Discussion on “Navigating the Impact of U.S. Tariffs on Latin America and the Caribbean: Risks, Responses, and Opportunities”

Carlos Giraldo
Chief Economist

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Introduction

- Thank you for the insightful presentation

- Nearshoring might be a natural response to the new wave of geoeconomic fragmentation, particularly in the aftermath of the trade shock (U.S. tariffs and escalating U.S.-China tensions)

- But the key questions are:

  - Is nearshoring a opportunity, or one possible scenario in today's highly uncertain world?
    - Who really knows?
  - Let's suppose this is an opportunity — can Latin America truly turn it into sustainable growth amid such high global uncertainty?

The opportunity channel: Nearshoring potential

- The region could capture between 1.5% and 3% of GDP in additional exports to the U.S. over the next decade[1/]

- Costa Rica shows what's possible when strong institutions, skilled labor, and effective public-private coordination converge—Intel's investment led to productivity gains and structural transformation
  - This dispels the specter of immiserizing growth (Johnson, 1955-67)

- The increasing diversification of FDI sources—particularly from Europe—is a welcome shift away from excessive dependence on China or the U.S.

- LatAm is heterogeneous to take advantage of this opportunity: Mexico and Central America are deeply integrated into U.S.-centered value chains, and this offers strong nearshoring opportunities

[1/] IFC (2024) for LAC-10.

A Cautionary note: U.S. uncertainty shocks and the role of macroeconomic and financial stability

- A global uncertainty shock triggered by the U.S. persists despite tariff reversals. Its duration is unknown—though more intense in the short term—and it poses risks to macroeconomic and financial stability across the region

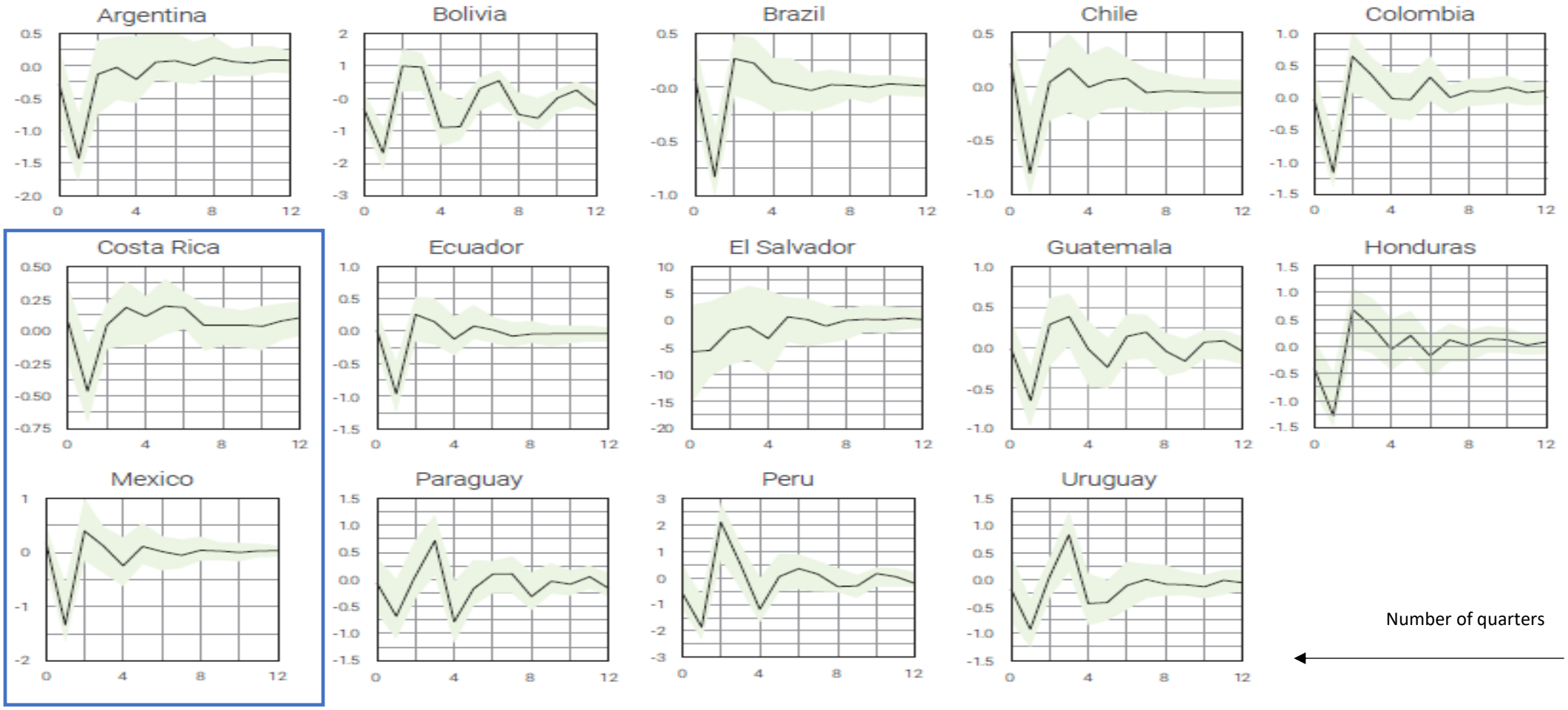
- Our recent research shows that the primary transmission channel of U.S. policy uncertainty shocks to 14 Latin American economies is the real sector, through trade and investment

  - Uncertainty tightens credit conditions, constraining private investment even amid strong FDI announcements

- Economies well-positioned for nearshoring are also among the most vulnerable to these shocks

Note: Response to a one standard deviation shock. The shadowed area corresponds to 95% confidence intervals constructed by bootstrapping. We also evaluate the effects of real, financial and monetary policy uncertainty.
Source: Giraldo *et* al (2023).

GDP response to a U.S. policy uncertainty shock



Note: The figure shows the response of GDP in Latin American countries to US economic policy uncertainty. The shadowed area corresponds to 95% confidence intervals constructed by bootstrapping.

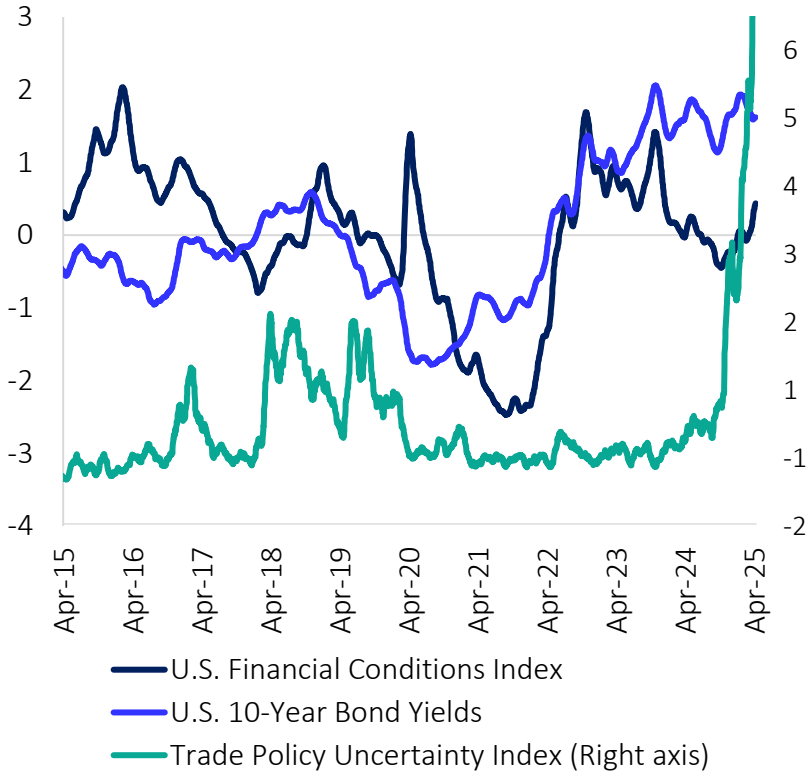
Note: Response to a one standard deviation shock. The shadowed area corresponds to 95% confidence intervals constructed by bootstrapping. We also evaluate the effects of real, financial and monetary policy uncertainty.
Source: Giraldo *et* al (2023).

But recent developments under the U.S. tariffs scenario have generated atypical repercussions in financial markets and may pose long-term risks to the international financial system

In a high-interest-rate environment, political uncertainty shocks contribute to a further tightening of global financial conditions.

10-year treasury bond yields, financial conditions, and trade policy uncertainty index

(In standard deviations, 30-day moving average)



In April, U.S. Treasuries did not behave as safe-haven assets.

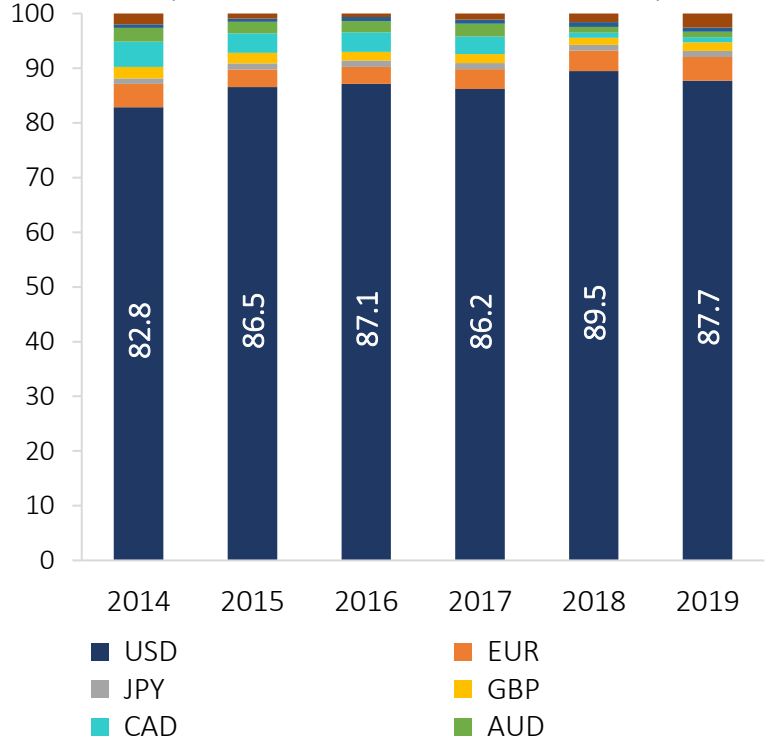
CDS on a 10-year treasury bond

(basis points)

The rise in U.S. Treasury yields [1/] may negatively impact central bank international reserves behavior (external buffer)

LA7: Composition of international reserves by currency [1/]

(% of total international reserves)

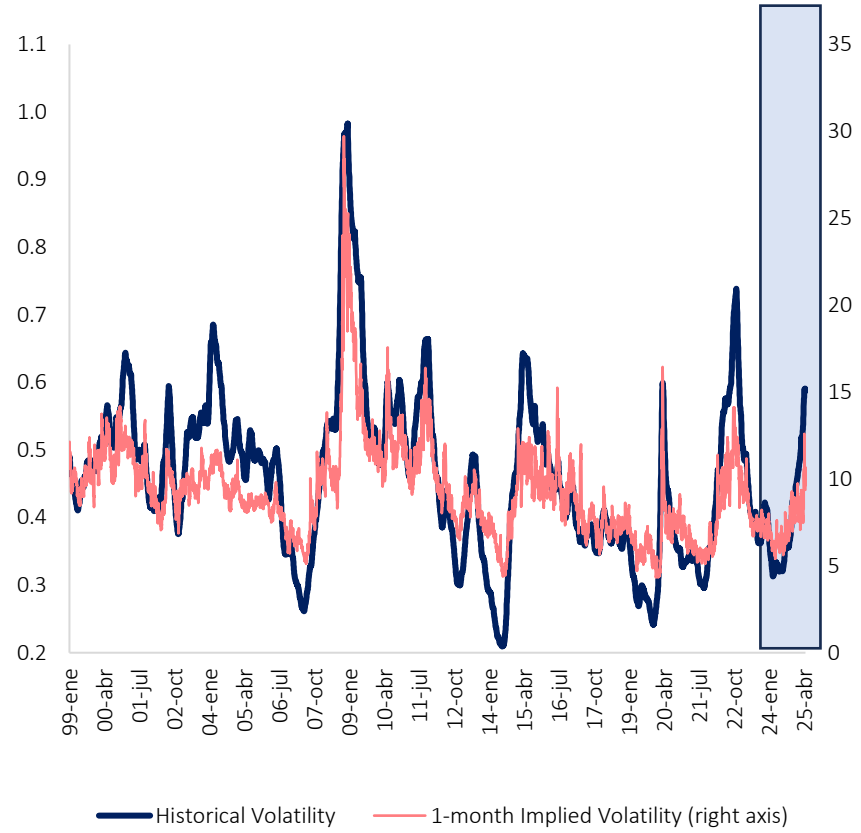


Source: Bloomberg, Investing and Goldman Sachs.

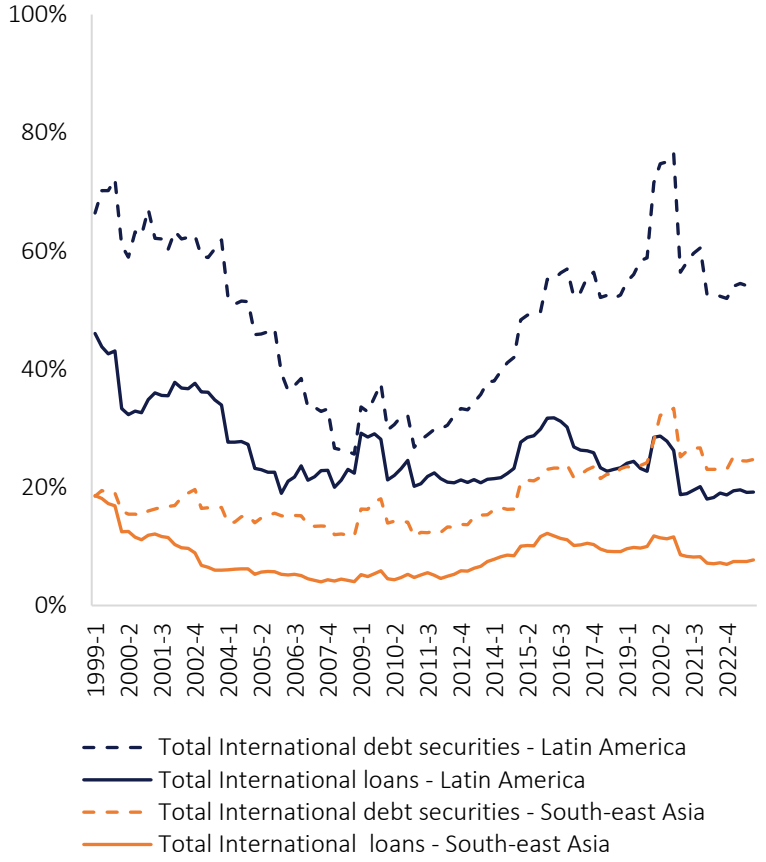
[1/] Recalling the impact of President Nixon's 1971 decision to end the dollar's convertibility into gold at a fixed rate.

Moreover, an often-overlooked risk channel is the rise in financial vulnerabilities stemming from the high exposure of the non-financial corporate sector to dollar-denominated liabilities

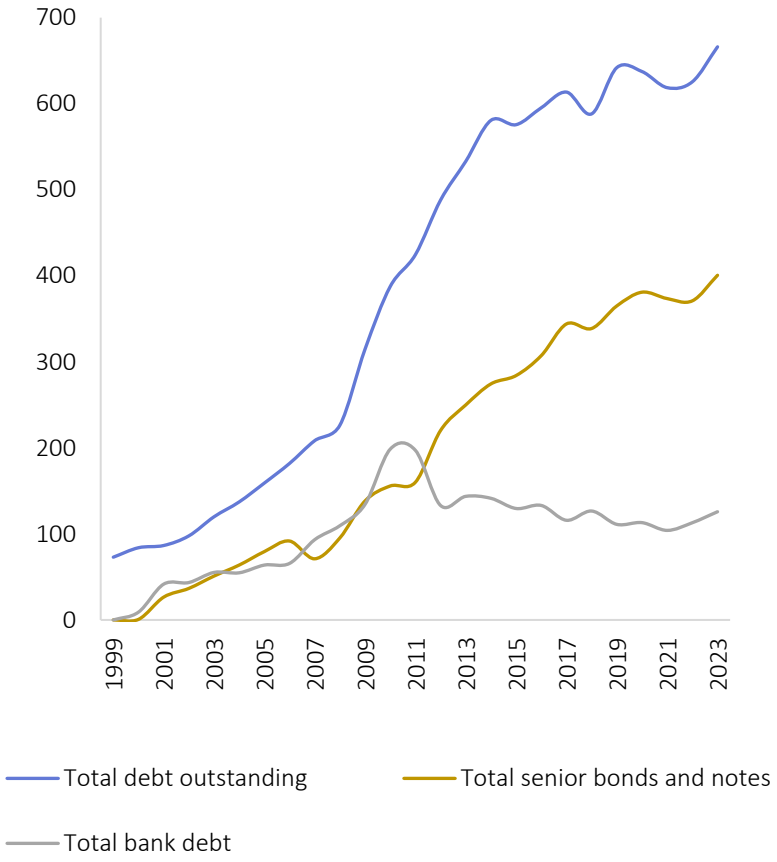
Global USD volatility [1/]
(%)



International dollar debt of non-banks
(% exports)



Debt securities vs. Bank loans NFC [2/] in LA7
(USD billions)



[1/] As a measure of global dollar strength we use the DXY index. To estimate historical volatility we use a stochastic volatility model using Bayesian techniques. Implied volatility is calculated using options on the 30-day

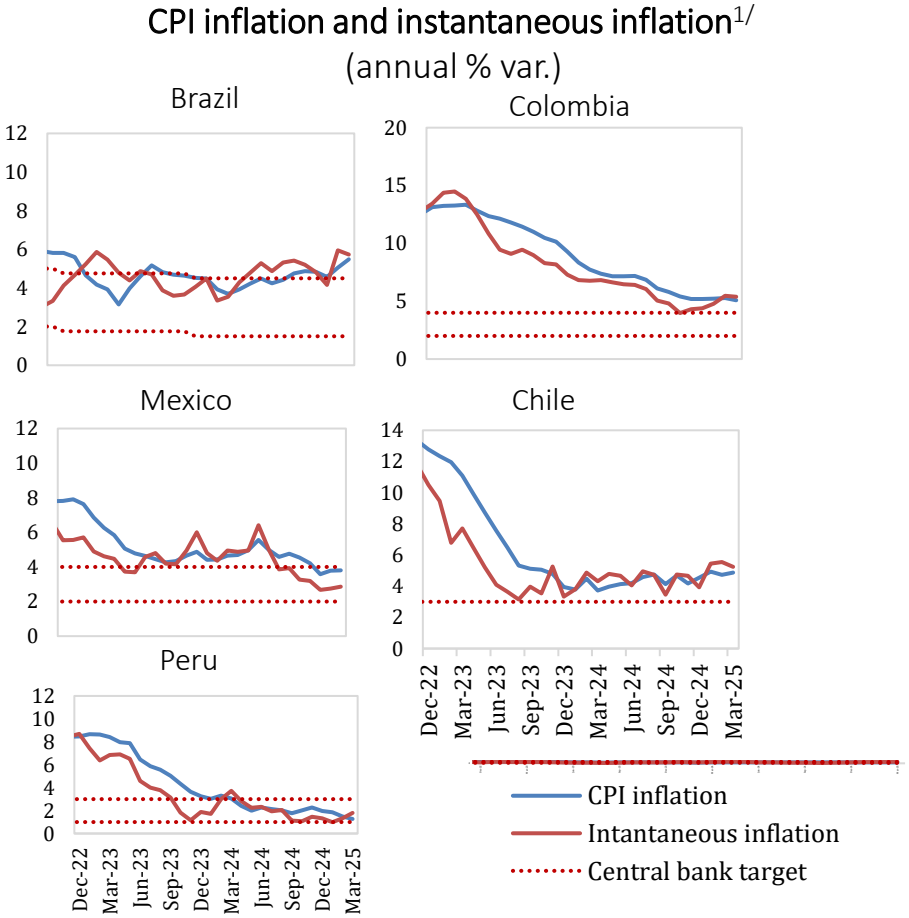
[2/] NFC: Non-Financial Corporations

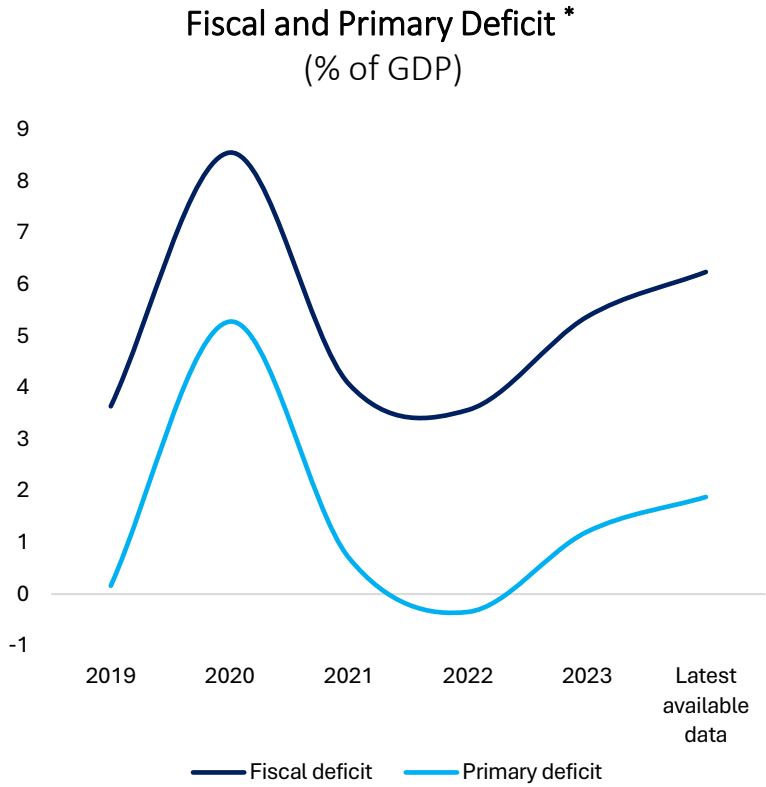
Source: Own elaboration using data from Capital IQ and Bloomberg

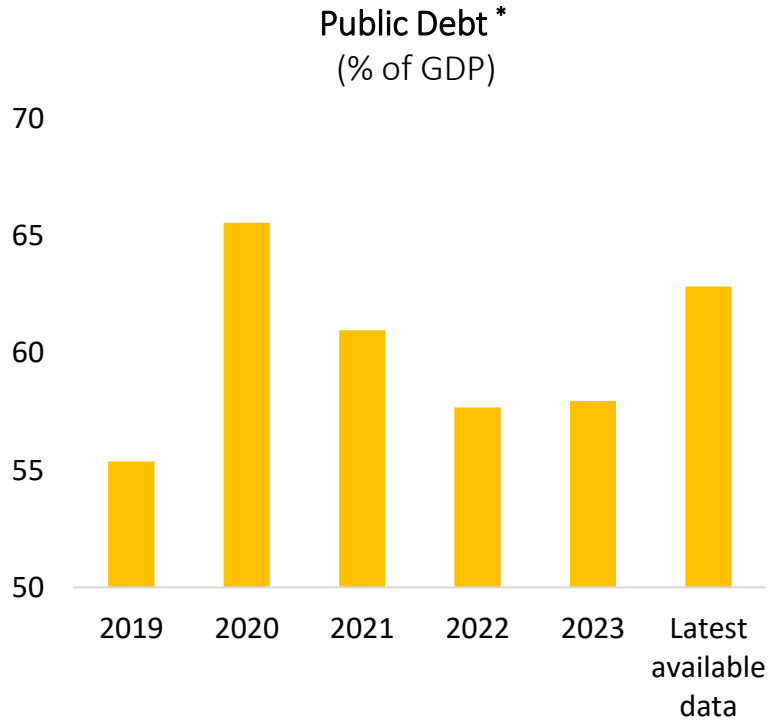
And there is limited and uneven countercyclical response capacity

CPI inflation remains above or near the upper bound of the target range in several IT economies, with short-term pressures reflected in instantaneous inflation.

Rising public deficits and high public debt (as a share of GDP) weaken policy space and risk eroding confidence in macro-financial stability in a highly volatile environment. Higher debt levels may also put upward pressure on sovereign spreads during episodes of global risk aversion.







* The latest data corresponds to December 2024. Considered levels of government are: General government: Brazil and Chile; Central government: Colombia and Paraguay; Public sector: Mexico; Non-financial public sector: Peru; and Non-monetary public sector: Uruguay.

1/ Instantaneous inflation assigns a greater weight to more recent data and reduces the influence of older data through a *kernel* function, following the approach developed by Eeckhout (2023). On the other hand, we optimize the *kernel* smoothing parameter using the methodology proposed by Caicedo, Martínez, Vallejo & Garavito (2025), presented in the Colombia's central bank Monetary Policy Report (Box N.°1) from jan-2025.

Source: Central Banks and own calculations following methodologies from Eeckhout (2023) and Caicedo, Martínez, Vallejo & Garavito (2025).

All this brings us to a crucial point:

- Macroeconomic and financial stability is once again at the core of the regional policy agenda

- Maintaining stability is essential to secure long-term capital inflows, such as FDI
  - Investors need confidence that their capital will be preserved

Implication:

- Countries that combine nearshoring potential with credible macro frameworks and stable financial systems will be well-positioned to attract and retain foreign investment

What domestic conditions must be strengthened?

Key structural reforms (Commented by Andres)

From a macroeconomic standpoint:

- Robust countercyclical frameworks are essential to cushion volatility
- Countries should leverage fiscal consolidation, inflation-targeting regimes, and macroprudential tools to build credibility, reduce exposure to external shocks and attract FDI
- Ultimately, macro-financial stability is a precondition for development through investment

Institutional coordination matters:

- Costa Rica's case shows that attracting investment is only the first step. The real challenge is generating local spillovers

Conclusion

- Nearshoring might be an opportunity for some countries. Without coherent national strategies and institutional readiness, it could easily be missed

- LatAm needs to prepare the “fertile ground” for these external seeds to take root and flourish

- As both the presentation and the uncertainty shocks literature suggest, countries that succeed will be those that pair strategic vision with macro-financial soundness

Thank you!

References

- Giraldo, Carlos, et al (2023). US uncertainty shocks, credit, production, and prices: The case of fourteen Latin American countries. FLAR working paper.

- Giraldo, Iader; Turner, Philip (2022) *The dollar debt of companies in Latin America: the warning signs, FLAR working papers*