Box 1

GLOBAL STRUCTURAL DRIVERS AND FINANCIAL CONDITIONS IN LATIN AMERICA

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The role played by the global financial markets in how emerging market economies perform

Between 1980 and 2025, the aggregate stock of the United States' Treasury and corporate bonds and market capitalisation rose from around 100% of its GDP to 400%. Against this backdrop, global financial market dynamics have become ever more relevant to understanding macroeconomic developments and, as a result, to designing monetary policy, both at global level and, especially, in the emerging market economies (EMEs).

Building on Cieslak and Pang (2021),[2] Albagli, Carlomagno, Ledezma and Reszczynski (2026) propose a methodology for analysing financial conditions and their macroeconomic effects, placing particular emphasis on EMEs, with the premise that similar movements in different financial asset prices may reflect distinct underlying conditions. For example, a rise in an economy's long-term yields may reflect either a contraction (if it is attributable to a higher risk premium) or an expansion (if it is the result of an improved growth outlook). If there is no structural decomposition to disentangle these mechanisms, central banks run the risk of incorrectly diagnosing the state of financial conditions and, consequently, adopting a sub-optimal response.[3]

This issue also affects the most commonly used financial conditions indices (FCIs). Since these indices are constructed as the weighted average prices of various assets, they do not distinguish between the nature of the underlying shocks. As a result, they may offer misleading signals when the combination of drivers is out of the ordinary. Under the proposed methodology, daily asset price changes are decomposed into a set of structural drivers, which are used to construct FCIs.

Main structural drivers of global financial conditions

The methodology used is based on a daily structural vector autoregression (SVAR) model.[4] The baseline model includes seven variables for identifying the structural drivers of global financial markets, namely: 2-year US Treasury bond yields, 10-year US Treasury bond yields, the S&P 500 index and a series of principal components summarising – individually for 15 EMEs – 2-year sovereign yields, 10-year sovereign yields, stock market indices and bilateral dollar exchange rates.[5] Drawing on contemporaneous sign and magnitude restrictions,[6] the authors identify seven structural shocks as drivers of global financial market movements:

i) *US growth shock,* which captures revisions to the United States' economic outlook.

ii) *US monetary policy shock,* which reflects unexpected changes in the Federal Reserve System's stance.

iii) *Global hedging risk-premium shock,* associated with typical risk-on/risk-off dynamics. In bouts of heightened risk aversion on the global financial markets, investment portfolios shift towards safe assets, bringing down both long-term yields in the United States and the price of riskier assets, including those of EMEs and those on the US stock market.

iv) *US common risk-premium shock,* reflecting an increase in the term premium operating in opposing directions on the stock market and bonds in the United States (a fall in stock market prices and a rise in bond yields, particularly at the long end). This can be interpreted as a preference for liquidity shock, which tends to depreciate all assets at global level

1 This box is based on Elías Albagli, Guillermo Carlomagno, Javier Ledezma and María Teresa Reszczynski. (2026). "Fundamental Drivers of Financial Conditions". Documentos de Trabajo, 1080, Banco Central de Chile.

2 Anna Cieslak and Hao Pang. (2021). "Common shocks in stocks and bonds". *Journal of Financial Economics,* 142(2), pp. 880-904.

3 In this spirit, pages 9 and 10 of this report present structural decompositions of the recent movements in bilateral exchange rates against the US dollar and in local currency long-term yields for Brazil, Chile, Colombia, Mexico and Peru.

4 Recent literature has used SVAR models estimated with high-frequency financial data to identify structural shocks. This approach allows for untangling monetary policy surprises from other macroeconomic news (Troy Matheson and Emil Stavrev. (2014). "News and monetary shocks at a high frequency: a simple approach". *Economics Letters,* 125(2), pp. 282-286) and distinguishing between different financial shocks relevant to activity and estimating their effects on EMEs (David Lodge and Ana-Simona Manu. (2022). "EME financial conditions: Which global shocks matter?". *Journal of International Money and Finance,* 120(102479)). It also enables risk shocks that affect both the equity and bond markets to be identified (Cieslak and Pang (2021); Anna Cieslak and Andreas Schrimpf. (2019). "Non-monetary news in central bank communication". *Journal of International Economics,* 118, pp. 293-315).

5 For each group of variables, the first principal component – which accounts for the largest part of the dataset's variability in the estimation period (4 January 2010 to 9 April 2026) – is included. The 15 economies are: Brazil, Chile, Colombia, Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Poland, South Africa, South Korea, Sri Lanka and Thailand.

6 For the specific structure of sign and magnitude restrictions, see Albagli, Carlomagno, Ledezma and Reszczynski (2026) and the references included therein.

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and leads to the dollar appreciating against all currencies, especially EME currencies.

v) *Dollar-hedging risk shock,* which captures episodes of global investors reducing their exposure to all US assets, including the dollar. These could be considered a reduction in the US convenience yield.[7] This type of movement is key to understanding the developments observed in 2025 (higher long-term US yields and dollar depreciation) that do not fit the usual interpretations attributable to other drivers.[8]

vi) *China growth shock,* which reflects changes in the Chinese economic outlook and is particularly important for EMEs.

vii) *Emerging markets' specific risk-premium shock,* which captures changes in the risk perception associated with this group of countries, beyond global financial cycle movements.

Effects of global drivers on the financial variables of Latin American economies such as Chile, Brazil and Mexico

After estimating the structural drivers of global financial market movements using the above model, Albagli, Carlomagno, Ledezma and Reszczynski (2026) estimate similar, country-specific SVAR models for a group of individual EMEs, including Latin American economies. Identification of the structural shocks in these individual models is conditional on the seven types of shock extracted from the global model.

This strategy allows for a decomposition of each country's asset prices into the contribution from global drivers and that from a set of idiosyncratic structural shocks associated with: local growth, local monetary policy, local hedging risk premium (risk-on/risk-off), local common risk premium and terms of trade, which capture movements in commodity prices relevant to each country that are not explained by global shocks.[9]

By way of illustration, Chart 1 presents a decomposition of the nominal bilateral exchange rates of Chile, Brazil and Mexico against the dollar.[10] The chart covers the period from July 2025 (after the global markets had recovered from the effects of the tariff announcements at the start of the year) to 9 April 2026. The outbreak of the war in the Middle East marks a clear dividing point in this period, with the three countries' currencies appreciating in nominal effective terms by 10%-15% before it began, and depreciating by 3%-6% afterwards.

In the period prior to the conflict, the three countries saw a noticeable decline in the emerging markets' specific risk-premium shock as a major global driver of currency appreciation, suggesting a shift in global investor preference towards EMEs in general and towards Latin America in particular. This could hypothetically be associated with an improvement in macroeconomic fundamentals, increased geopolitical interest in the region, a smaller relative exposure to tariffs and the region's distance from the main conflict hotspots. Indeed, the reduction in local risk also makes a significant contribution in all three cases.

As regards the other global structural drivers, China's growth, which was able to maintain its pace of expansion despite the trade war, also made a noticeable contribution to currency appreciation. Also noteworthy was the contribution of monetary policy in Brazil, where policy rates remained at a high level (see page 20 of this report).

The start of the war in the Middle East marked a turning point from these dynamics. Some factors that had contributed to currency appreciation changed sign, while others made a greater contribution to depreciation (Chart 2). There were noticeable rises in the emerging markets' specific risk-premium shock and local risk, suggesting a correction of the previous increase in risk appetite for EMEs. Moreover, the US-centred risk factors, which had also previously exerted downward pressure, continued to become increasingly important. This notwithstanding, the moderation has not led to a complete reversal of the shift in preferences towards EMEs.

7 The convenience yield is the amount that investors are willing to pay to hold US Treasury bonds rather than other financial assets with similar risk and liquidity characteristics. The ensuing higher bond value results in a lower interest rate.

8 Unlike global hedging risk-premium shocks, these do not reflect a search for safe-haven US treasury bonds and, unlike US common risk-premium shocks, they do not necessarily imply a greater preference for liquidity.

9 This would primarily reflect commodity supply shocks, which are not captured by the global drivers.

10 Page 9 of this report also presents an analysis of the decomposition of the region's exchange rates into their structural drivers using an SVAR model. As in this box, the analysis identifies the appreciation pressure attributable to the lower local risk before the conflict in the Middle East began. As regards the external structural factors, it also identifies the contribution of US growth and monetary policy shocks, commodity price shocks (not included in this box) and an additional aggregate global risk shock, which is detailed separately in this box.

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Financial condition indices with a structural interpretation

Drawing on the changes in the global, idiosyncratic and structural drivers estimated in the individual models for each economy, it is possible to construct FCIs that can be interpreted structurally. Unlike traditional FCIs[11] (which simply aggregate asset prices such as interest rates, equities or exchange rates), the proposed FCI aggregates structural shocks using as weights the impulse response

Chart 1
Decomposition of the cumulative nominal exchange rate between 1 July 2025 and 9 April 2026 (%)

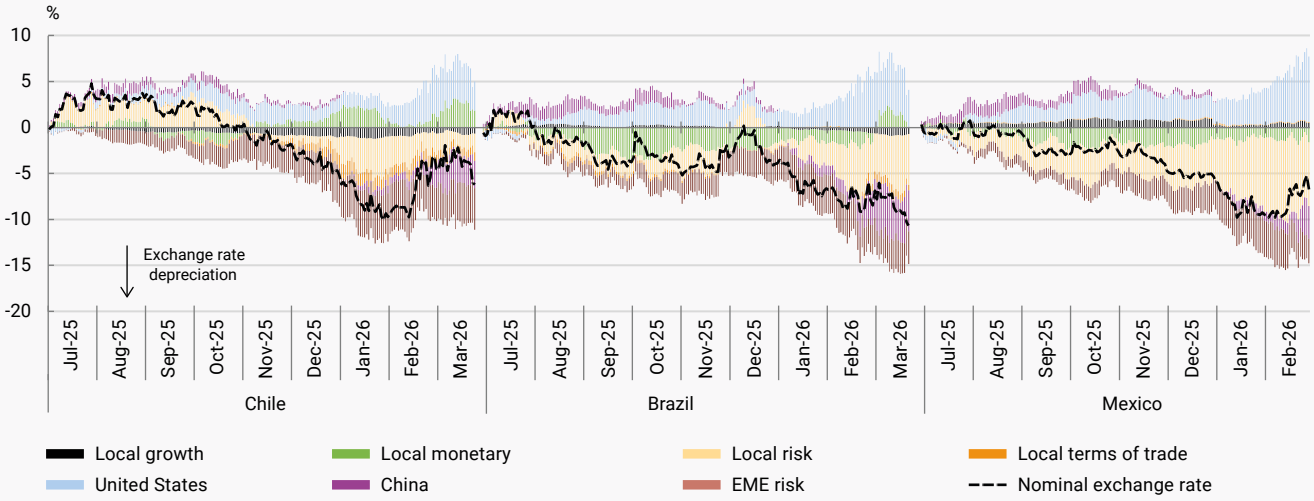
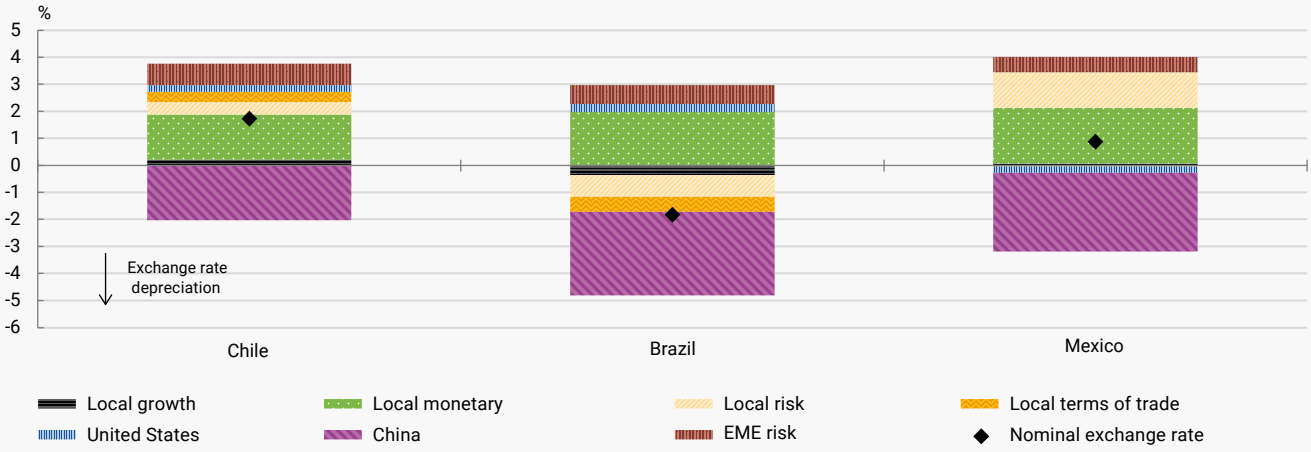


Chart 2
Decomposition of the cumulative nominal exchange rate between 28 February 2026 and 9 April 2026 (%)



SOURCE: Banco Central de Chile.
NOTE: "Local monetary" reflects the difference between US and local monetary policy shocks. "Local risk" incorporates both the shock associated with the local hedging risk premium (risk-on/risk-off) and the local common risk premium. "United States" groups together the external shocks associated with that country: growth, US common risk premium, global hedging risk premium and dollar-hedging risk.

11 The FCIs used for the analysis on page 8 of this report are constructed as a weighted aggregation of variables (Juan Carlos Berganza and Luis Molina. (2026). "The use of Financial Conditions and Stress Indices to monitor Emerging Market Economies". Forthcoming) but, unlike more usual FCIs, they separate the internal FCI component (constructed using variables more related to a country's domestic conditions, such as its stock exchange) from the external component (constructed using valuations in global financial markets, such as the sovereign spread on external debt). Focusing on developments since October 2025, the analysis finds, as in this box, that the FCIs – particularly in their external component – of Chile, Brazil and Mexico eased until the conflict in the Middle East began.

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coefficients of a macroeconomic aggregate (such as GDP, consumption or investment) to each shock. These coefficient estimates are based on the local projections approach.[12]

Chart 3 presents the quarterly FCIs associated with total gross fixed capital formation, again for Chile, Brazil and Mexico, in the period 2019 Q1-2026 Q3. During the pandemic (2020-21), dynamics were dominated by shocks

Chart 3
Decomposition of FCIs. Annual variation (%)

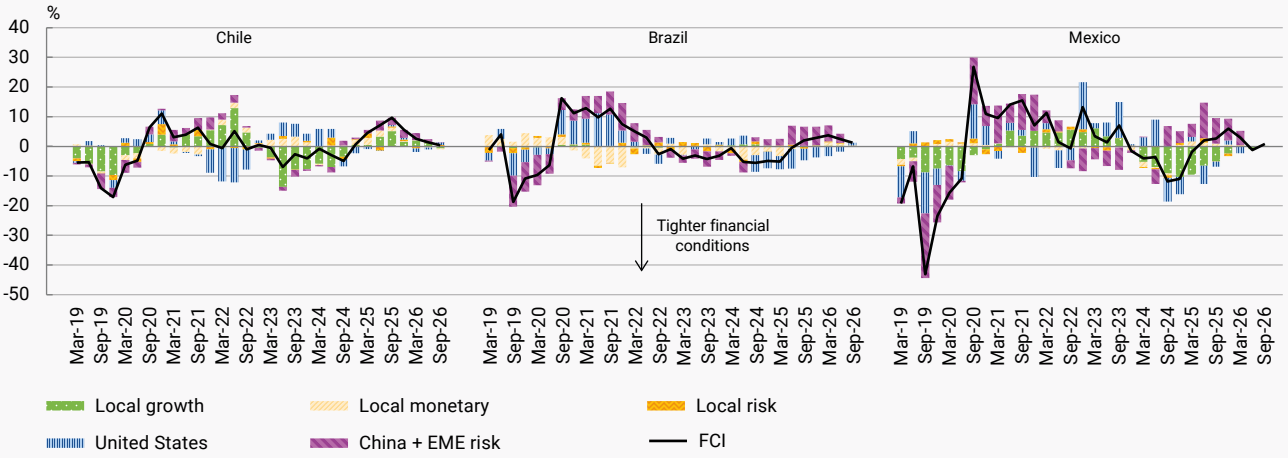
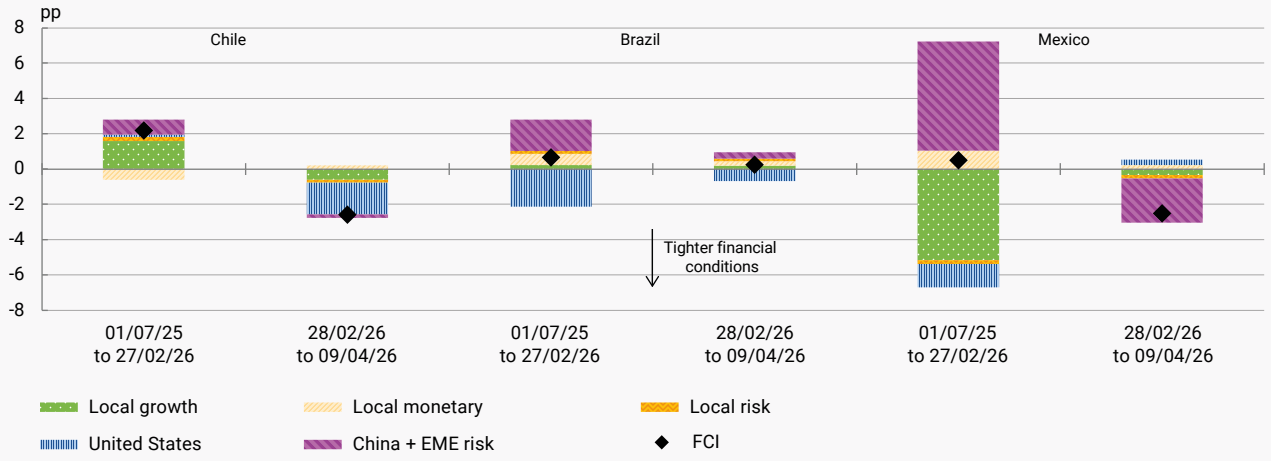


Chart 4
Decomposition of FCIs. Variation between the period 1 July 2025-27 February 2026 and the period 28 February 2026-9 April 2026 (pp)



SOURCE: Banco Central de Chile.
NOTE: The FCIs are constructed taking a forward-looking approach. For each quarter, the effects on gross fixed capital formation for the current quarter and the following three quarters are included. To complete the information for the current quarter (2026 Q2), it is assumed that from 10 April onwards each shock will converge to the average observed between 28 February 2026 and 9 April 2026. For the following quarters, it is assumed that there are no further shocks.
"Local monetary" reflects the difference between US and local monetary policy shocks. "Local risk" incorporates both the shock associated with the local hedging risk premium (risk-on/risk-off) and the local common risk premium. "United States" groups together the external shocks associated with that country: growth, US common risk premium, global hedging risk premium and dollar-hedging risk.

12 Òscar Jordà. (2005). "Estimation and Inference of Impulse Responses by Local Projections". *American Economic Review,* 95(1), pp. 161-182.

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to the external and internal growth-related structural drivers, which acted in a contractionary manner. As from 2021, when interest rate hike cycles began, local monetary policies became a significant source of financial tightening, whose effects were especially visible in Chile and Brazil.

In more recent years, the decline in the emerging markets' specific risk-premium shock and the improvement in China's growth outlook have operated as a significant expansionary impulse for investment in the region, as can be observed in the contribution of the aggregate of these two global structural drivers to the easing of the FCIs associated with gross fixed capital formation (Chart 4). Since the war in the Middle East began, these factors have reversed, easing the impulse from financial conditions to investment.

Conclusion

Albagli, Carlomagno, Ledezma and Reszczynski (2026) stress that, from a central banking perspective, it is not enough to just carefully analyse asset price movements: it is important to understand their key causes. The proposed methodological framework finds that, from mid-2025 to the start of the war in the Middle East, asset prices in EMEs – particularly in Latin America – benefited from a shift in global investor preferences, which contributed to an expansion of their financial conditions and bolstered domestic demand. The Chinese economy's resilience to the new tariff scenario also appears to have played a major role in the expansion of these economies' financial conditions. Since the start of the war, the preference for regional assets has eased, almost neutralising the impulse from external financial conditions to local demand.