or interest rate swaps (as at the last week of June 2023), except for Peru (Consensus, June 2023).
- The broken lines represent the policy interest rates priced in by futures markets in the last week of June 2023. Current cycles begin in March (Brazil), June (Mexico), October (Colombia), July (Chile) and August (Peru) 2021 and March (United States) and July (euro area) 2022. Past cycles begin in 2000, when the five countries adopted the inflation-targeting regime.



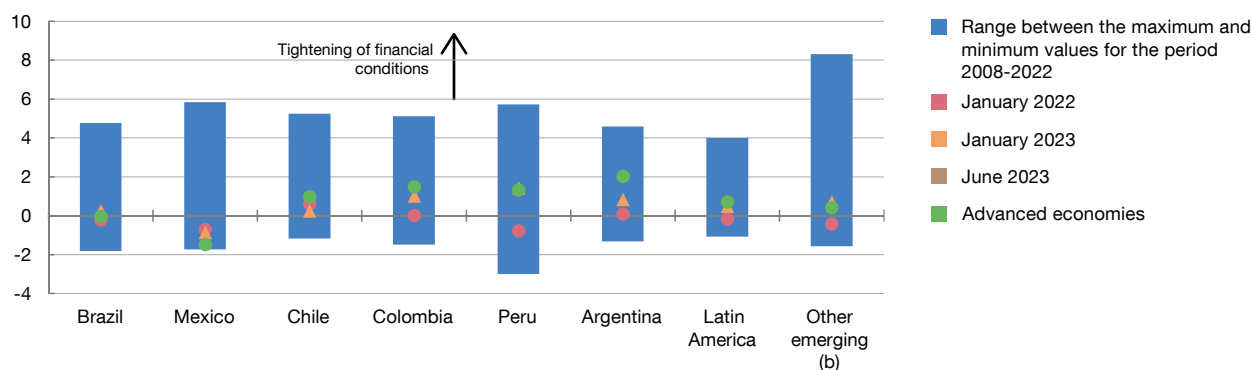
<sup>9</sup> For details on the effect of this monetary tightening on credit and credit conditions, see pages 17 and 18 of the [Report on the Latin American economy. Second half of 2022](#).

## 12 The financial variables performed somewhat better in the region than in the other emerging economies

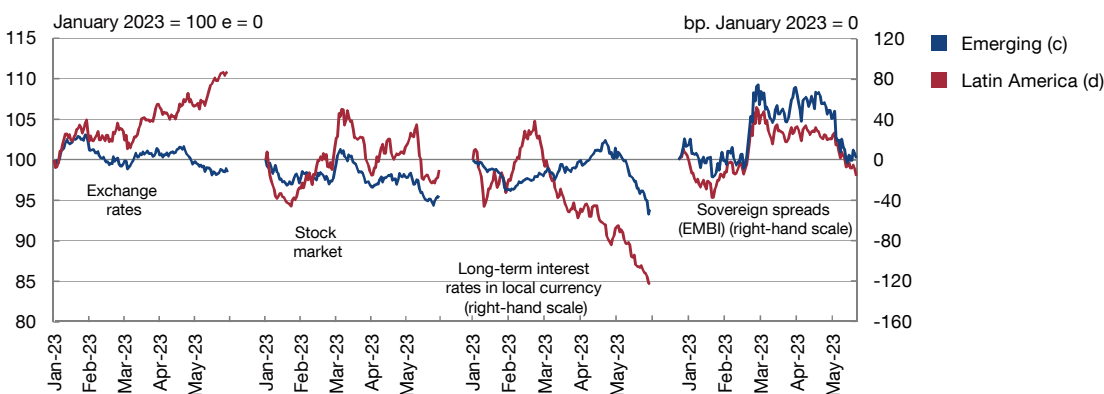
- In the year so far, much like in the other emerging economies, financial conditions in the region have remained relatively stable (see Chart 12.a), thanks to the pause in policy interest rate hikes in most of these economies and, in the case of the Latin American markets, to the gradual declines in long-term local currency debt yields (see Chart 12.b).
- In general, the region's financial variables performed better than those of other emerging economies (see Chart 12.b), albeit less so in the case of sovereign bond spreads. Expectations of a slow, restrained monetary easing cycle in the region (see page 15) could work in favour of the Latin American currencies (the “carry trade” effect), as could upside surprises in terms of growth in Brazil and Mexico, the region's two largest economies (see page 5).

Chart 12

### 12.a Financial conditions indices (a)



### 12.b Financial market variables



SOURCES: Refinitiv, Consensus and JP Morgan.

- Based on the main components of between 7 and 12 significant financial variables for each country. An increase denotes a tightening of financial conditions, and values higher than zero imply that financial conditions are tighter than the historical average.
- Calculated by Goldman Sachs. Average of China, Thailand, India, Russia, Turkey, South Africa, Indonesia, Czech Republic, South Korea, Israel, Hungary, Malaysia, Poland and the Philippines.
- Simple average of the variables for Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, South Korea, Malaysia, the Philippines, Thailand, India and Indonesia, except in the case of sovereign spreads, where it is the simple average for the regions of Eastern Europe, Asia, Middle East and Africa.
- Simple average of long-term interest rates in Brazil, Mexico, Chile, Colombia and Peru, or Latin American sovereign spread (EMBI).



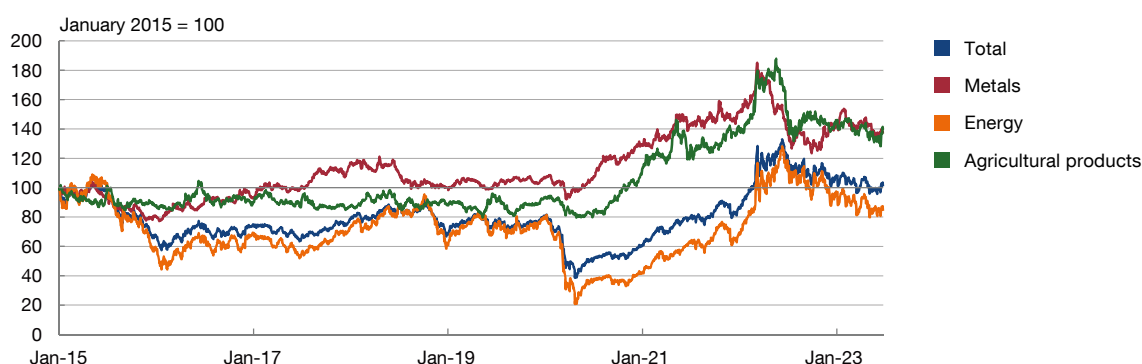


### 13 Several factors appear to be behind the better performance of the financial markets

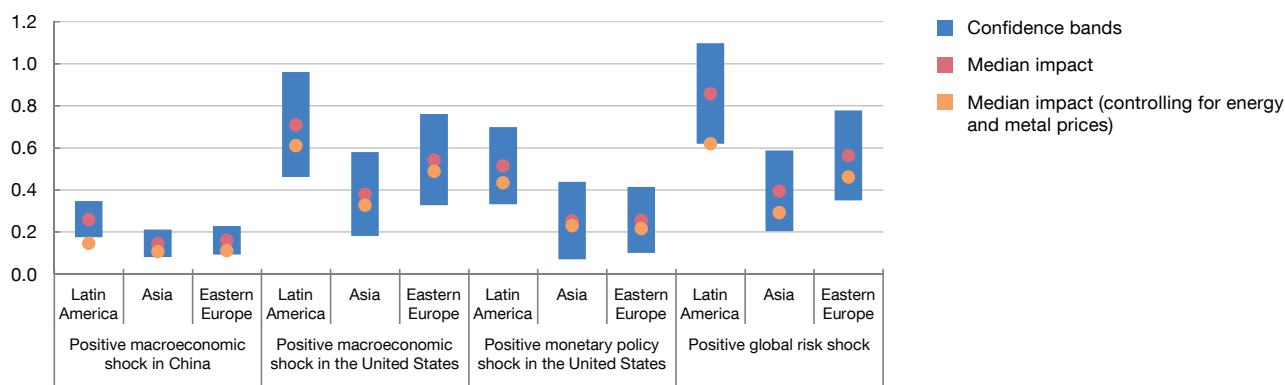
- In addition to the favourable carry-trade, the region has a lower geostrategic risk in the current setting, it has the implicit backing of the International Monetary Fund (IMF)<sup>10</sup> and it is a net exporter of commodities, whose prices remain above the historical average despite having fallen in the first half of the year (see Chart 13.a).
- Part of the positive differential performance compared with other emerging economies appears to be the result of external shocks. According to estimates,<sup>11</sup> a positive macroeconomic shock in the United States and the pause in its contractionary monetary policy cycle is behind the region's better relative financial market performance (see Chart 13.b).<sup>12</sup>

Chart 13

13.a Price of Latin America's main export commodities



13.b Effects of various shocks on emerging economies' stock markets (a)



SOURCES: Banco de España and ECB.

a Estimated effects based on a local projections model including the shocks shown in the charts, along with financial variable lags and other controls (VIX and Citigroup's US and global surprise index). The shocks are obtained from a Bayesian vector autoregression (BVAR) model with sign restrictions for the period January 2017 to September 2022, with a daily frequency, which includes Chinese financial variables (the short and long-term rates, the stock market and the exchange rate against the US dollar), the US long-term rate and the rate spread between China and the United States.



<sup>10</sup> Mexico, Chile, Colombia, Peru and Panama have signed precautionary lending facilities with the IMF.

<sup>11</sup> D. Lodge, S. Manu and I. Robays. (2023). "China's footprint in global financial markets". Forthcoming. The model identifies five types of shocks using sign restrictions in a Bayesian VAR (Chinese and US macroeconomic and monetary policy shocks and global turmoil shocks), which are then entered into a regression together with other financial variable controls and lags using the local projections methodology.

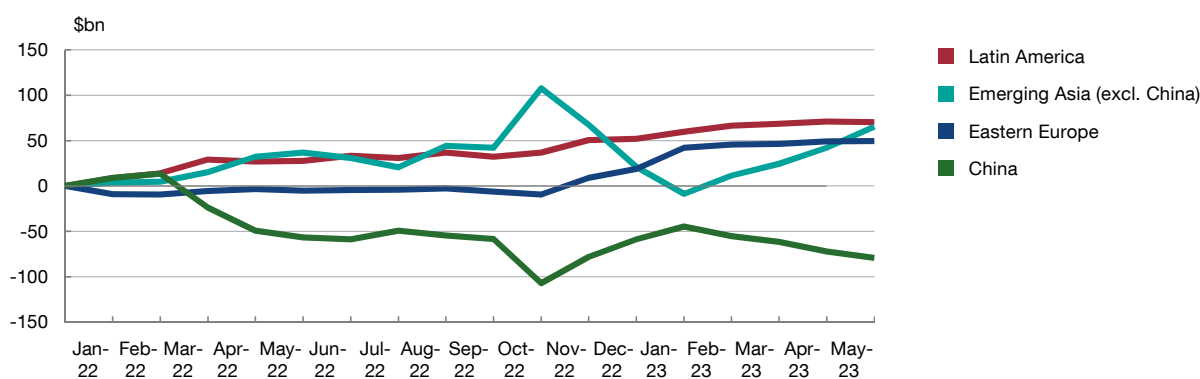
<sup>12</sup> In the case of positive macroeconomic shocks in China, the differential performance would stem from their effect on commodity prices.

## 14 The region has continued to attract portfolio capital, while fixed-income placements remain low

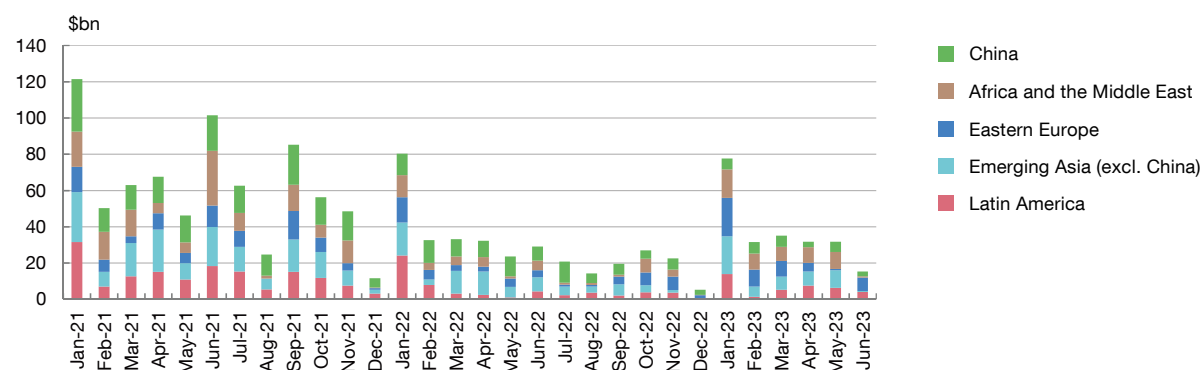
- The region received portfolio inflows amounting to almost \$20 billion in the first five months of 2023, a similar amount to last year. This makes Latin America the emerging region to receive the largest amount of this type of external capital since 2022 (see Chart 14.a).
- Portfolio capital inflows invested in fixed-income securities in the first five months of 2023 (\$10 billion) were higher than in the same period of 2022 (\$8 billion). However, bond placements in international markets remained at very low levels by historical standards (see Chart 14.b), a trend that has persisted over the past year and a half across all emerging economies. Tighter global financial conditions and lower refinancing needs could lie behind the low level of placements. Sovereign bonds, especially from small or low-rated countries, accounted for the bulk of debt issuance (73% of the total) and their placement costs increased by almost 2.8 pp compared with the same period of 2022, similar to the increase in other emerging regions.

Chart 14

14.a Net non-resident portfolio capital flows (\$bn, cumulative)



14.b Fixed rate issuance in international markets (\$bn)



SOURCES: Institute of International Finance and Dealogic.

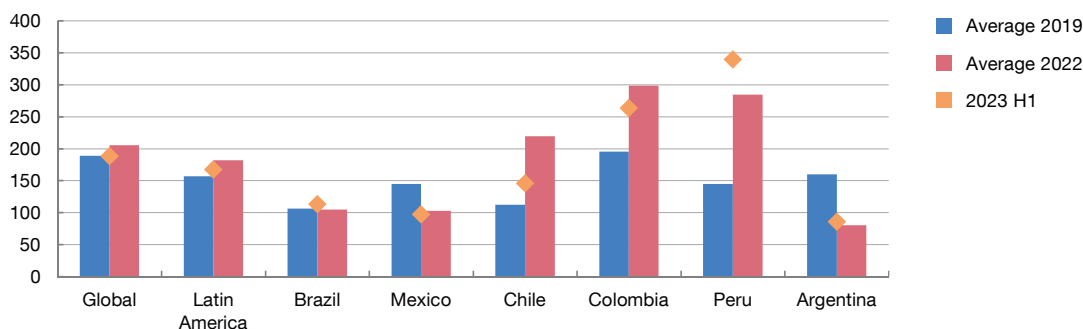


## 15 Policy uncertainty and social unrest have generally remained high in the region in recent quarters

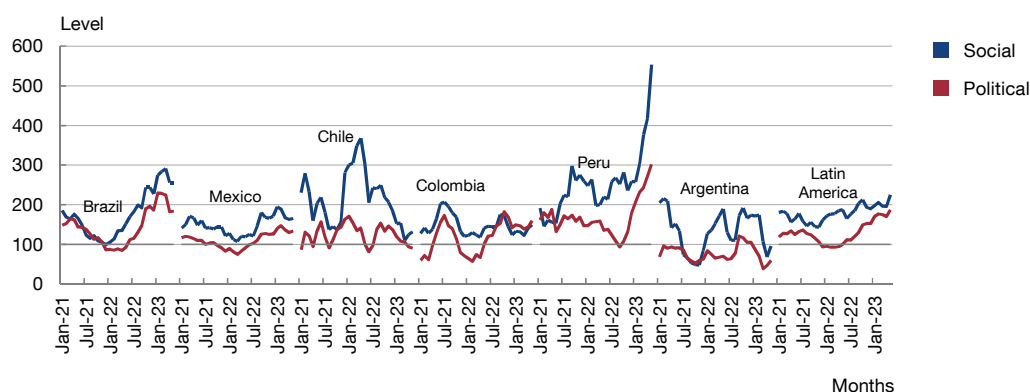
- The indicator of uncertainty about the future course of economic policies rose in the first months of 2023 in Brazil – although the approval of the new fiscal rules and the reaffirmation of the central bank’s independence should reduce this uncertainty in the future – and was higher than in 2022 (see Chart 15.a). Throughout the region, with the exception of Mexico, these indicators are higher than before the pandemic.
- Indicators of social and political unrest continued to trend upwards across the region (see Chart 15.b), especially in Brazil and, above all, in Peru, where they reached levels 50% above previous all-time highs after the country’s president was ousted from power and social protests ensued. In the year to date, these indicators have reached levels similar to or higher than the peaks of the last ten years in all countries except Chile, which recorded its ten-year peak in 2019.

Chart 15

15.a Indicators of economic policy uncertainty (EPU) (a)



15.b Indicators of social and political unrest (b)



SOURCES: Banco de España and Economic Policy Uncertainty.

- Erik Andres-Escayola, Corinna Ghirelli, Luis Molina, Javier J. Pérez and Elena Vidal. (2022). “Using newspapers for textual indicators: which and how many?”. Working Papers, 2235, Banco de España. Economic Policy Uncertainty (EPU) is an index based on words relating to economic policy uncertainty in local and international newspapers.
- Social and political unrest indices calculated using the methodology in Baker, Bloom and Davis with words relating to each of these topics, based on national and international newspapers (Erik Andres-Escayola, Corinna Ghirelli, Luis Molina, Javier J. Pérez and Elena Vidal. (no date). “What do we mean when we talk about social unrest?”, mimeo).

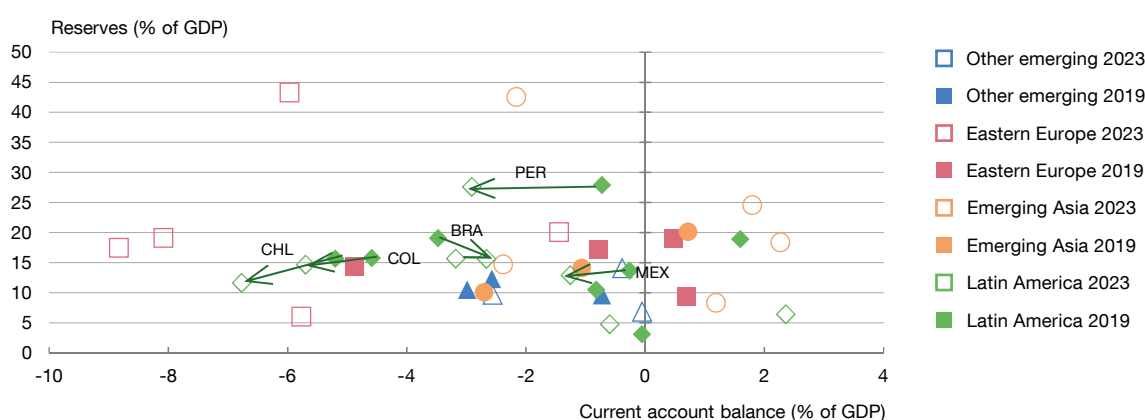


## 16 Indicators of external and fiscal vulnerabilities have deteriorated in the region...

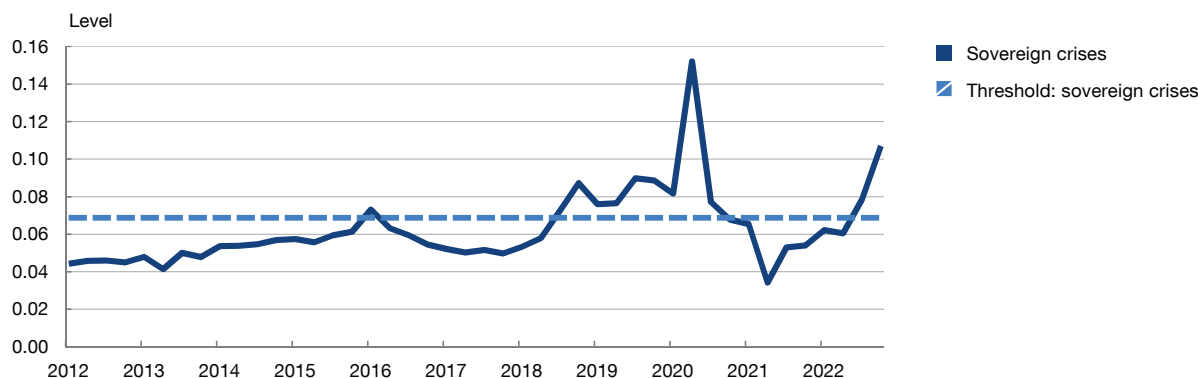
- In 2023 Q1, in general, the region had a larger external imbalance and lower international reserves than in the year before the pandemic, except in Brazil<sup>13</sup> (see Chart 16.a). In addition, there has been an increase in short-term external debt, and in some countries also in total external debt, since 2019, although debt servicing has generally fallen.
- Meanwhile, in the first stretch of the year the synthetic indicator of public finance vulnerability has remained on the upward path of recent quarters (see Chart 16.b), mainly as a result of the slowdown in activity, the persistently high levels of public debt (see page 21) and the sharp rise in interest rates.

Chart 16

16.a External vulnerabilities: indicators of external sustainability (a)



16.b Synthetic indicators of vulnerability to sovereign crises in Latin America (b)



SOURCES: IMF and Refinitiv.

a Comparison of pairs of the two variables represented, at end-2019 and in 2023 Q1.

b The synthetic indicators represent the likelihood of being in a state of vulnerability, estimated using a logit model for three types of crisis (banking, currency and sovereign) with pre-selected variables based on the emission of correct signals six quarters before a crisis (threshold of an ROC curve). An increase in a synthetic indicator thus implies an increase in the likelihood of a crisis being recorded in each of the categories. The regional indicators are the average of the synthetic indicators for eight countries in Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Ecuador and Uruguay), five in Asia (China, India, Indonesia, South Korea and Thailand), and six in eastern Europe (Czech Republic, Hungary, Poland, Romania, Russia and Turkey).

13 See "Indicators of vulnerability in Latin America".

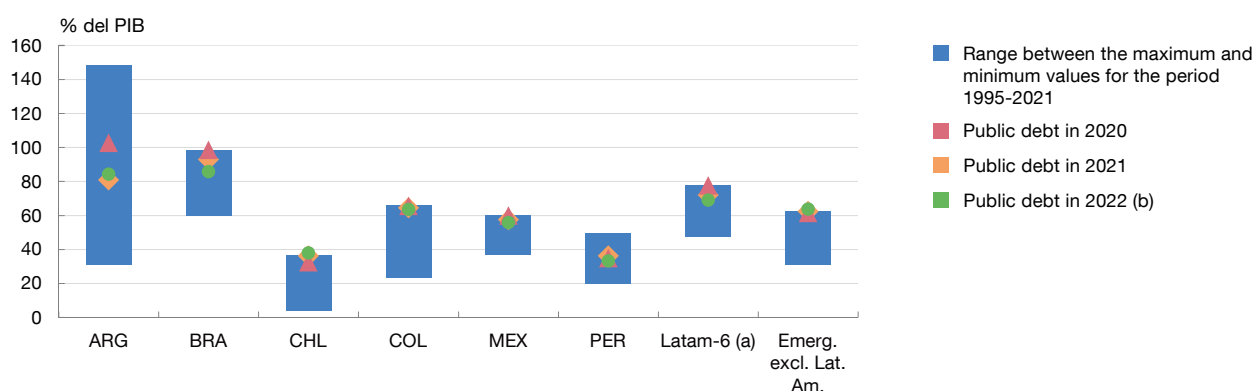


## 17 ...and the medium-term outlook for public finances continues to be less favourable than before the pandemic

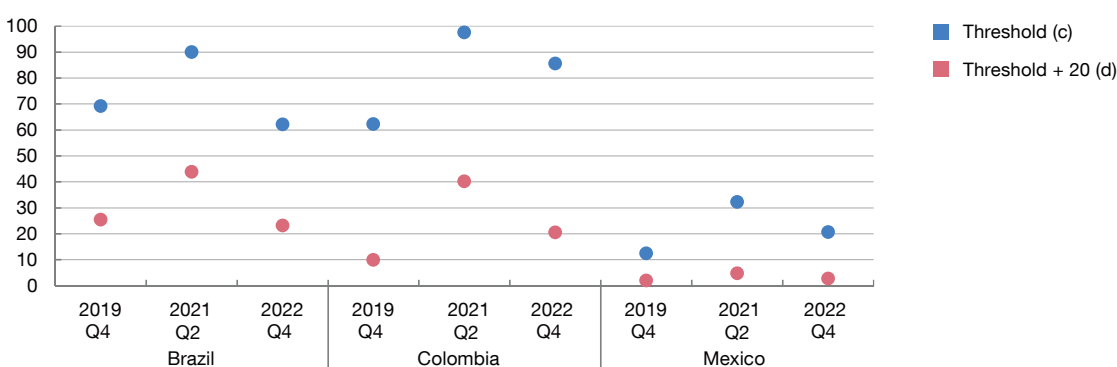
- In 2022 and 2023 Q1 government deficits narrowed slightly in most Latin American countries (see Table 1) due to the withdrawal of certain pandemic-related fiscal stimulus measures and strong nominal economic growth, which more than offset the increase in debt servicing payments. However, primary structural deficits are not correcting, with the notable exception of Chile (where it corrected by 10 pp in 2022). Public debt remains high in historical terms (at almost 70% of GDP in 2022) and compared with other emerging regions (see Chart 17.a), which is one of the main challenges facing Latin America.<sup>14</sup>
- Simulation exercises<sup>15</sup> of the future course of public debt determinants in three of the region's largest economies (see Chart 17.b) show that the probability that the public debt-to-GDP ratio will be above its pre-pandemic level in ten years' time has increased, indicating a higher vulnerability of public finances today.

Chart 17

### 17.a Gross public debt



### 17.b Probability of public debt exceeding a certain threshold in ten years' time



SOURCES: IMF, Refinitiv, national statistics and Banco de España.

a Aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru.

b The 2022 figure is the IMF's April 2023 WEO forecast.

c The threshold for each country is its public debt-to-GDP ratio (in percentage terms) in 2019, the last year before the pandemic (80 % for Brazil and 50 % for Colombia and Mexico).

d The threshold for each country is its public debt-to-GDP ratio (in percentage terms) in 2019 plus 20 pp.



14 Inter-American Development Bank. (2023). *Dealing with debt*.

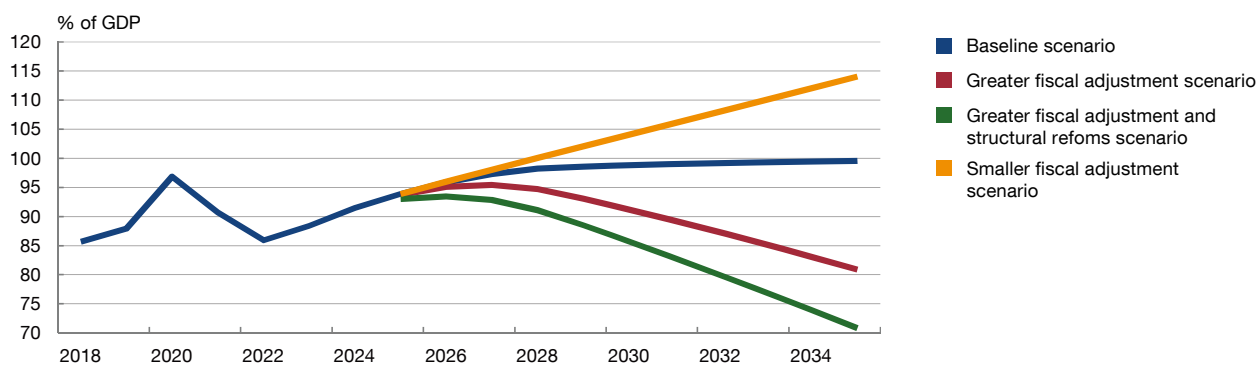
15 See Box 3, "Public debt sustainability in Latin America" of the *Report on the Latin American economy. First half of 2022* for a description of the methodology.

## 18 Debt sustainability would notably improve if structural reforms and fiscal consolidation programmes were implemented

- This weakness of public finances comes at a time when the tight monetary policy stance (see page 13) is expected to continue (see page 15) and the medium-term growth outlook is very subdued (see page 7). These additional factors make public finances even more vulnerable.
- By way of illustration, Chart 18.a provides simulations of the future course of public debt in Brazil in various alternative scenarios. Under the baseline scenario, after rising until 2028, public debt stabilises at levels slightly below 100% of GDP, thanks to a sustained primary surplus. A scenario of an additional consolidation of public finances that entails a cumulative improvement in the structural balance of 2 pp leads to debt stabilising at around 95% of GDP in 2026 and declining thereafter. Further, these favourable debt dynamics would be strengthened if structural reforms were implemented that boosted Brazil's potential output.

Chart 18

18.a Brazil. Debt sustainability (a)



SOURCES: Banco de España, Refinitiv, IMF and World Bank.

a The simulations use a debt sustainability analysis framework that includes the essential features of Latin American economies, such as the existence of foreign currency-denominated debt, and whose limits are extended by introducing a behavioural model linking and jointly determining the future values of aggregate demand, inflation, the fiscal balance and the exchange rate through shocks to the macroeconomic fundamentals (I. Kataryniuk, R. Lorenzo Alonso, E. Martínez Casillas, J. Timini. (2023). "An extended Debt Sustainability Analysis framework for Latin America", mimeo). All scenarios are constructed with data up to 2022 and IMF forecasts for 2023 and 2024, and are based on the model from 2025 onwards. In the baseline scenario, the primary balance is anchored to the IMF forecasts for 2028. The scenario of an improved primary structural balance assumes a fiscal policy that reduces the primary structural balance by a further 0.5 pp of GDP each year for four years (2025-2028). The scenario of an improved primary structural balance and structural reforms assumes that, in addition, structural reforms are implemented that increase potential GDP growth by 1 pp after 2025. The scenario of a worsening primary structural balance assumes that it remains at 0% of GDP from 2026 onwards. This entails a 1.5 pp difference in 2028.



Table 1

## Latin America: main economic indicators

	2007-2021 average	2022	IMF projections (April 2023 WEO)		2021		2022				2023
			2023	2024	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>GDP (change on previous period) (a)</b>											
Latin America and the Caribbean (b)	1.9	3.6	1.6	2.2	1.0	1.7	0.8	0.9	0.5	0.0	1.2
Argentina	1.4	5.2	0.2	2.0	2.9	2.5	0.6	1.4	0.8	-1.7	0.7
Brazil	1.7	2.9	0.9	1.5	0.4	1.0	1.0	1.1	0.5	-0.1	1.9
Mexico (c)	1.4	3.0	1.8	1.6	-1.1	1.2	1.0	1.1	0.9	0.6	1.0
Chile	3.1	2.4	-1.0	1.9	4.3	2.4	-0.6	-0.6	-1.1	0.2	0.8
Colombia (c)	3.5	7.3	1.0	1.9	4.8	5.3	0.7	0.9	0.3	0.4	1.4
Peru	4.4	2.7	2.4	3.0	2.1	0.4	0.9	0.1	0.5	0.1	-1.1
<b>CPI (year-on-year rate) (a)</b>											
Latin America and the Caribbean (b)	5.8	9.8	13.3	9.0	7.2	8.2	8.8	10.0	9.2	8.0	7.5
Argentina	22.4	72.4	98.6	60.1	51.9	51.4	52.8	61.0	77.6	91.8	102.0
Brazil	5.6	9.3	5.0	4.8	9.6	10.5	10.7	11.9	8.7	6.1	5.3
Mexico	4.2	7.9	6.3	3.9	5.8	7.0	7.3	7.8	8.5	8.0	7.5
Chile	3.4	11.6	7.9	4.0	4.9	6.6	8.3	11.5	13.7	13.0	11.8
Colombia	4.0	10.2	10.9	5.4	4.3	5.2	7.8	9.3	10.8	12.6	13.3
Peru	3.0	7.9	5.7	2.4	4.7	6.0	6.2	8.3	8.6	8.4	8.6
<b>Budget balance (% of GDP) (a) (d)</b>											
Latin America and the Caribbean (b)	-4.1	-3.7	-5.2	-4.4	-4.2	-4.3	-3.7	-3.7	-3.7	-3.7	-4.4
Argentina	-3.8	-3.8	-3.8	-3.6	-2.9	-3.6	-3.7	-4.0	-4.0	-3.8	-4.2
Brazil	-5.5	-4.6	-8.8	-8.2	-4.7	-4.3	-3.1	-4.2	-4.3	-4.6	-6.1
Mexico	-3.1	-3.5	-4.1	-2.7	-2.7	-3.2	-3.3	-3.1	-3.4	-3.5	-3.9
Chile	-1.3	1.1	-1.8	-1.2	-7.4	-7.7	-6.3	-2.0	0.4	1.1	0.8
Colombia	-2.8	-4.2	-4.0	-2.1	-5.8	-6.9	-6.5	-5.6	-6.0	-4.2	-3.5
Peru	-0.8	-2.2	-2.0	-1.9	-5.0	-3.4	-2.1	-1.2	-1.8	-2.2	-2.8
<b>Public debt (% of GDP) (a)</b>											
Latin America and the Caribbean (b)	56.9	62.0	68.2	68.9	64.4	63.2	62.7	61.0	60.9	60.3	—
Argentina	60.2	84.8	76.3	73.6	71.6	68.5	69.3	60.5	63.5	68.0	—
Brazil	73.4	72.9	88.4	91.5	80.3	78.3	77.4	76.7	75.3	72.9	73.0
Mexico	48.9	50.0	55.6	55.8	52.6	52.2	52.8	51.8	51.3	50.0	50.5
Chile	17.3	38.0	36.6	38.5	35.5	36.4	36.4	36.8	37.3	38.0	37.2
Colombia	44.9	56.6	62.0	61.1	61.5	60.7	58.0	57.2	58.3	59.7	58.2
Peru	26.4	33.8	33.0	33.3	34.5	35.9	33.4	33.6	34.2	33.8	32.9
<b>Current account balance (% of GDP) (a) (d)</b>											
Latin America and the Caribbean (b)	-1.8	-2.9	-1.8	-1.7	-1.4	-2.2	-2.3	-2.8	-3.2	-2.9	—
Argentina	-0.9	-0.6	1.0	0.8	1.2	1.4	0.9	0.2	-0.9	-0.6	—
Brazil	-2.4	-3.0	-2.7	-2.7	-2.3	-2.8	-2.4	-2.9	-3.3	-3.0	-2.7
Mexico	-1.2	-1.3	-1.0	-1.0	0.5	-0.6	-0.8	-1.3	-1.4	-1.3	-1.3
Chile	-2.8	-9.0	-4.2	-3.8	-5.1	-7.3	-8.1	-9.7	-10.0	-9.0	-6.8
Colombia	-3.8	-6.2	-5.1	-4.6	-4.9	-5.6	-6.2	-6.1	-6.4	-6.2	-5.7
Peru	-2.3	-4.1	-2.1	-2.3	-1.3	-2.2	-3.2	-3.3	-3.9	-4.1	-2.9
<b>External debt (% of GDP) (a)</b>											
Latin America and the Caribbean (b)	37.7	—	43.3	42.2	43.3	42.5	—	—	—	—	—
Argentina	41.4	43.8	—	—	59.7	55.3	52.8	48.9	45.0	44.0	—
Brazil	29.0	35.5	—	—	41.0	40.6	40.2	37.0	36.0	35.4	35.0
Mexico	22.7	—	—	—	30.0	29.2	—	—	—	—	—
Chile	55.4	77.6	—	—	75.3	75.2	76.5	74.5	74.3	77.4	75.8
Colombia	33.1	53.6	—	—	54.1	53.8	53.5	51.3	50.6	53.4	—
Peru	34.1	41.8	—	—	42.9	45.2	45.0	43.5	42.6	41.8	41.4
<b>MEMORANDUM ITEMS: Aggregate of emerging economies excluding Latin America and China (IMF, April 2023 WEO)</b>											
GDP (year-on-year rate)	4.1	4.5	3.7	4.4							
CPI (year-on-year rate)	7.1	13.4	11.4	8.4							
Budget balance (% of GDP)	-2.9	-4.2	-5.2	-4.8							
Public debt (% of GDP)	41.9	56.3	58.8	59.9							
Current account balance (% of GDP)	0.7	1.7	0.2	-0.2							
External debt (% of GDP)	27.5	26.5	26.0	25.3							
Share of global GDP, in PPP (%)	31.8	32.3	32.6	33.1							

**SOURCES:** IMF, Refinitiv, LatinFocus and national statistics.

- a** Latin America and the Caribbean account for 7.3% of global GDP measured in PPP. The six economies shown account for 86% of all Latin America and the Caribbean (IMF).  
**b** Quarterly data, aggregate of the six main economies (Argentina, Brazil, Chile, Colombia, Mexico and Peru), and for inflation, aggregate excluding Argentina.  
**c** Seasonally adjusted series.  
**d** Four-quarter moving average.

Box 1

**CENTRAL AMERICA AND THE DOMINICAN REPUBLIC: MONETARY POLICY AND BANKING SECTOR DEVELOPMENTS**

**Monetary policy**

Faced with rising inflation in Central America and the Dominican Republic (CADR),<sup>1</sup> most of the regions' central banks tightened monetary policy in 2022. Costa Rica saw the most aggressive increase in policy rates, which were hiked from 1.75% to 9% between January and December

2022. By contrast, Guatemala, Nicaragua and the Dominican Republic raised their policy rates more modestly, and Honduras left them unchanged (see Chart 1).

Two countries began to reduce their policy rates in 2023. Costa Rica's policy rate was cut by 150 basis points (bp)

Chart 1  
Monetary policy rate (a)

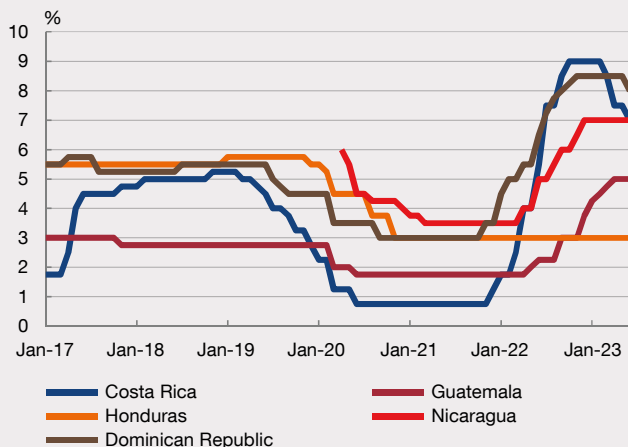


Chart 2  
Monetary aggregate M1

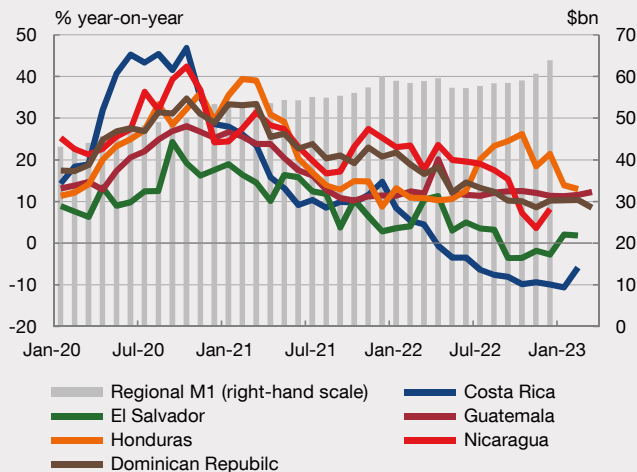


Chart 3  
Liquidity indicator for banking systems in the region (b)

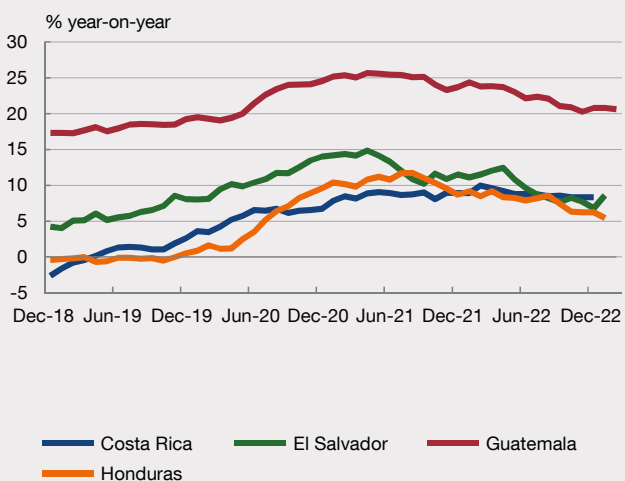
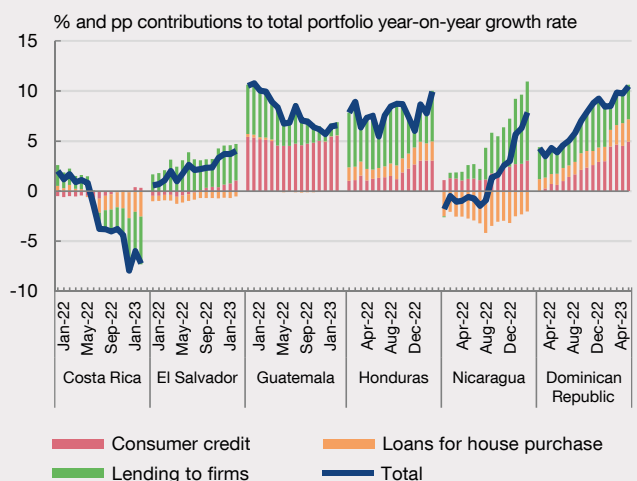


Chart 4  
Growth rate of total lending and contribution to growth disaggregated by purpose for other deposit institutions



SOURCE: Secretaría Ejecutiva del Consejo Monetario Centroamericano.

a Costa Rica, Guatemala, Honduras and the Dominican Republic have a monetary policy rate. The monetary repo reference rate is used for Nicaragua.  
b The liquidity indicator is calculated as the result of dividing the difference between deposits and lending by banking system assets.

1 The countries comprising CADR (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic) are generally considered together since they have a shared institutional framework to deepen their trade and financial integration.



## Box 1

**CENTRAL AMERICA AND THE DOMINICAN REPUBLIC: MONETARY POLICY AND BANKING SECTOR DEVELOPMENTS (cont'd)**

(50 bp in March and 100 bp in April), while the Central Bank of the Dominican Republic cut its policy rate by 50 bp in late May. The change in these two countries' monetary policy stance is mostly attributable to the long-standing downward trend in their rates of inflation. In Nicaragua, policy rates have remained unchanged, while in Guatemala the policy rate has continued to rise in 2023 (from 3.75% to 5%) as part of a strategy which seeks to drive inflation towards its target without significantly hampering its economic buoyancy.

**Liquidity**

Restrictive monetary policies in all CADR countries have dampened growth in their most liquid monetary aggregates (M1). The slowdown correlates negatively with interest-rate changes. Thus, M1 fell most in Costa Rica, whereas the decline in El Salvador (the region's only dollarised economy) was relatively small (see Chart 2).

In Guatemala, the Dominican Republic and Nicaragua – countries that have seen relatively modest tightening of the monetary policy – M1 growth has steadily eased, especially from 2022 Q2 onwards. In Honduras, by contrast, where the policy rate is unchanged, M1 growth slowed from 2022 Q3 onwards as a result of the central bank using open market operations.

The pace of bank deposit growth has slowed throughout the CADR region, although the level of bank deposits remains high owing to their strong momentum during the pandemic years, which was driven by the increase in household savings and firms' and households' greater preference for liquidity. Together, the above factors mean that banking systems throughout the region enjoy comfortable liquidity positions (see Chart 3).

**Credit**

CADR banking systems have high liquidity levels and adequate solvency levels. With the exception of Costa Rica, earnings have enjoyed a strong recovery after being hard hit by the pandemic-related crisis.

Real credit growth in Guatemala, Honduras and the Dominican Republic has exceeded 5% since 2022 Q3. By component, Guatemala's strongest growth comes in the consumer credit segment, with rates around 13%. In Honduras and the Dominican Republic, all credit components are highly buoyant, although the consumer credit segment has picked up pace in recent months. Lending to firms has gained ground in El Salvador, while in Nicaragua the total lending portfolio has expanded since 2022 H2, driven by both lending to firms and consumer credit (Chart 4). In Costa Rica, the credit portfolio has generally shrunk, although, based on the most recent data, the rate of deceleration appears to have fallen in line with changes in the country's monetary policy stance.

The quickening pace of credit growth observed in most of the region's countries comes in spite of tighter monetary policies both domestically and worldwide, indicating that other reasons lie behind the change. Transmission of monetary policy to lending depends on financial depth. Thus, monetary policy may have a greater effect on Costa Rica than on the rest of the CADR because financial depth, measured as the credit-to-GDP ratio, is approximately 50%, higher than levels in Guatemala, the Dominican Republic and Nicaragua, which stand at around 37%, 21% and 26%, respectively. However, it is likely that the pandemic has shifted the region's financial structure, changing the transmission mechanism of monetary policy to lending. For instance, in those countries with relatively less financial depth (particularly Guatemala and the Dominican Republic), the lockdown had significant consequences for financial inclusion, thus altering long-run trends in lending. In Nicaragua, credit growth is the result of the economic recovery in the wake of a deep recession triggered by political factors in 2018. In addition, CADR countries saw an uptick in remittances during and after the pandemic, particularly from the United States, which, given the mobility restrictions, were routed through formal channels, thereby enabling a structural change in the financing sources for intermediation.

## Box 2

## RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS

In 2022 the Banco de España identified five Latin American countries among those deemed to be of material significance to the Spanish banking system:<sup>1</sup> Mexico, Brazil, Chile, Peru and Colombia. This box reviews recent developments in their banking systems.

The data show that credit to the private sector in real terms (deflated by CPI) slowed notably in Chile, Colombia and Peru, but gained momentum in Brazil and Mexico (see Chart 1). In the case of Brazil, credit has been driven by loans to households and by the riskier lending

Chart 1  
Bank loans to the private sector: real, by country (a)

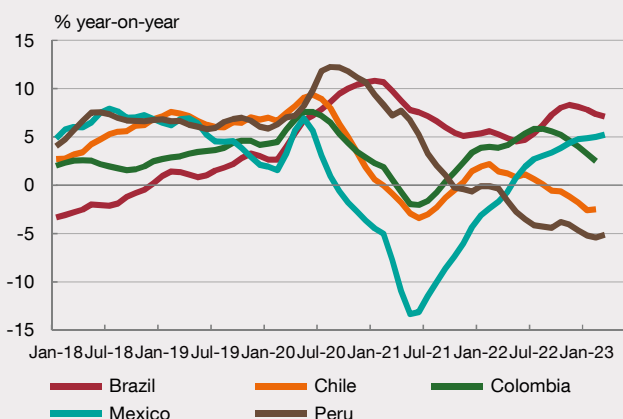


Chart 2  
Bank loans to the private sector: real, by type of loan (a)

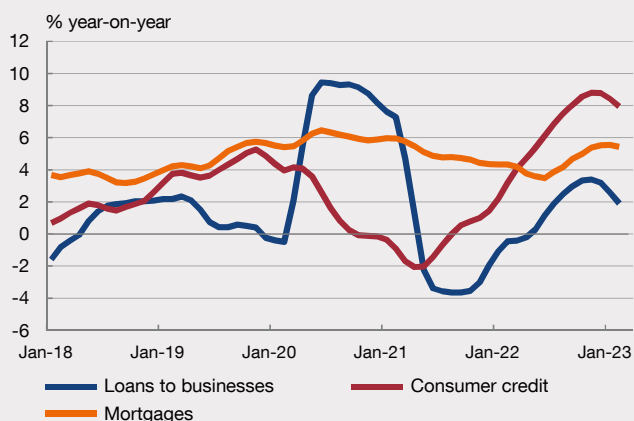


Chart 3  
Private sector deposits: real (b)

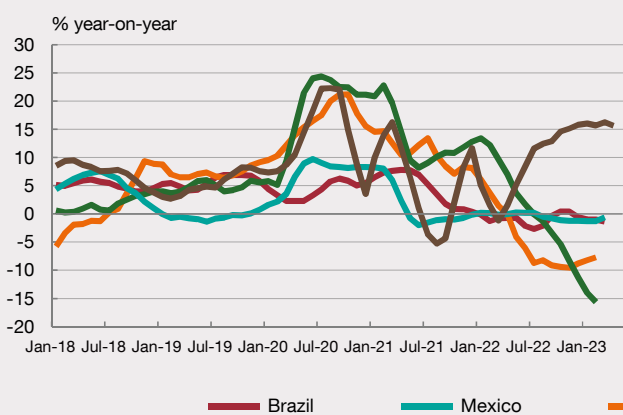
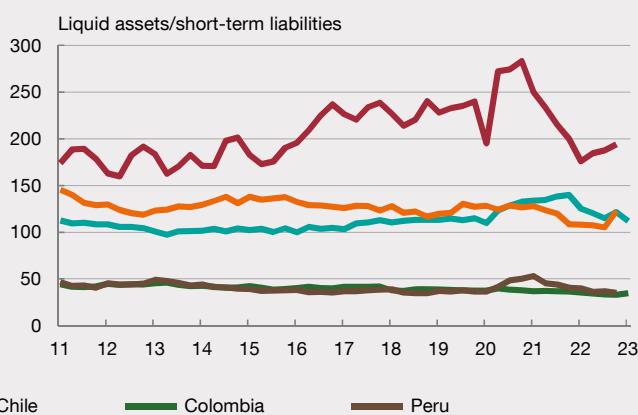


Chart 4  
Liquidity (c)



SOURCES: National statistics, Refinitiv, IMF and Banco de España.

- a Real credit growth rates are calculated as the difference between the nominal credit growth rate and the CPI inflation rate. The aggregate for Latin America by type of loan is calculated as the average of the year-on-year rates of the five countries, weighted by GDP in purchasing power parity terms.
- b Calculated as the nominal growth in deposits less the CPI inflation rate.
- c Defined as liquid assets divided by short-term liabilities, except in the case of Chile where it is the current ratio (current assets divided by current liabilities).

<sup>1</sup> Each year, the Banco de España identifies third countries (i.e. outside the European Economic Area) that are materially significant to the Spanish banking system for the purpose of the countercyclical capital buffer (CCyB). To this end, the size of Spanish banks' international exposures is analysed according to the European Systemic Risk Board's guidelines. In 2023 nine material countries were identified – the United States, the United Kingdom, Turkey, the five Latin American countries mentioned above and Argentina (which is added to the list of material countries). See the [section on the CCyB](#) on the Banco de España's website.

Box 2

**RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS** (cont'd)

segments (such as credit cards), both to firms and to individuals. Moreover, “earmarked credit” (government-imposed bank lending for certain types of investment and construction) grew by around 10% year-on-year.

In the region overall, credit growth rates have eased across nearly all sectors since end-2022, although mortgage lending was more resilient (see Chart 2). Further, in countries for which data are available, loans denominated in US dollars grew faster than loans in domestic currencies owing to their lower interest rate cost, although their level of dollarisation stands close to pre-pandemic levels.

As regards bank funding, there was also a broad-based slowdown in real deposits growth over the course of 2022 (see Chart 3), even reaching negative rates towards the end of the period. The exception was Peru, where deposits growth gathered steam, especially in time deposits. As was the case in other emerging economies, Latin American banks brought debt placements on international markets to a standstill. Despite the negative performance in deposits, the standard liquidity ratios (liquid assets to short-term liabilities) revealed no significant impairment (see Chart 4).

Banks in the region have not experienced problems akin to those of some mid-size US banks and Credit Suisse,

Chart 5  
Regulatory capital

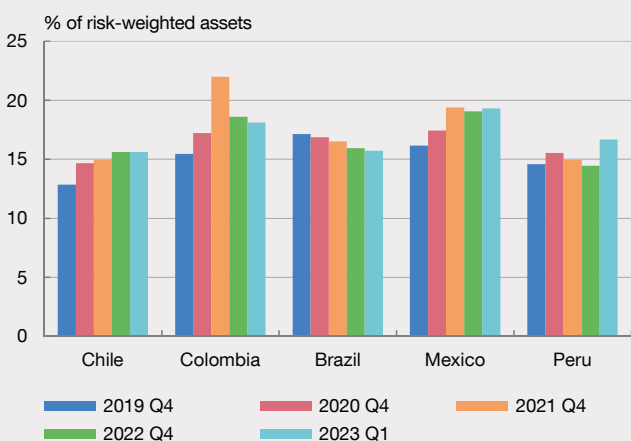


Chart 6  
Banking industry stock prices (a)



Chart 7  
Profitability (a)

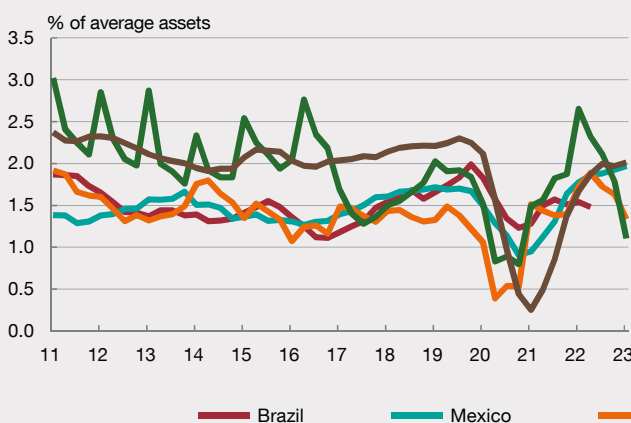
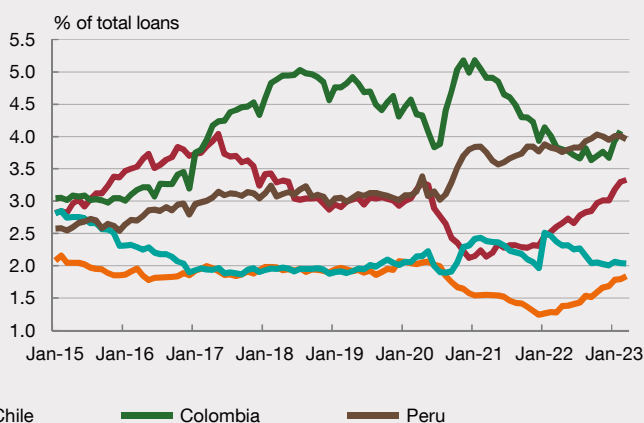


Chart 8  
Non-performing loans



SOURCES: National statistics, Refinitiv, IMF and Banco de España.

a Return on average assets (ROA).

## Box 2

**RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS** (cont'd)

which came to light in March 2023. Indeed, the capital ratios of the region's banking systems held stable above the regulatory requirements (see Chart 5), banks' stock prices have broadly risen in 2023 to date (see Chart 6) and the financial stability reports published by authorities ruled out any serious concerns related to the recent turmoil in the US banking system.<sup>2,3</sup>

Nor have profitability indicators shown any significant signs of deterioration; in fact, they increased in some countries thanks to stronger net interest income as a result of higher interest rates (see Chart 7). The main exception was Colombia, where profitability indicators declined due to provisioning expenses for non-performing loans (NPLs), whose share of total loans climbed further in early 2023 and is the highest in the region.<sup>4</sup> NPLs continued to rise in the rest of the region and, with the exception of Mexico, returned to pre-pandemic levels (see Chart 8). This increase was driven, above all, by loans to households (except in Mexico), and within these by the riskier loans (e.g. credit cards in Brazil).

On the regulatory side, as a precautionary measure in view of the heightened external uncertainty, in May 2023

the Board of the Central Bank of Chile decided to activate the counter-cyclical capital buffer, setting it at 0.5% of risk-weighted assets and giving banks a one-year adaptation period. In Peru, the regulatory changes to align with Basel III requirements entered into force in January 2023, introducing a new capital framework for the financial system. The upshot was the total capital ratio rising from 14.5% in December 2022 to 16.4% in January 2023.

In their regular financial stability reports, the central banks or supervision authorities in Latin American countries of material importance to the Spanish banking system analyse recent developments in the main banking sector indicators, but also flag a series of risks to their banking systems.<sup>5</sup> In particular, the reports for the first half of 2023 identified certain risks that were common to all of these economies – including those discussed in this report – and other risks that were more specific to each country.<sup>6</sup> Figure 1 summarises the main country-specific risks for the Brazilian, Chilean, Colombian, Mexican and Peruvian banking systems according to their national supervisors.

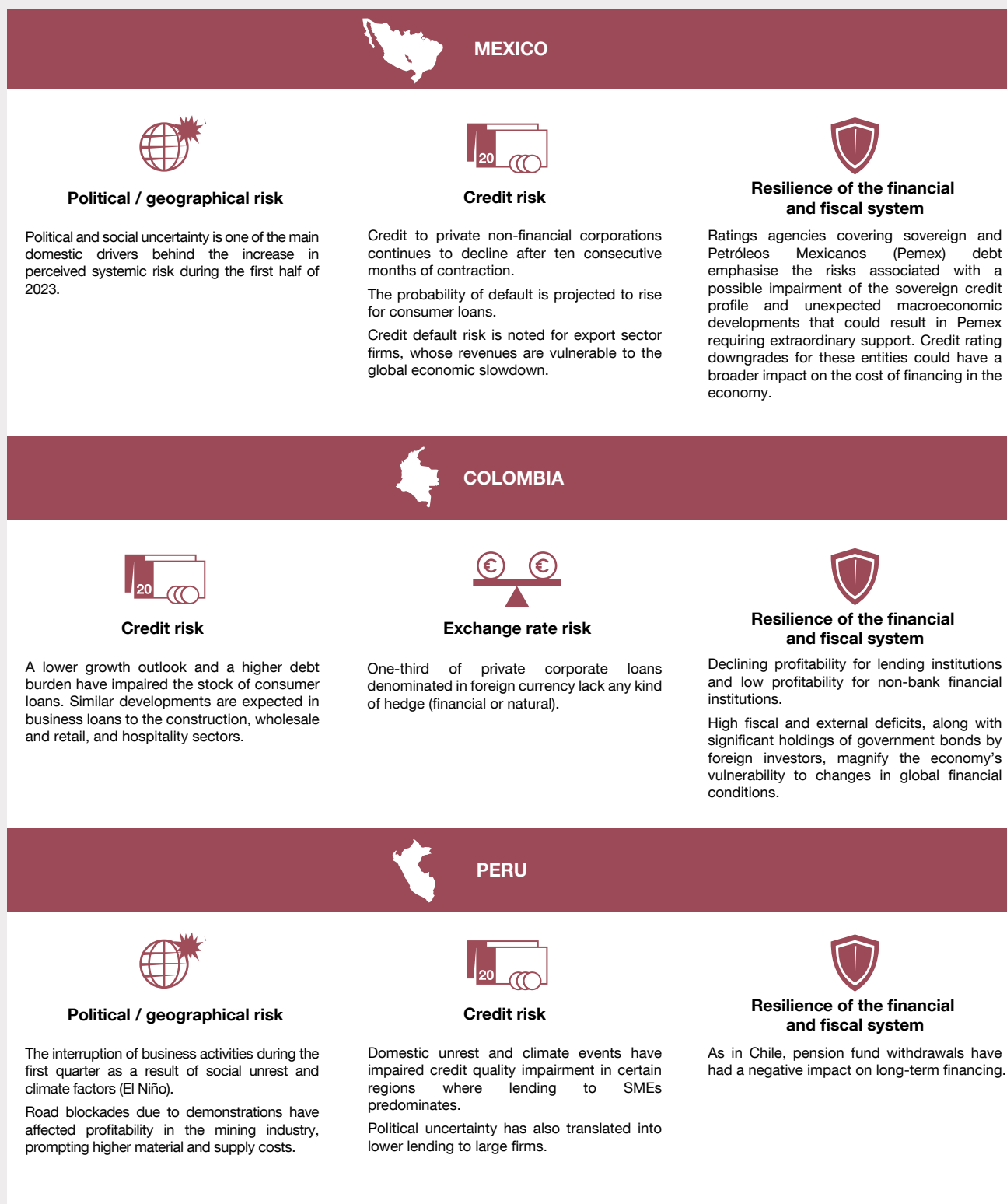
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- 2 In its most recent financial stability report, the Brazilian central bank conducted a stress test taking into account the portion of debt that banks hold to maturity (4.2% of all assets in the system), finding that there were sufficient liquid assets in the system to cover potential cash outflows. Nor is the potential need to provide liquidity support to bank-linked investment funds thought to be a significant risk. The insolvency of the Lojas Americanas retail chain dealt a larger blow to confidence in the Brazilian banking industry, after the retailer filed for bankruptcy protection with around \$8 billion in debt and several banks among its main creditors. Nonetheless, the central bank concluded that the bankruptcy did not pose a risk for the financial sector as a whole (see the [Financial Stability Report](#) (text in Portuguese) of May 2023).
  - 3 In the case of Peru, the International Monetary Fund's recent review of the Flexible Credit Line includes a box on the subject, indicating that Peruvian banks did not face risks similar to those experienced by US banks because, among other reasons, assets held to maturity account for just 2% of total assets in the system.
  - 4 Colombian banks' return on assets (ROA) and their stock market performance may be shaped by, first, increased uncertainty over economic policy, and, second, by the various problems facing the Banco de Bogotá (such as handing direct control of Porvenir – a pension fund – to Grupo Aval – the bank's parent company –, and the spin-off of its Panama-based subsidiary AC Holding International, which operates in Central America).
  - 5 In all cases these are reports published by the central banks, although the supervision authorities are different in some countries. For instance, banking supervision is conducted in Brazil by the country's central bank, in Colombia by the Financial Superintendency, in Chile by the Superintendency of Banks and Financial Institutions, in Mexico by the National Banking and Securities Commission and in Peru by the Superintendency of Banking, Insurance and Private Fund Administrators.
  - 6 The aforementioned reports are available online: [Relatório de Estabilidade Financeira](#) (Brazil), [Reporte de Estabilidad Financiera](#) (Mexico), [Financial Stability Report](#) (Chile), [Reporte de Estabilidad Financiera](#) (Colombia) and [Reporte de Estabilidad Financiera](#) (Peru).

## Box 2

## RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS (cont'd)

Figure 1

The central banks of the main economies in the region highlight specific risks

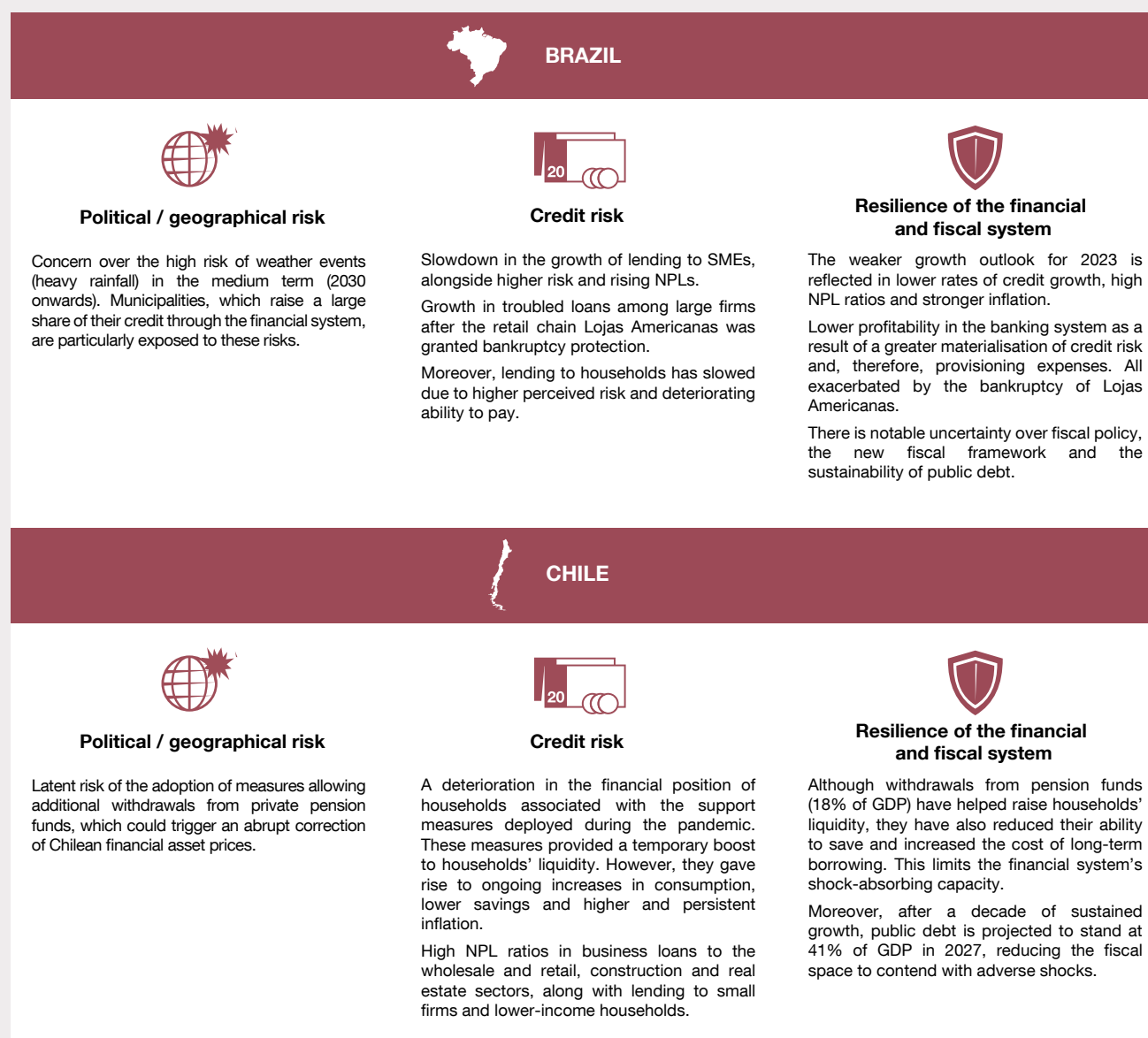


SOURCE: Banco de España.

## Box 2

## RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS AND THE RISKS TO FINANCIAL STABILITY ACCORDING TO THE REGION'S CENTRAL BANKS (cont'd)

Figure 1  
The central banks of the main economies in the region highlight specific risks (cont'd)



SOURCE: Banco de España.

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