Editorial

It is nearly one year since Latin American central banks began to lower their policy interest rates. The monetary easing process is progressing in line with financial market expectations and has been consistent with the economies' position in the business cycle and the pattern of falling inflation. Nevertheless, the decline in rates has been uneven across countries in terms of scale, pace and duration, owing to differences in cyclical conditions, inflation levels and fiscal policy stances.

Financial markets expect further policy rate cuts in the region in the coming quarters, although they see relatively limited scope for additional cuts in several countries. This process will also be influenced by US monetary policy decisions.

The baseline scenario has not changed significantly since early 2024. Inflation in the region is expected to continue to decline in the coming quarters, as it has in 2024 H1, to within the central banks' target ranges. This pattern will be underpinned by an environment in which the economies are growing at rates close to their potential and where there are no large positive output gaps. The credibility of the central banks will likely continue to anchor inflation expectations. However, this disinflation process is expected to remain gradual, given the stickiness of the services component, which is a characteristic seen around the world.

The region's currencies have depreciated against the dollar during this period of rate cuts, mainly as a result of the narrowing of the policy rate differential vis-à-vis the United States. However, the increase in the price of certain commodities produced and exported by some Latin American countries has cushioned the fall.

Financial conditions have deteriorated since March, primarily owing to higher interest rates on sovereign debt in both domestic and foreign currencies. However, unlike such episodes in the past, the monetary easing has not, as yet, been accompanied by financial market upheaval or capital outflows. Indeed, financial markets have remained somewhat buoyant. However, a flare-up of financial strains in the future cannot be ruled out. This could be prompted by, for instance, policy rates in the United States remaining at their current levels for longer than expected, a heightening of risk or uncertainty either at the global or domestic level, or a downturn in commodity prices. Furthermore, public finances in the region are highly vulnerable, especially in certain countries.

Lending has picked up slightly since the rate cuts began and is expected to gather momentum in the coming quarters. The risks to the banking systems remain contained, although non-performing loans are still high by historical standards.

This report includes four boxes.

- Box 1 describes recent developments in inflation and other economic variables in Argentina.

- Box 2 sets out different public debt scenarios for Brazil and Mexico using a new sustainability analysis tool developed by the Banco de España.

- Box 3, prepared in collaboration with the OECD Development Centre, provides an overview of tax revenue in Latin America.

- Box 4 examines bank lending in Latin America and how it is affected by domestic and international monetary policy, drawing a distinction between domestic and foreign banks, and within the latter group singling out Spanish banks.