Report

Contents

1 Economic activity in Latin America remains more buoyant than expected… 5

2 … although a significant slowdown is anticipated in the coming quarters... 6

3 … against a backdrop of low potential growth and high uncertainty 7

4 Inflation has continued to moderate across the region, albeit unevenly across countries and to a lesser extent in the case of underlying inflation 8

5 The downward stickiness of underlying inflation is mainly due to the services component... 9

6 ... which has continued to surprise on the upside in recent months 10

7 Inflation is expected to continue declining gradually 11

8 Long-term inflation expectations are still anchored around the inflation targets and bear little relation to past inflation 12

9 Against this backdrop, the region’s central banks have gradually been pausing their interest rate hiking cycles 13

10 The restrictive monetary policy stance in the region’s main economies appears well suited to tackling the current inflationary episode 14

11 The financial markets are pricing in very gradual policy rate cuts 15

12 The financial variables performed somewhat better in the region than in the other emerging economies 16

13 Several factors appear to be behind the better performance of the financial markets 17

14 The region has continued to attract portfolio capital, while fixed-income placements remain low 18

15 Policy uncertainty and social unrest have generally remained high in the region in recent quarters 19

16 Indicators of external and fiscal vulnerabilities have deteriorated in the region… 20

17 …and the medium-term outlook for public finances continues to be less favourable than before the pandemic 21

18 Debt sustainability would notably improve if structural reforms and fiscal consolidation programmes were implemented 22

1 Economic activity in Latin America remains more buoyant than expected…

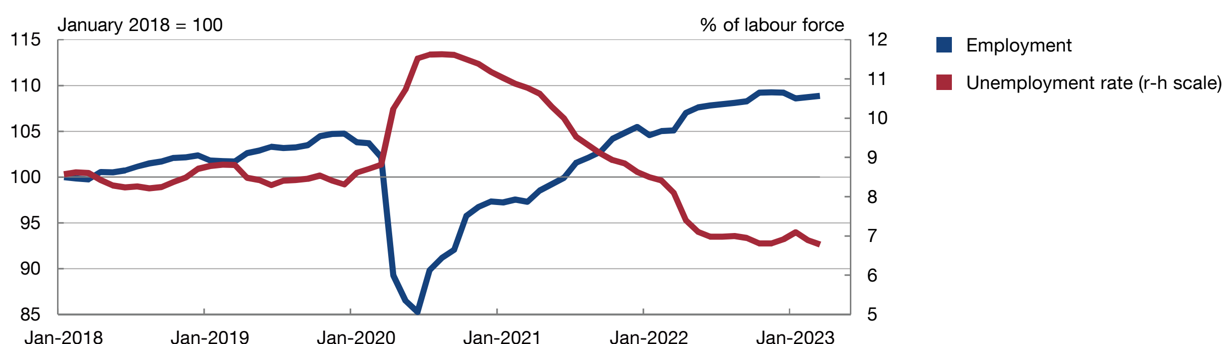
— As in 2022, GDP growth in the main Latin American economies surprised on the upside in 2023 Q1, with a quarterly growth rate in the period of 1.2%, compared with the analysts' forecast of 0% at the start of the year. Growth was uneven across the region (see Table 1), with strong momentum in Brazil, 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).

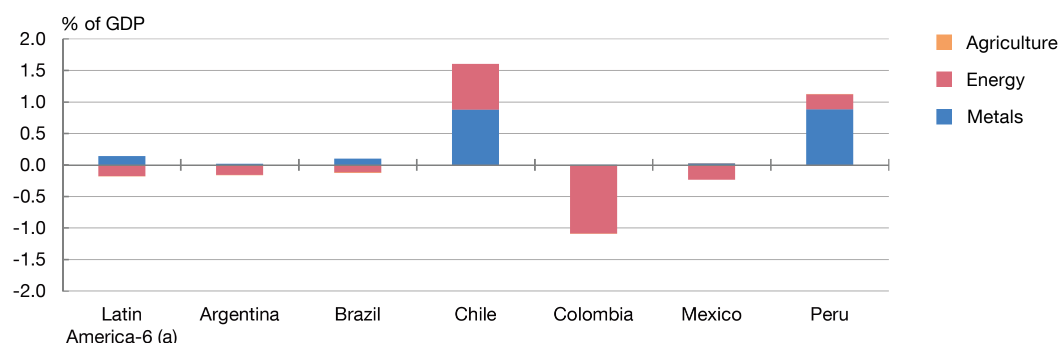
— In the first half of 2023, commodity price developments compared with the previous half-year had a positive impact on the trade balances of countries that export metals and an adverse impact on the trade balances of those that export oil. This also partly explains the uneven growth observed across 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.

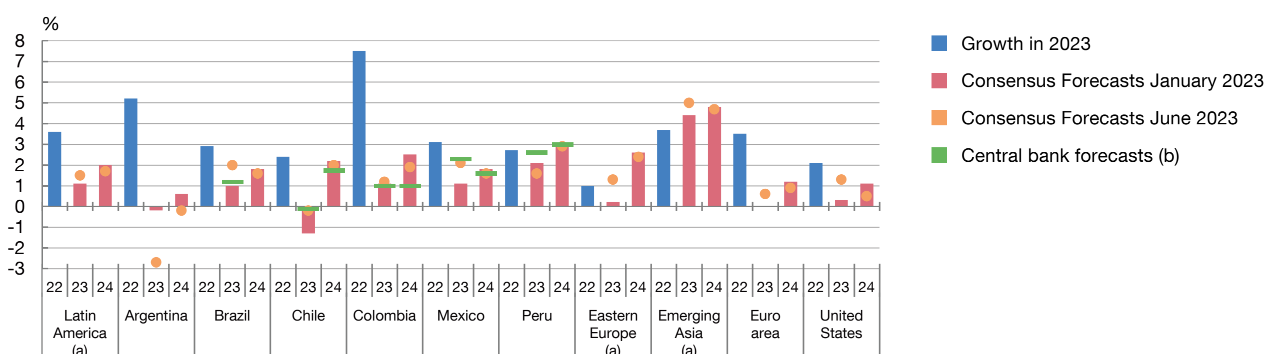
2 … although a significant slowdown is anticipated in the coming quarters…

— 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.

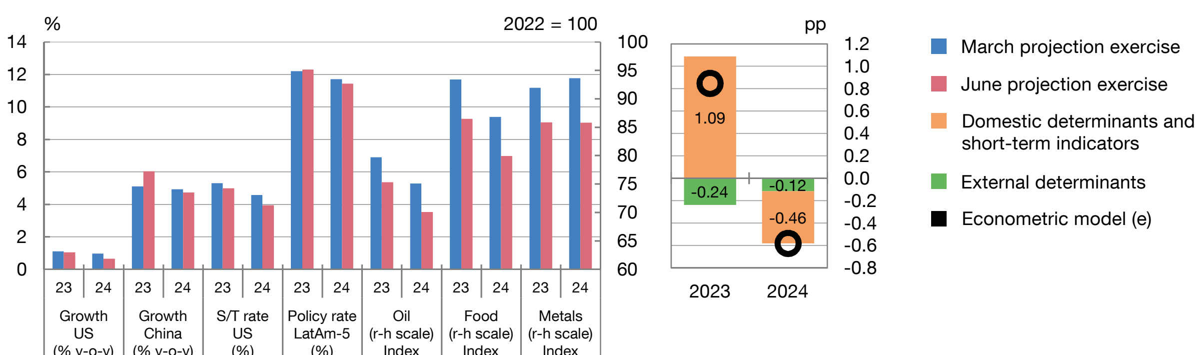
— Compared with the start of the year, the outlook for Latin America has been revised up for 2023, but down slightly for 2024. The less favourable global environment and lower expected prices (measured by futures) for key commodities on the international markets dilute the expected growth and are only 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

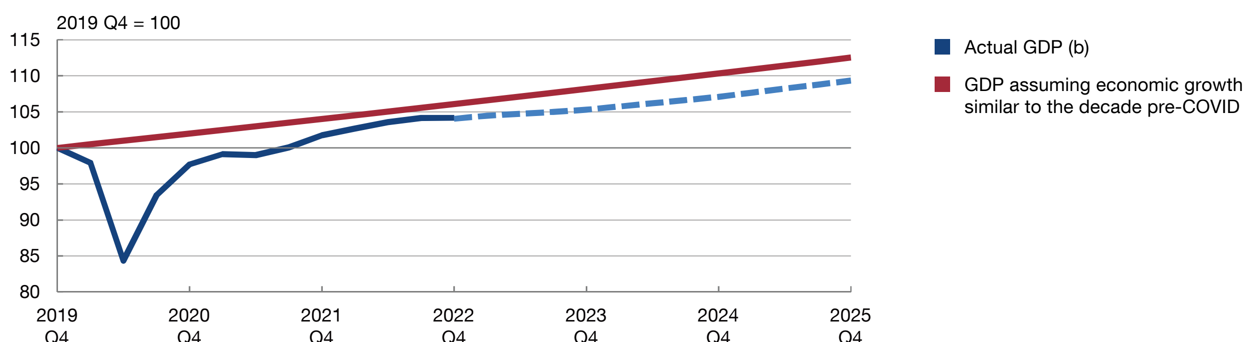
— At-end 2022, the aggregate GDP of the main economies of the region was 4% above its pre-pandemic level, although very uneven across countries. Further, it was 2% lower than would have been the case had economic growth in those three pandemic years equalled that observed in the decade 2010-2019, which 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[1] 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).[2]

— 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"*.

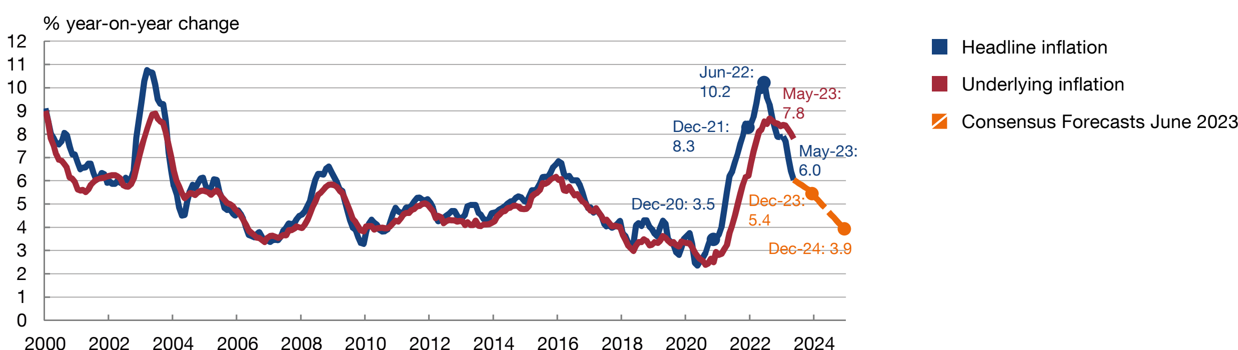
4 Inflation has continued to moderate across the region, albeit unevenly across countries and to a lesser extent in the case of underlying inflation

— 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).

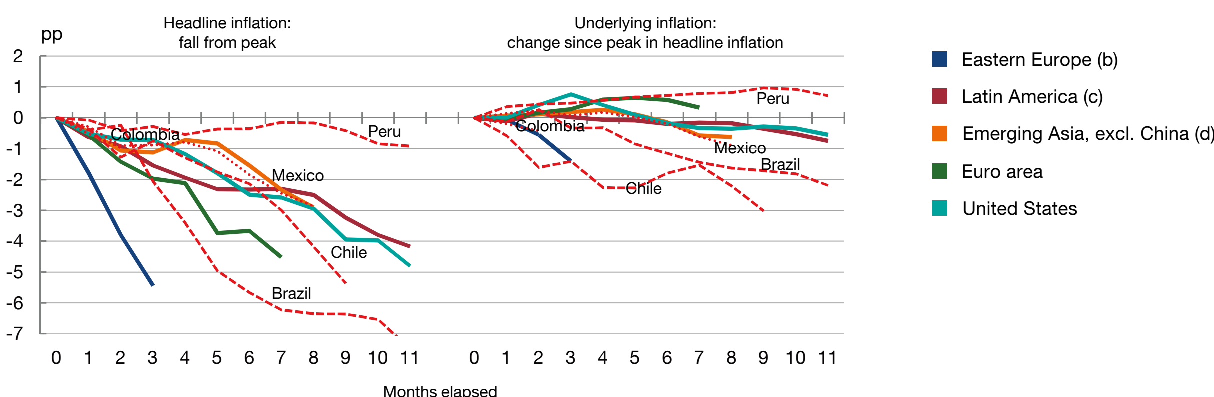
— Underlying inflation began to head down two months later than headline inflation in the region overall, standing at 7.9% in May, 0.8 pp off its August 2022 peak (see Charts 4.a and 4.b). The lag compared with headline inflation was uneven across countries (nine months in Peru and four months in Mexico, 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.

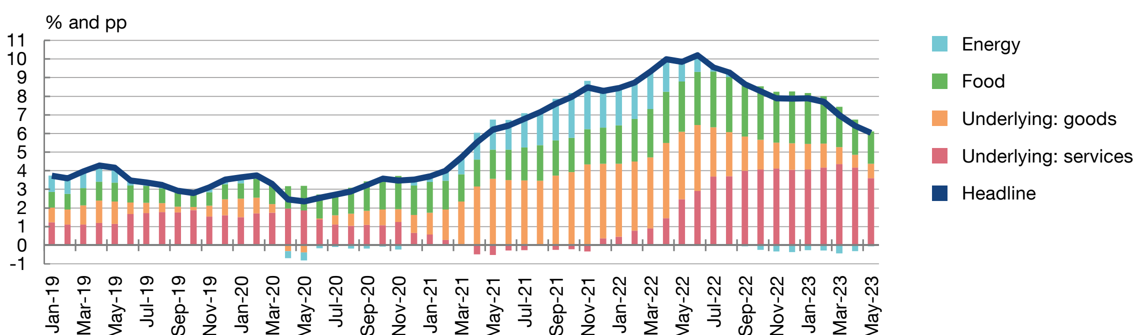
5 The downward stickiness of underlying inflation is mainly due to the services component...

— 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)[3] and its heavy weighting in the consumption basket (around 25%).

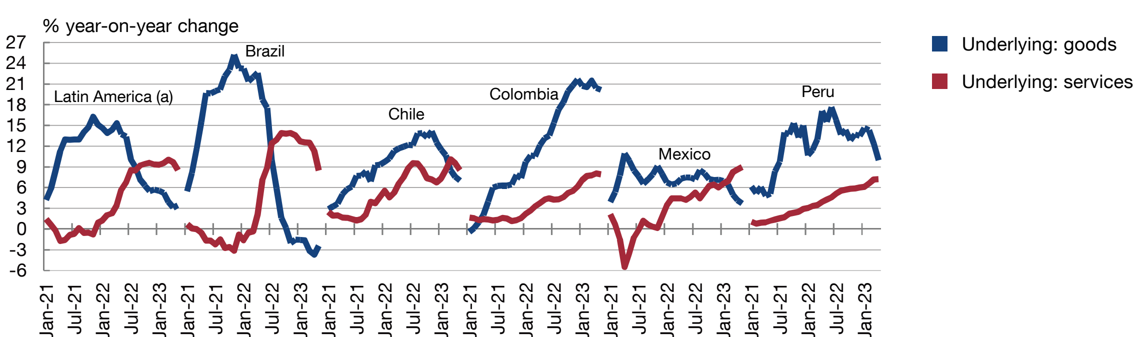
— As regards the underlying inflation components, non-energy goods also saw a sharp decline (making a contribution of -2.8 pp to the fall in headline inflation from June 2022), attributable in part to the unwinding of bottlenecks and currency appreciation. By contrast, services continue to account for 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.

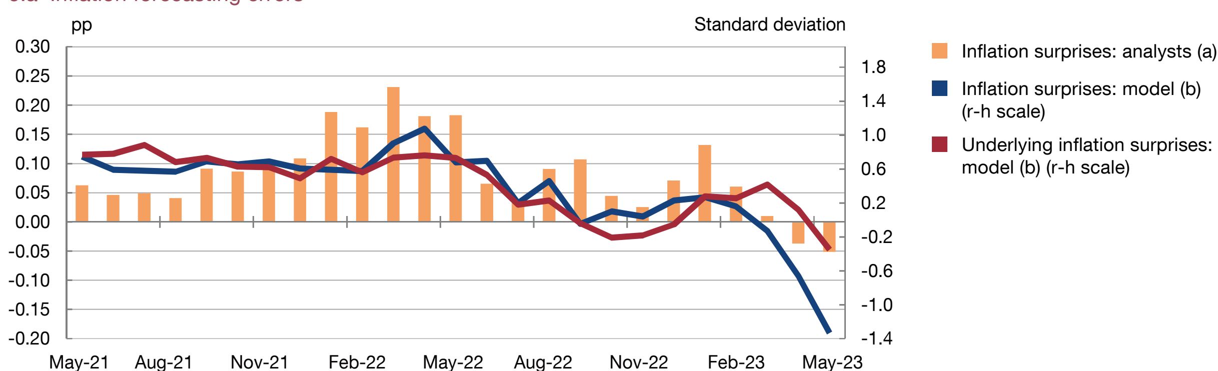
6 ... which has continued to surprise on the upside in recent months

— 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.

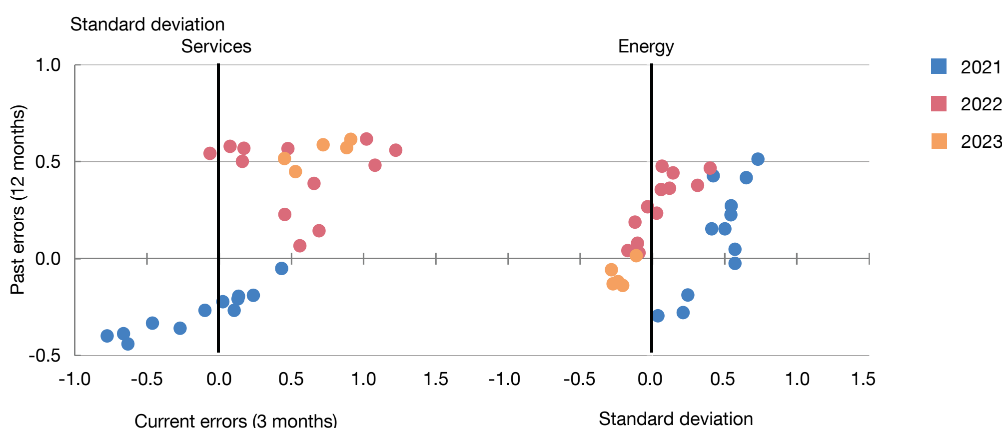
— This difference between the surprises in headline and underlying inflation is due mainly to services inflation, where figures have been consistently higher than projected and have not corrected in the most recent months (the forecasting errors over the last three months are higher than over the last 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.

a 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.
b 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.
c 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.

Back to contents

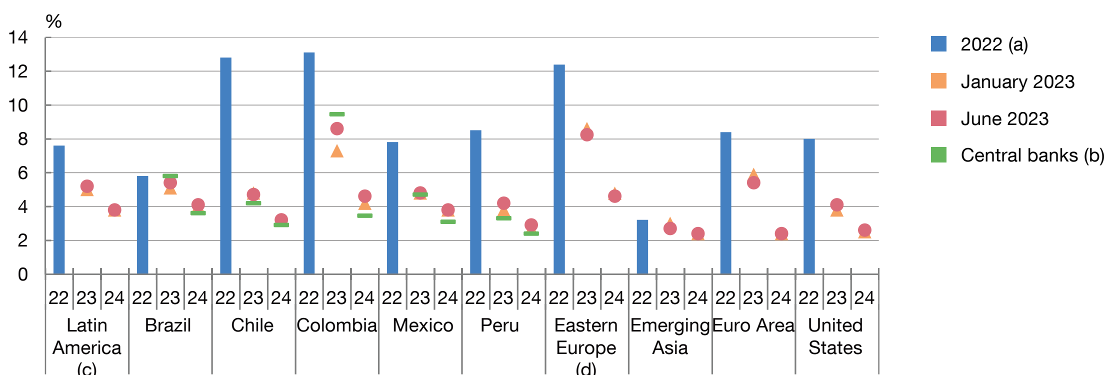
7 Inflation is expected to continue declining gradually

— 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).

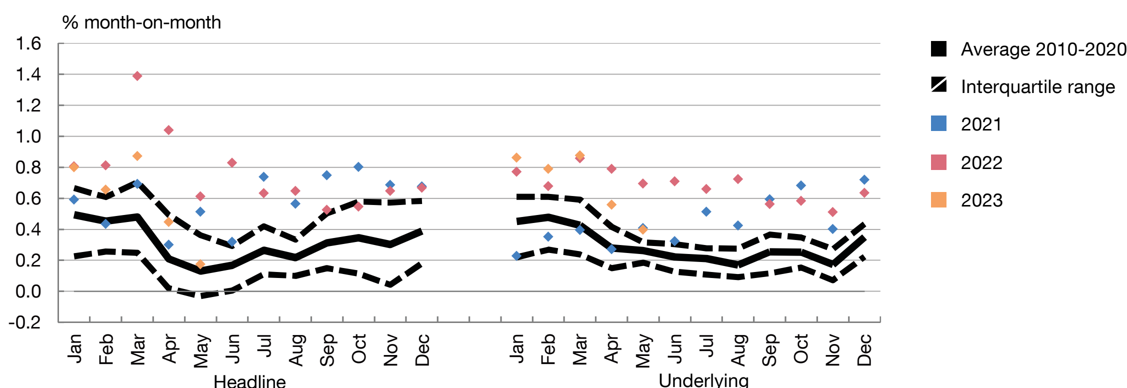
— In their regular reports, the central banks of the region's main economies detail some of the factors that will lead to a gradual decline in inflation: the asymmetric fall in food inflation as international benchmark prices fall[4] and exchange rates appreciate; the extent to which nominal contracts 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.[5]

Chart 7

7.a Inflation forecasts



7.b Inflation in historical perspective (e)



SOURCES: Consensus Forecasts and Refinitiv.

a Final inflation data for 2022.
b Central bank forecasts published in their latest monetary policy reports.
c Excluding Venezuela and Argentina
d Includes Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Slovakia and Slovenia, weighted by GDP in PPP terms.
e 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.

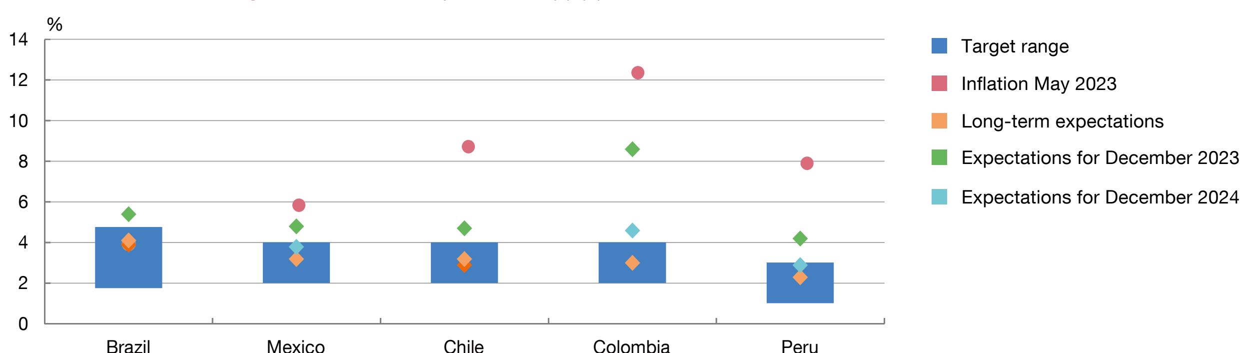
8 Long-term inflation expectations are still anchored around the inflation targets and bear little relation to past inflation

— 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).

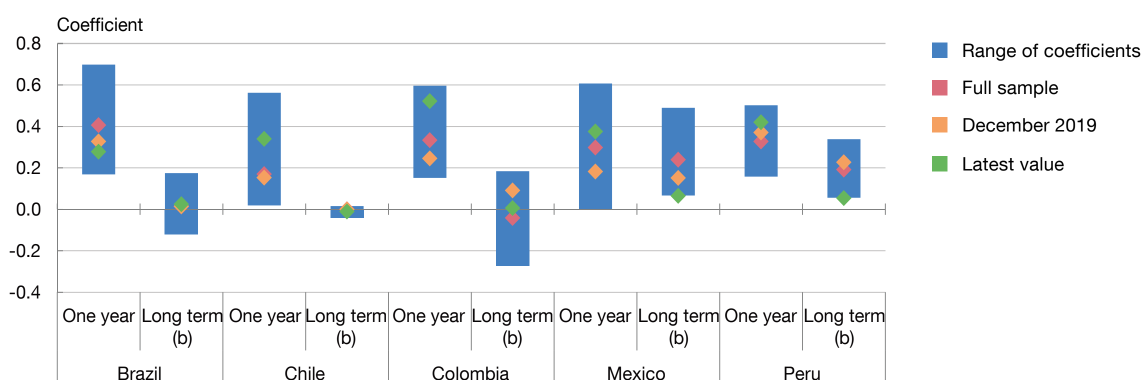
— The higher sensitivity of short-term inflation expectations to past inflation seen in recent months[6] is not reflected in more backward-looking long-term expectations (see Chart 8.b).[7] This indicator allows for an optimistic view as regards the risk of significant indirect and second-round effects 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 α of the regression equations: $\pi_t^{ecp} = \alpha\pi_{t-1} + (1-\alpha)\pi_t^{elp} + \varepsilon_t$ y $\pi_t^{elp} = \alpha\pi_{t-1} + (1-\alpha)\pi^* + \varepsilon_t$, estimated using five-year rolling windows; where π_t^{ecp} is one-year-ahead inflation expectations, π_{t-1} is year-on-year inflation for the previous quarter, π_t^{elp} is long-term inflation expectations and π^* 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.

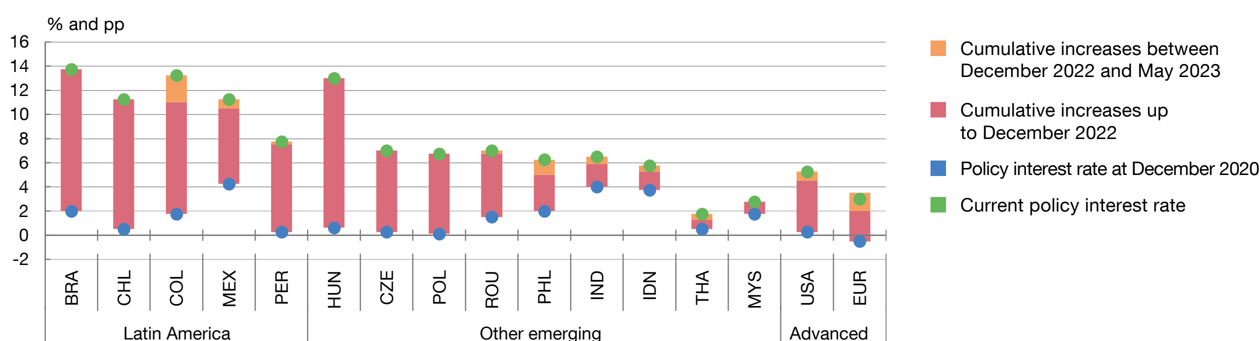
9 Against this backdrop, the region's central banks have gradually been pausing their interest rate hiking cycles

— 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.

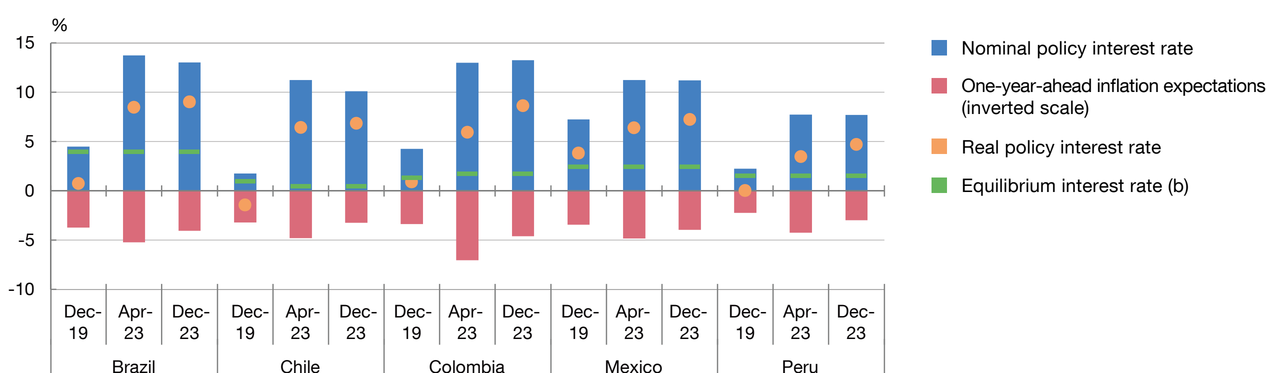
— Real interest rates in Latin America's inflation-targeting economies point to a markedly restrictive monetary policy stance (see Chart 9.b). Moreover, in most countries this restrictive stance could be maintained or even intensified in the coming months if the expectations that policy interest rate 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

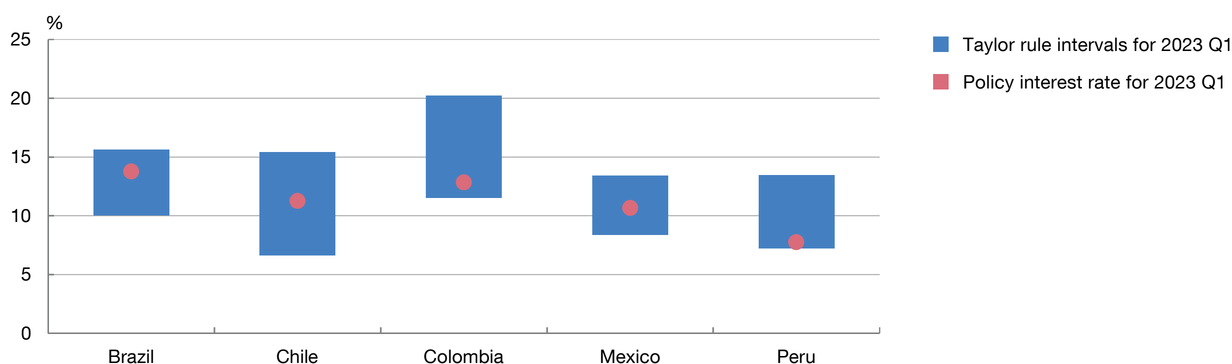
— To analyse whether the restrictive nature of current monetary policy (see Chart 9.b) reflects the present needs of the region's main economies, this policy stance is compared with the standard monetary policy rules, such as the Taylor rule. These rules offer estimations as to the "right" policy interest 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.[8]

— 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.

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

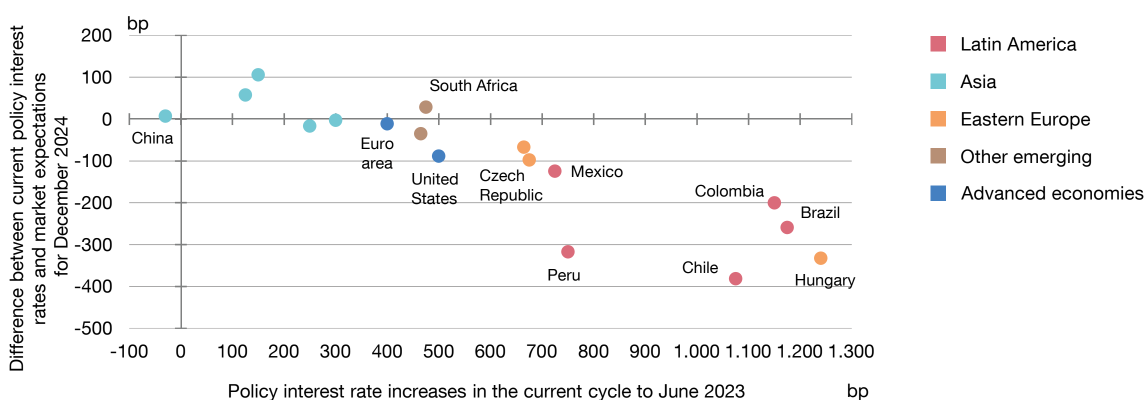
11 The financial markets are pricing in very gradual policy rate cuts

— 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).[9]

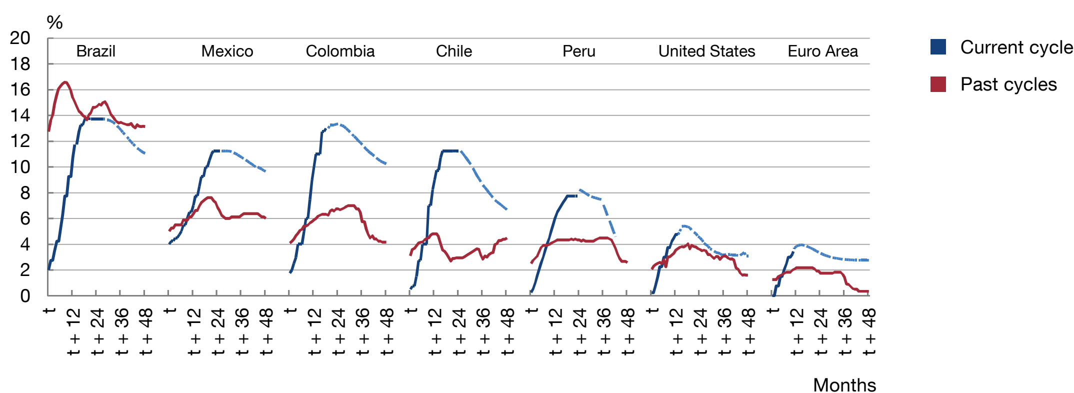
— Meanwhile, expectations as regards monetary policy developments in Latin America are subject to considerable uncertainty, and will be heavily influenced by the also uncertain monetary policy developments in the advanced economies, particularly the United States.

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.

a 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).

b 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.

9 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.

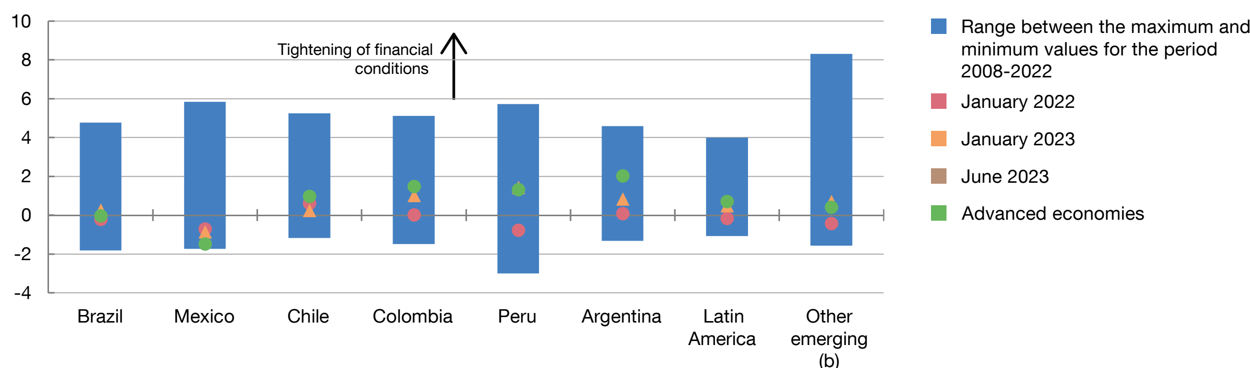
12 The financial variables performed somewhat better in the region than in the other emerging economies

— 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).

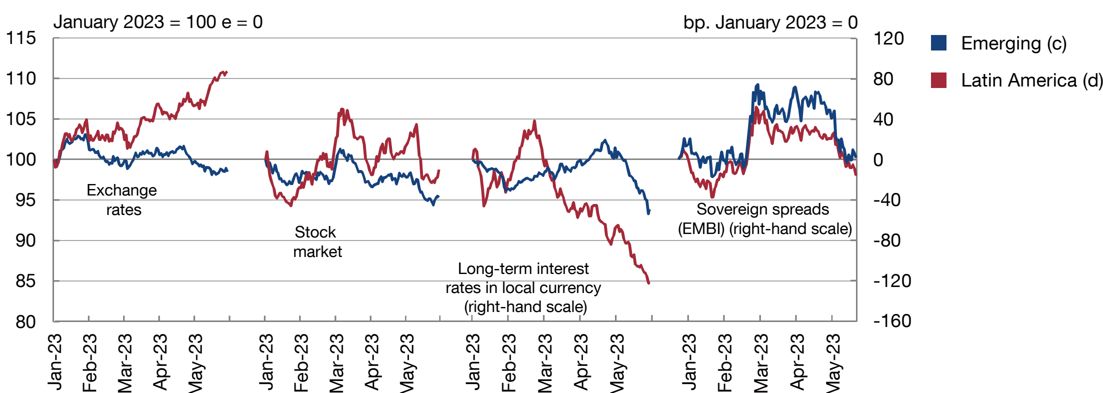
— In general, the region's financial variables performed better than those of other emerging economies (see Chart 12.b), albeit less so in the case of sovereign bond spreads. Expectations of a slow, restrained monetary easing cycle in the region (see page 15) could work in favour of the Latin American 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.

a 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.
b 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.
c 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 Europea, Asia, Middle East and Africa.
d Simple average of long-term interest rates in Brazil, Mexico, Chile, Colombia and Peru, or Latin American sovereign spread (EMBI).

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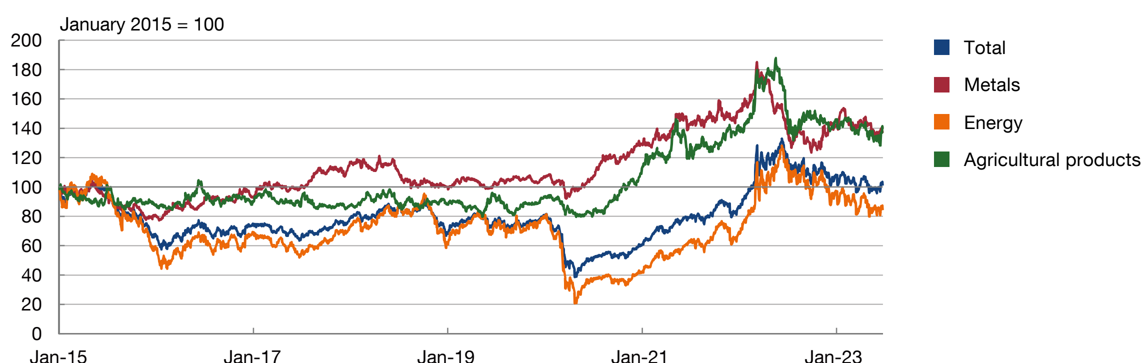
13 Several factors appear to be behind the better performance of the financial markets

— 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)[10] 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).

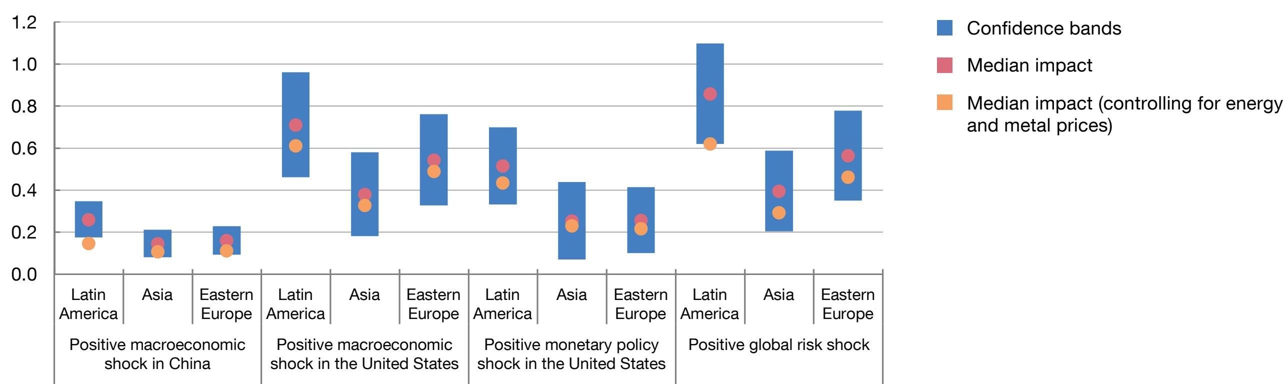
— Part of the positive differential performance compared with other emerging economies appears to be the result of external shocks. According to estimates,[11] a positive macroeconomic shock in the United States and the pause in its contractionary monetary policy cycle is behind the region's better relative financial market performance (see Chart 13.b).[12]

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.

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

11 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.

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

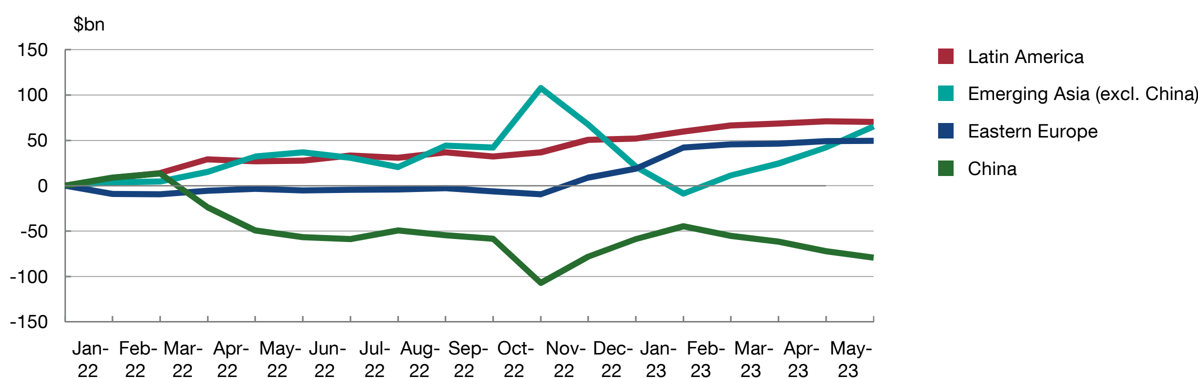
14 The region has continued to attract portfolio capital, while fixed-income placements remain low

— 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).

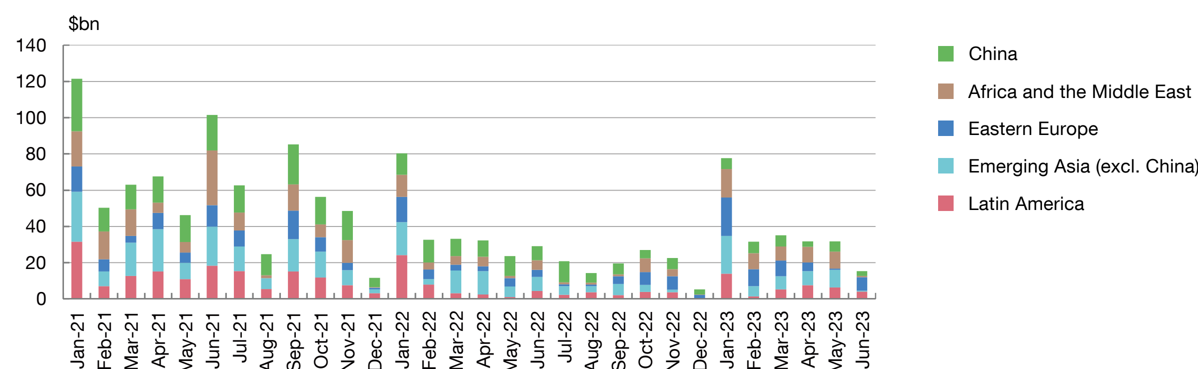
— Portfolio capital inflows invested in fixed-income securities in the first five months of 2023 ($10 billion) were higher than in the same period of 2022 ($8 billion). However, bond placements in international markets remained at very low levels by historical standards (see Chart 14.b), a trend that 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.

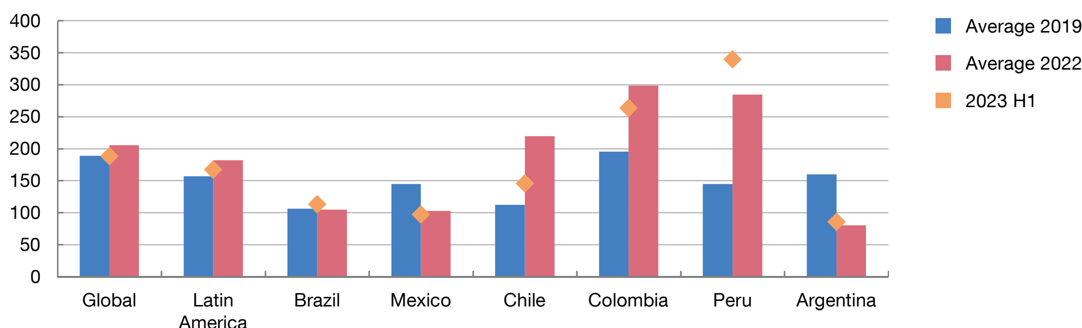
15 Policy uncertainty and social unrest have generally remained high in the region in recent quarters

— 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 particularly in Peru, 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.

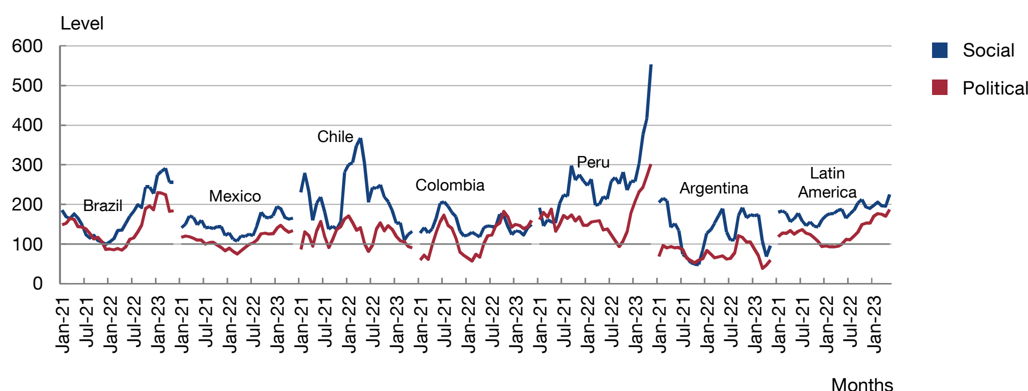
— Indicators of social and political unrest continued to trend upwards across the region (see Chart 15.b), especially in Brazil and, above all, in Peru, where they reached levels 50% above previous all-time highs after the country's president was ousted from power and social protests ensued. In the year 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.

a 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 newpapers.

b 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).

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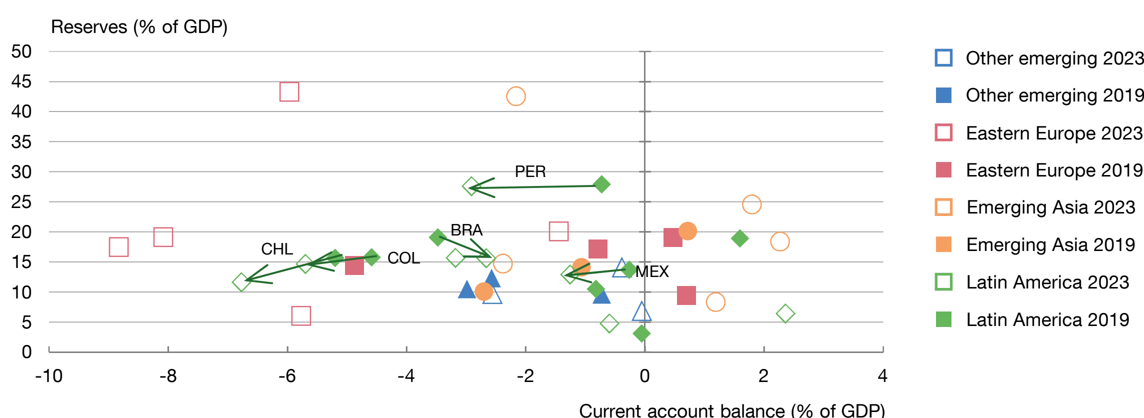
16 Indicators of external and fiscal vulnerabilities have deteriorated in the region…

— 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[13] (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.

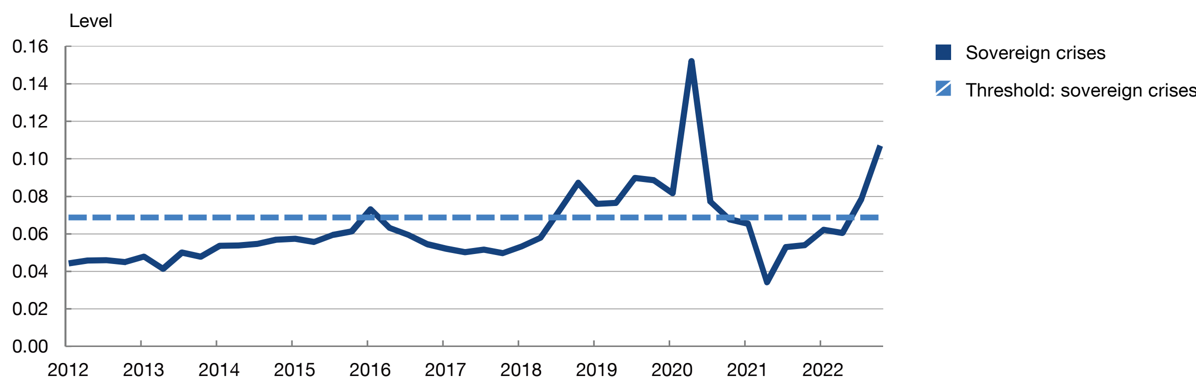
— Meanwhile, in the first stretch of the year the synthetic indicator of public finance vulnerability has remained on the upward path of recent quarters (see Chart 16.b), mainly as a result of the slowdown in activity, the persistently high levels of public debt (see page 21) and the sharp rise in interest 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".

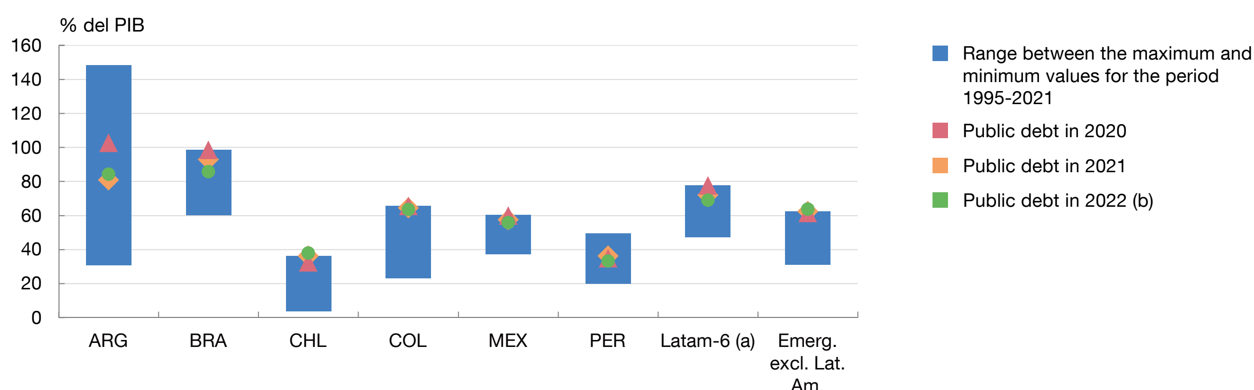
17 …and the medium-term outlook for public finances continues to be less favourable than before the pandemic

— 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.[14]

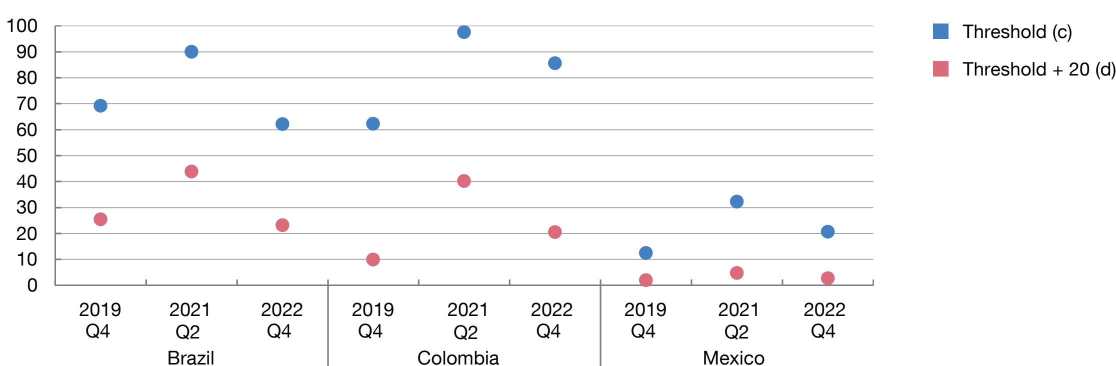
— Simulation exercises[15] of the future course of public debt determinants in three of the region's largest economies (see Chart 17.b) show that the probability that the public debt-to-GDP ratio will be above its pre-pandemic level in ten years' time has increased, indicating a higher vulnerability 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.

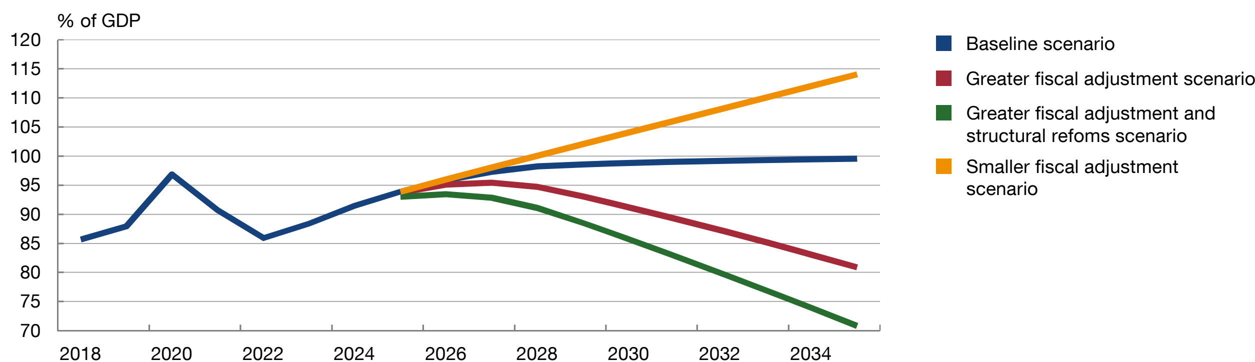
18 Debt sustainability would notably improve if structural reforms and fiscal consolidation programmes were implemented

— 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. Martinez 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
GDP (change on previous period) (a)											
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
CPI (year-on-year rate) (a)											
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
Budget balance (% of GDP) (a) (d)											
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
Public debt (% of GDP) (a)											
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
Current account balance (% of GDP) (a) (d)											
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
External debt (% of GDP) (a)											
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
MEMORANDUM ITEMS: Aggregate of emerging economies excluding Latin America and China (IMF, April 2023 WEO)											
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.