REPORT ON THE LATIN AMERICAN ECONOMY

The disinflation process: key factors

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Editorial

In 2023, economic activity in Latin America slowed to a growth rate of around 2% (from 3.6% in 2022), with marked cross-country heterogeneity. This lower growth owed mainly to weaker domestic demand (due to the cumulative effects of tight monetary policy and households losing purchasing power amid high inflation) and a less favourable external environment. Slower growth is expected in 2024 (just under 1.5%), with the notable exception of Argentina, where a sharp economic contraction is anticipated. Some downside risks to economic growth persist, most of them external: the possibility of a tighter than anticipated US monetary policy stance and the economic slowdown in China proving sharper than expected. In the medium term, the outlook for Latin America's potential growth rate remains around 2%, less than forecast for other emerging regions.

Inflation has steadily declined across the region in recent quarters and is expected to continue to ease, albeit very gradually, to stand within the central banks' target intervals in 2024. Going forward, the pace of disinflation will primarily depend on how quickly inflationary pressures ease in services (which have displayed some general downward price stickiness) and in food (the prices of which have risen far more sharply than other consumer basket prices and also face upside risks associated with the El Niño climate phenomenon) and on countries adopting a fiscal stance more consistent with the tight monetary policy stance.

Against this economic backdrop, the region's main inflation-targeting central banks (with the exception of the Banco de México) began lowering their policy interest rates in the second half of 2023. In the near term, central banks face the challenge of calibrating the monetary easing cycle in response to movements in inflation, with the external conditioning factor of policy rate decisions adopted in other jurisdictions, particularly in the United States.

In line with the policy rate cuts, financial conditions have begun to ease in the region and financial markets continue to perform better than those in other emerging regions. In the banking sector, credit growth moderated virtually across the board in 2023, owing to weak demand and tighter lending standards. There was also an increase in non-performing loans, particularly in the corporate segment. On balance, however, the indicators available suggest that banking system risks remain very much contained.

Notably, public finances have generally been rendered more vulnerable by relatively high levels of public debt and large structural deficits compared with recent decades. Making matters worse are the expected unfavourable interest burden dynamics, low growth rates (both observed and expected) and uncertainty over the actual enforcement of the fiscal rules.

Compliance with these fiscal rules and the introduction of structural measures to boost potential growth are two of the key challenges facing the region. With some exceptions, substantive reforms aimed at addressing the main structural challenges, such as demographics and climate change, have not been forthcoming. The indicators available point to some easing of social and political unrest, which could pave the way for these reforms in the near term. Moreover, some countries could benefit from the complex global geopolitical situation if the incipient trend – observed in some qualitative data – of productive activity being relocated to nearby countries (nearshoring) takes hold. The benefits of this would mainly be through greater foreign direct investment.

This report includes three boxes. Box 1 offers a synopsis of recent developments in the Argentine economy following the presidential elections in late 2023, and the measures proposed by the new Government to tackle the country's economic imbalances. Box 2 provides an overview of the Latin American insurance sector, pointing out the scope for the industry to grow and develop in the region, in particular driven by new insurance needs stemming from climate change (as also seen elsewhere in the world) and an increasing number of natural disasters (to which the region is particularly prone). Lastly, Box 3 discusses immigration to Spain from Central America, Panama and the Dominican Republic. Such immigration has grown markedly in recent years, owing, among other factors, to improved economic conditions in Spain (pull factors) and episodes of social and political unrest in the countries of origin (push factors).

Report

Contents

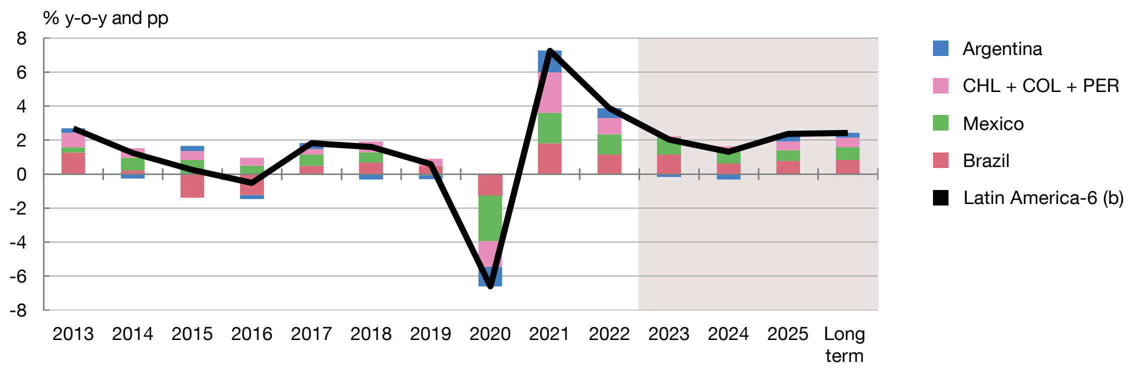
1 Economic activity in the region slowed in 2023, with notable heterogeneity across countries, and the consensus forecasts point to lower growth in 2024

— Economic activity in the region increased by around 2% in 2023 (vs 3.6% in 2022), as growth slowed or held steady in most countries (see Charts 1.a and 1.b and Table 1). Nonetheless, momentum was stronger than anticipated six months ago in Brazil (thanks to agriculture) and Mexico (thanks to investment), and also in Argentina, despite the sharp fall (see Box 1).

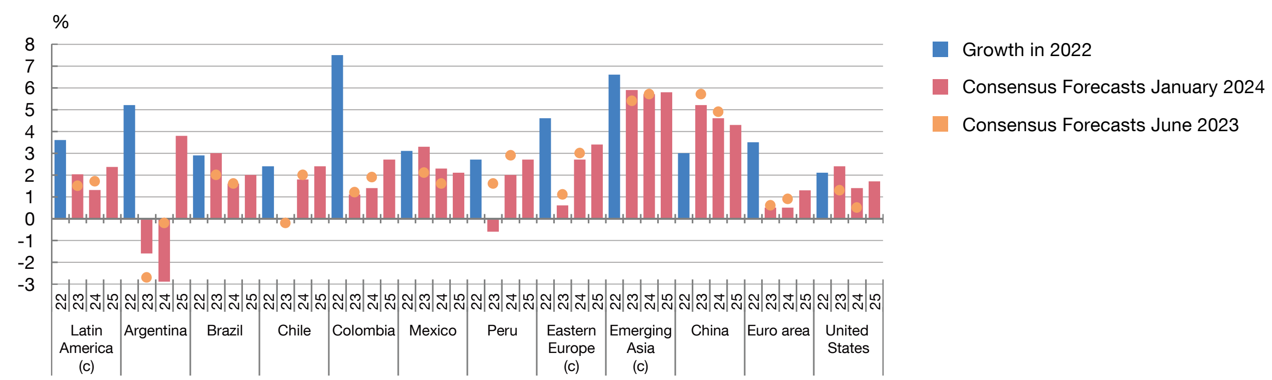
— The consensus forecasts point to weaker growth in 2024 (1.3%), lagging somewhat behind other emerging areas and 0.4 percentage points (pp) lower than envisaged midway through 2023, due in particular to the sharp downward revision for Argentina. For the other economies, compared with June, the brighter outlook for the prices of some commodities produced in the region, for growth in the United States and for monetary policy in the region (less restrictive) is likely to be offset by the slower momentum expected in China, among other factors. The consensus forecasts suggest that growth in 2025 will likely be slightly above the potential growth rate (2%).

Chart 1

1.a Contributions to GDP growth in Latin America-6 (a)



1.b GDP growth projections for 2023, 2024 and 2025



SOURCES: Refinitiv and Consensus Forecasts.

a Latin American Consensus Forecasts for 2023, 2024 and 2025 and over the long-term (2029 to 2033).
b Aggregate of Argentina, Brazil, Chile, Colombia, Mexico and Peru, weighted by GDP in PPP.
c Latin America: Argentina, Brazil, Chile, Colombia, Mexico and Peru; Eastern Europe: Bulgaria, Czech Republic, Hungary, Poland and Romania; Emerging Asia: India, Indonesia, Malaysia, the Philippines and Thailand. All aggregates weighted by GDP in PPP.

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2 In 2024 the output gaps of most countries in the region are expected to be negative or zero, which should help to bring down inflation

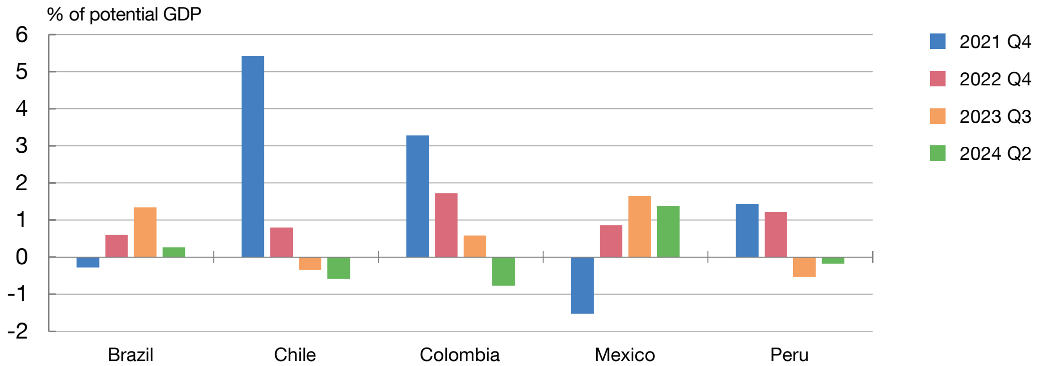
— Thanks to recent growth dynamics, the positive output gaps in Brazil and Mexico widened in 2023, while narrowing in the Andean economies and even turning negative in the case of Chile and Peru, based on the Banco de España's estimations (see Chart 2.a).

— In Mexico the output gap is expected to narrow somewhat in the first half of 2024, albeit remaining in clearly positive territory, possibly explaining the Mexican central bank's cautious approach to loosening its monetary policy. The output gap is expected to narrow to virtually zero in Brazil, while turning negative in Colombia and remaining negative in Chile and Peru.

— With the occasional caveat, this assessment of the degree of slack in these economies generally tallies with those in the most recent inflation reports from the region's central banks.[1]

Chart 2

2.a Output gaps in Latin America (a)



SOURCES: Refinitiv, LatinFocus Consensus and ECB.

a The trends in the economies are calculated using a two-sided Hodrick-Prescott filter with a smoothing parameter of 1,600, to this end using the published GDP figures from 2000 Q1 to 2023 Q3 and the LatinFocus GDP growth forecasts (January 2024) for the period between 2023 Q4 and 2024 Q4.

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1 The Banco Central do Brasil considers that the output gap is likely to be lower, falling into negative territory (see pages 58 and 59 of its *Inflation Report,* Volume 25, Number 4, December 2023). Using a statistical method similar to the one used in the Banco de España's calculations, the Mexican central bank considers that the output gap is likely to be positive. However, since it forecasts stronger growth than that projected in the consensus forecasts, this gap is likely to remain at levels similar to those seen in 2023 Q3 through 2024 H1 (see page 110 of the Banco Central de México's *Informe Trimestral.* Julio Septiembre 2023).

3 A potentially tighter than anticipated monetary policy in the United States and a further slowdown in China are the main external risks to growth in the region

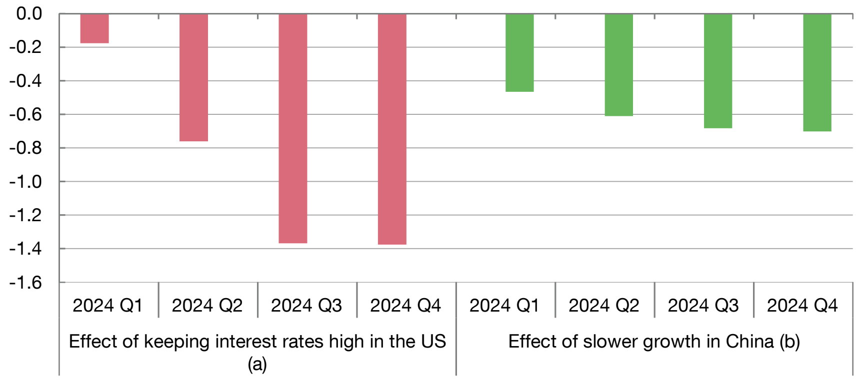
— In the domestic arena, the main risk to growth in the region is likely to come from a slower than expected decline in inflation (as compared with the expected inflation dynamics, see pages 8 to 12), as this is likely to squeeze households' disposable income and tighten domestic monetary policy.

— As far as the external risks are concerned, based on the Banco de España's simulation model,[2] if the interest rate path in the United States is in line with that projected by the members of the Federal Reserve's Federal Open Market Committee (FOMC), which is more restrictive than the path priced in by the financial markets (a 75 basis point (bp) cut to the policy rate in 2024 versus a 150 bp cut), GDP in Latin America at end-2024 could be 1.4% lower than projected in the consensus forecasts (see Chart 3.a).

— Meanwhile, a further slowing of the Chinese economy (owing, for example, to a worsening of the problems in the country's real estate sector and their potential spillover effects on the rest of the economy) is another potential downside risk to activity in the region, given the significant trade ties. It is estimated that a temporary 1 pp slowdown in economic activity in China could shave 0.7% off Latin American GDP in 2024.

Chart 3

3.a External effects on growth in Latin America



SOURCES: Alonso, Santabárbara and Suárez-Varela (2023) and Banco de España.

a Simulation of the impact of a change in interest rates in the United States based on a survey of the FOMC members (who anticipate an overall cut of 75 bp over the year), as opposed to the cut priced in by the futures markets (150 bp). The simulations assume that such deviations in interest rate cuts take place in the first three quarters of 2024. Extrapolated to Latin America based on results for Brazil and Mexico.

b The NiGEM model is used to show the impact of lower growth in China. For further details, see Irma Alonso, Daniel Santabárbara and María Suárez-Varela. (2023). "The potential global effects and transmission channels of a slowdown in Chinese growth", *Economic Bulletin - Banco de España,* 2023/Q4, Article 06. Extrapolated to Latin America based on results for Brazil and Mexico.

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2 Based on estimates of how monetary shocks in the United States have historically impacted GDP in Brazil and Mexico. These shocks are estimated as per Fry and Pagan. (2011). "Sign Restrictions in Structural Vector Autoregressions: A Critical Review". *Journal of Economic Literature,* 49 (4): 938-60, and Jarocinsky and Karadi. (2020). "Deconstructing Monetary Policy Surprises—The Role of Information Shocks". *American Economic Journal: Macroeconomics,* 12 (2): 1-43. The impact on GDP in each country is then estimated using regressions over different time horizons ("local projections"), whereby the two types of monetary shocks are simultaneously used as instruments for the short-term interest rate in the United States.

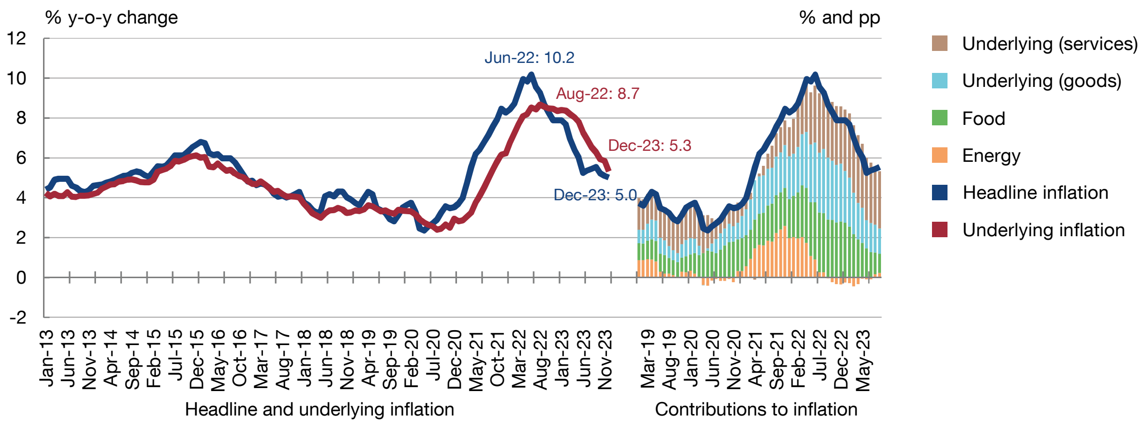
4 Inflation in Latin America has continued to ease gradually in recent quarters, albeit unevenly across components, with services showing greater downward stickiness…

— Inflation has continued to abate, standing at an average of 5% in December 2023, 5.2 pp below the peak recorded in June 2022. Underlying inflation has also trended downwards, standing at 5.3% in December (3.4 pp down on the August 2022 peak) (see Chart 4.a).

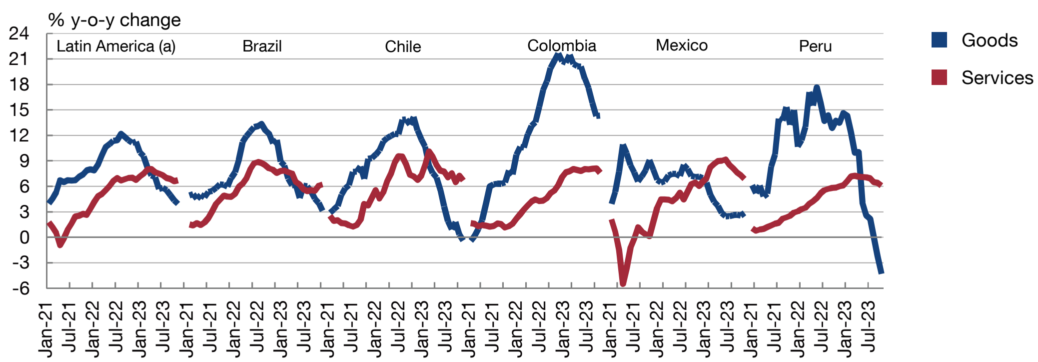
— By component (see Chart 4.a), although the contribution made by food declined gradually over the course of 2023 H2, it remained positive in November (0.8 pp). Meanwhile, energy made a small positive contribution in the last stretch of the year, following several months in negative territory. The underlying components continued to make the largest contributions (1 pp in the case of goods and 2.9 pp in the case of services), and services continued to display a degree of downward stickiness (see Chart 4.b).

Chart 4

4.a Latin Amercia: contributions to inflation (a)



4.b Inflation in Latin America: goods and services (b)



SOURCES: Refinitiv Eikon and national statistics.

a Aggregate of Brazil, Chile, Colombia, Mexico and Peru.
b The services series does not include energy, while the goods series excludes food.

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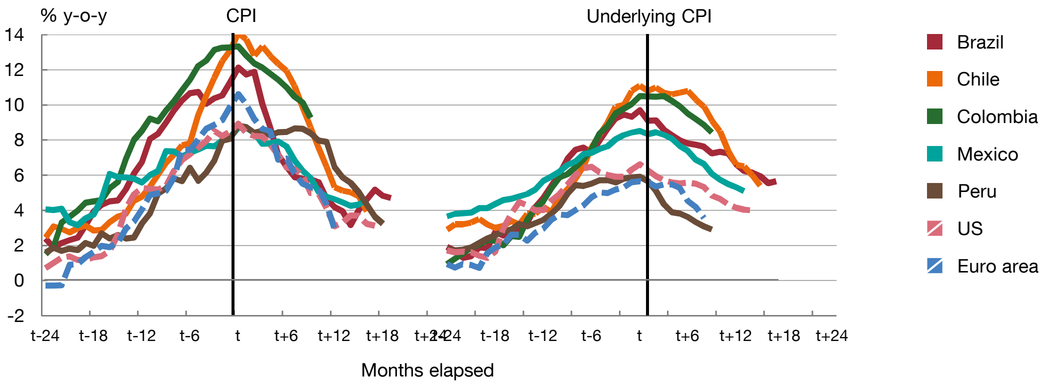
5 … and disinflation varying across the main countries of the region

— In terms of country-specific inflation, the slight uptick seen in Brazil in recent months (due in part to the base effect of the end to a subsidy on energy goods) stands out. Also noteworthy is Colombia's higher inflation rate, which remains close to two digits, partly because it peaked later than in other countries (see Chart 5.a).

— By component, services inflation continues high in most countries, while goods inflation remains somewhat heterogeneous, with a strikingly high rate of inflation in this component in Colombia, which has nonetheless started to fall thanks to a sizeable base effect and the easing of exchange rate pressures[3] (see Chart 4.b).

Chart 5

5.a Fall in inflation since its peak (a)



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

a t depicts the point at which headline and underlying inflation peaked in each country. Brazil (t CPI = Apr-22; t underlying CPI = Jun-22), Chile (t CPI = Aug-22; t underlying CPI = Sep-22), Colombia (t CPI = Mar-23; t underlying CPI = Jun-23), Mexico (t CPI = Aug-22; t underlying CPI = Nov-22), Peru (t CPI = Jun-22; t underlying CPI = Mar-23), United States (t CPI = Jun-22; t underlying CPI = Oct-22), Euro area (t CPI = Oct-22; t underlying CPI = Apr-23).

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3 Banco de la República. (2023). *Monetary Policy Report,* 10/2023, p.31.

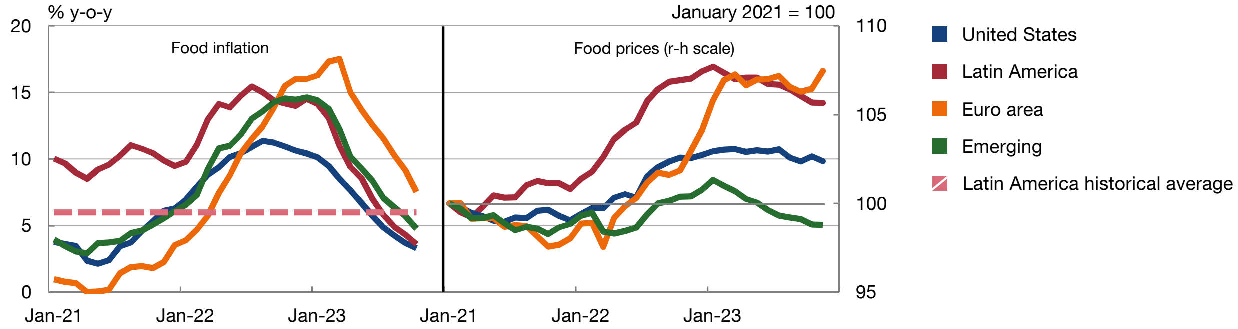
6 Despite the recent fall, food inflation is likely to remain high in the coming quarters

— Latin America has felt the impact of the rise in international food and energy commodity prices particularly hard (see the left-hand panel of Chart 6.a).[4] Thus, the food prices paid by Latin American households have risen significantly more than the price of the consumption basket as a whole, in contrast to other emerging economies where such prices grew less overall (see the right-hand panel of Chart 6.a).

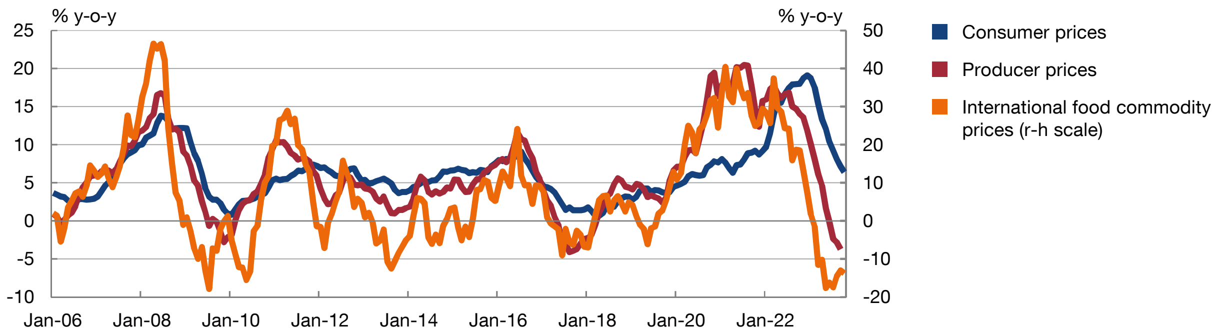
— Thanks to the most recent developments in commodities, food inflation has fallen significantly. Nonetheless, looking ahead, the fact that food commodity prices look set to steady, together with the more recent rise in or stabilisation of energy prices, is likely to slow the disinflation process in the region, in line with the Banco de España's econometric model,[5] given that increasingly expensive inputs and higher costs take time to pass through to food consumer prices (see Chart 6.b).

Chart 6

6.a Inflation and food prices in Latin America in a global context (a) (b) (c)



6.b Food prices over the value chain in Latin America



SOURCES: World Bank, national statistics and own calculations.

a An international comparison of food inflation is shown on the left. The broken line shows average food inflation between 2006 and 2019.
b Changes in the food CPI-to-overall CPI ratio since early 2021 are shown on the right.
c The Latin America aggregates are based on the five main countries: Brazil, Chile, Colombia, Mexico and Peru.

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4 Compared with other emerging areas in which the food basket has a similar weighting, this is in part due to the fact that items whose prices rose more account for a larger share of the Latin American consumption basket (see Report on the Latin American Economy, Second half of 2022).

5 F. Borrallo, L. Cuadro-Sáez, A. Gras Miralles and J. J. Pérez. (2023). "A note on the transmission of shocks to international food and energy commodity prices on food inflation in Latin America". Banco de España. Mimeo.

7 Also, El Niño continues to pose inflationary risks, although the effect is only significant for some counties

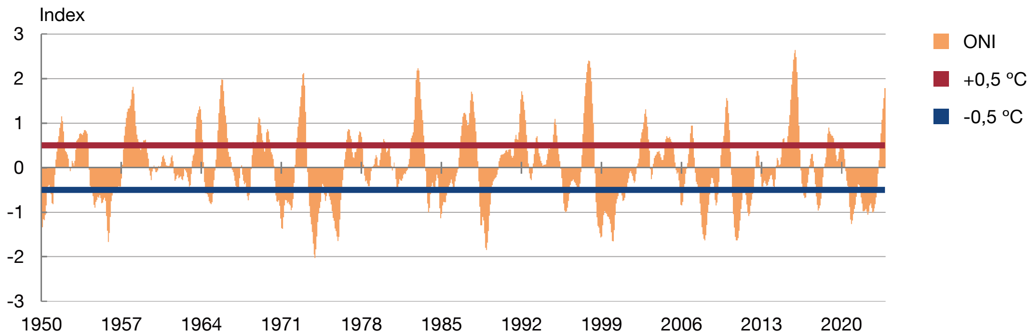
— Last year saw the start of the latest episode of El Niño, one of the phases of the cyclical El Niño-Southern Oscillation phenomenon, whereby the sea surface temperature rises in the Pacific Ocean (see Chart 7.a), triggering changes in ocean and air currents. The weather in Latin America changes significantly during these episodes.

— For instance, Brazil tends to experience droughts in the north and heavy rainfall in the south, whereas the opposite is true in Mexico. In Argentina rainfall is heavier than usual and Chile is hit by winter storms. Droughts and higher temperatures are concentrated in the Andean countries, Colombia and Venezuela, while flooding increases along the Pacific coast.

— These changes distort the production cycle and affect the prices of agricultural, energy and mining commodities. There is some agreement that El Niño may have a significant impact on inflation in the region for certain countries. For instance, the central banks of Colombia and Brazil have estimated the impact on headline inflation at 0.2-0.6 pp and 0.9 pp, respectively.[6]

Chart 7

7.a Oceanic Niño Index (ONI) (a)



SOURCE: US National Centers for Environmental Information.

a The Oceanic Niño Index (ONI) is the primary index for tracking the El Niño-Southern Oscillation seasonal climate pattern. It shows the extent to which the rolling 3-month average sea surface temperature of a region of the Pacific Ocean (120°-170°W) is significantly warmer (El Niño > 0.5ºC) or colder (La Niña < -0.5ºC) than the historical average. The recording of five consecutive index values above (below) the +0.5ºC (-0.5ºC) threshold is associated with an episode of El Niño (La Niña).

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6 See, respectively, the Banco Central de la República de Colombia's October 2023 *Monetary Policy Report,* and the Banco Central do Brasil's September 2023 *Inflation Report*. Also on this subject, see Cashin, Mohaddes and Raissi (2017), Martin (2016) and Aguirre, Ferreyros, Ledesma and Rojas (2023).

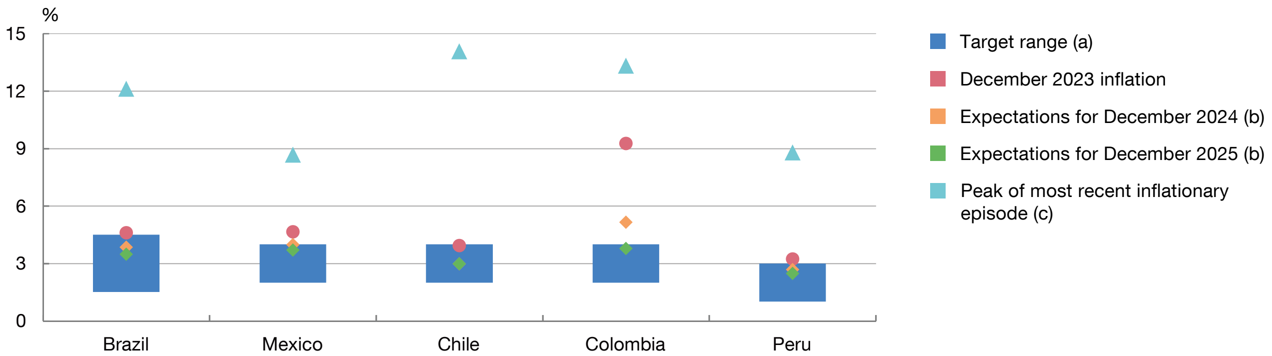
8 In any event, inflation is expected to continue declining gradually in the coming quarters, to lie within the central banks' target ranges in 2024

— According to the surveys conducted by the region's central banks, inflation is likely to continue falling gradually in 2024 (to stand within the respective target intervals this year) and in 2025. Nonetheless, with the exception of Chile, medium-term inflation expectations are likely to stand slightly above the specific inflation target (see Chart 8.a). This has tended to be the case, judging by the available historical records of several of the region's inflation-targeting central banks.[7]

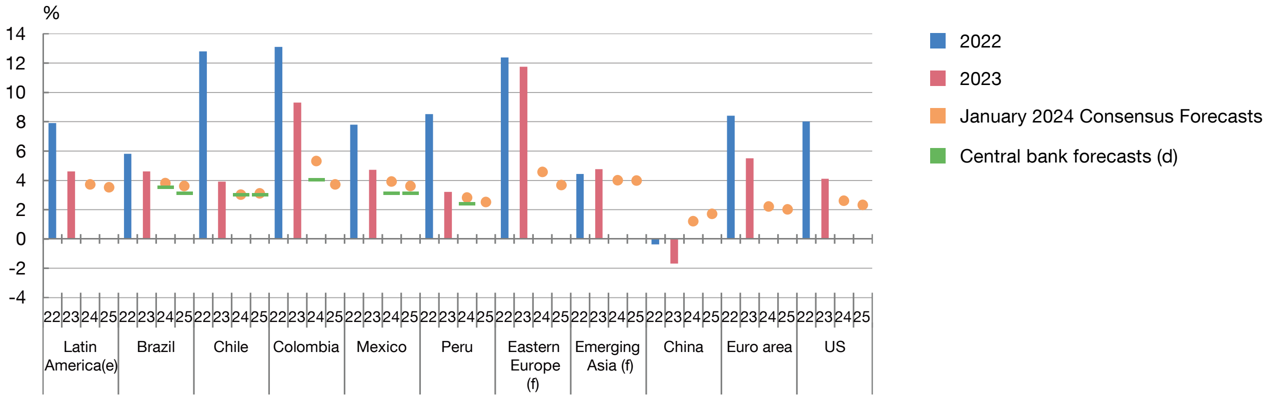
— The consensus view tallies with these expectations, which draw on central bank surveys (see Chart 8.b). The central banks themselves are slightly more optimistic about some countries in the region (see Chart 8.b), albeit continuing to note in their regular reports that the risks are tilted to the upside for most of the countries.

Chart 8

8.a Inflation, inflation targets and inflation expectations



8.b Inflation forecasts



SOURCES: Latin Focus, Consensus Forecast, Refinitiv and national statistics.

a The central banks' inflation target is 3% in the case of Brazil (from 2024 onwards), Chile, Colombia and Mexico, and 2% in the case of Peru.
b Inflation expectations for 2024 and 2025 are taken from the central bank surveys.
c Peak of the most recent episode: Brazil, April 2022; Mexico, September 2022; Chile, August 2022; Colombia, March 2023; Peru, June 2022.
d The central bank forecasts are taken from their most recent monetary policy reports.
e Excluding Venezuela and Argentina.
f January 2024 Consensus Forecasts. Eastern Europe includes Bulgaria, Czech Republic, Hungary, Poland and Romania; Emerging Asia includes India, Indonesia, Malaysia, the Philippines and Thailand. All aggregates weighted by GDP in PPP.

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7 See Chapter 3 of International Monetary Fund (2018). "Seizing the Momentum". Regional Economic Outlook: Western Hemisphere, April 2018.

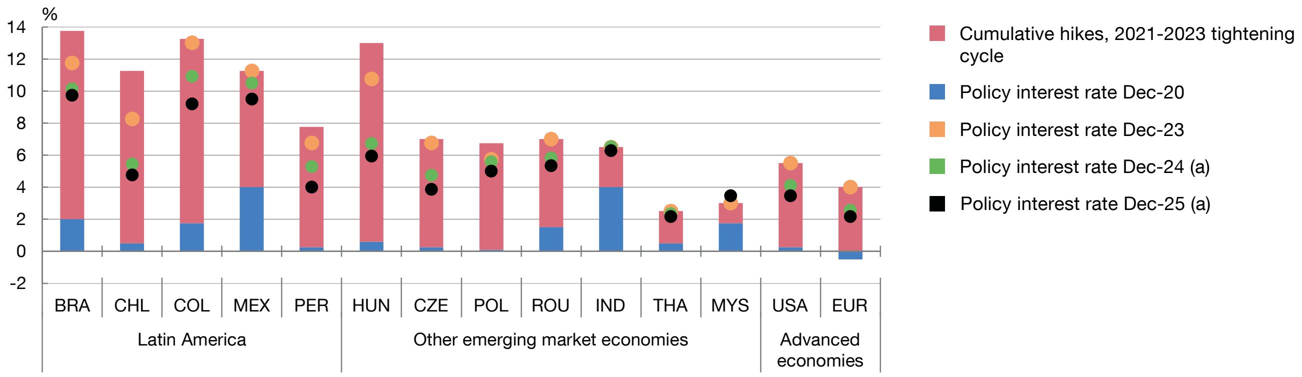
9 As the disinflation process has progressed, most central banks in the region have initiated a monetary easing cycle, in line with other emerging areas

— Following the consolidation of the disinflation process in the second half of 2023, the central banks of Brazil, Chile, Colombia and Peru, in line with other emerging market economies, reduced their policy interest rates (see Chart 9.a). The financial markets are factoring in further policy interest rate cuts over the coming quarters and Mexico's central bank joining the monetary easing cycle in 2024 Q1.

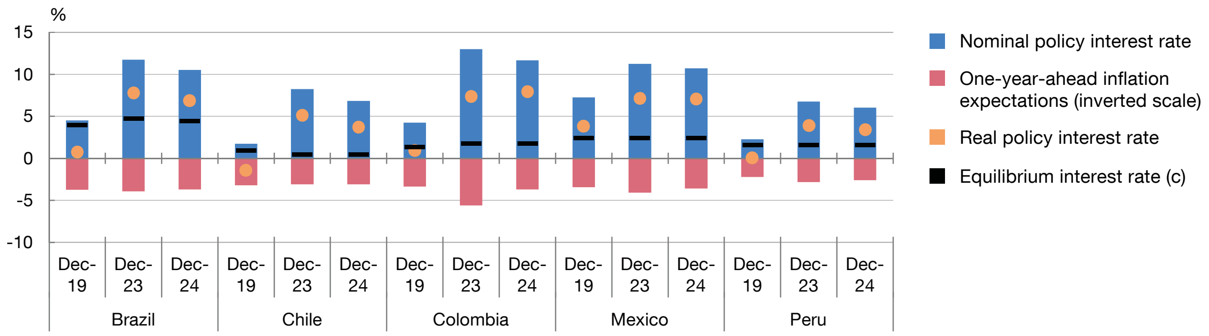
— Nonetheless, real interest rates are still expected to maintain a restrictive monetary policy stance at end-2024 (see Chart 9.b), since the interest rate cuts are unlikely to be much bigger than the expected declines in inflation, especially in Colombia and Mexico.

Chart 9

9.a Policy interest rates



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



SOURCES: National statistics and Refinitiv.

a Discounted by the financial markets.
b 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 2024, which is the policy rate according to futures or interest rate swaps less the inflation expected for end-2025 according to the January 2024 Latin American Consensus Forecasts.
c Equilibrium interest rates, drawing on estimates by the region's various central banks.

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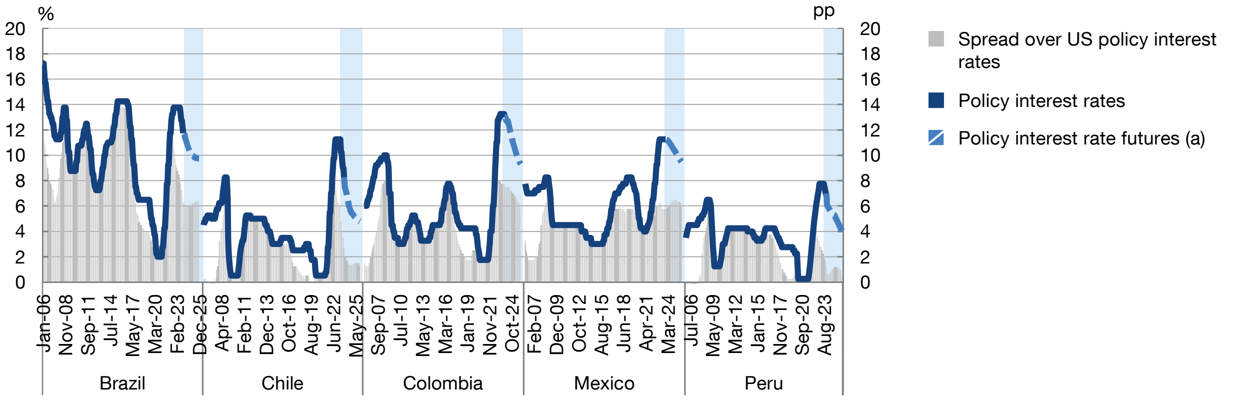
10 The monetary policy easing process will be influenced by decisions in this field adopted in other jurisdictions, particularly in the United States

— Uncertainty over monetary policy developments in the advanced economies, especially in the United States, could explain the caution exercised by most central banks in the region. The spread between the policy interest rates factored in by the futures markets and those of the United States will remain in line with previous episodes for Brazil, Chile and Peru, but will be larger for Colombia and Mexico. (See Chart 10.a).

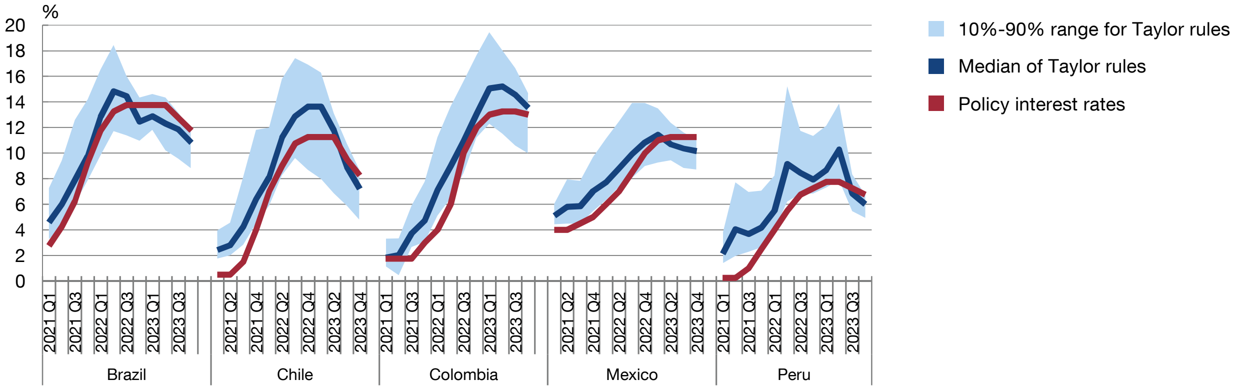
— The policy interest rates of the region's main inflation-targeting economies are in line with those deriving from the estimation of a wide range of Taylor rules,[8,9] which take into account developments in observed and expected inflation relative to the target and the cyclical situation of activity (see Chart 10.b).[10]

Chart 10

10.a Policy interest rates in Latin America and their spreads over the US policy rates



10.b Policy interest rates and Taylor rules (b)



SOURCES: Refinitiv, central banks, J.P. Morgan Markets, BM&F Bovespa, Chicago Board of Trade and Banco de España.

a The discounted interest rates for December 2024 and December 2025 are obtained from the futures markets.
b The combination of possible values for the coefficients and for inflation (headline inflation, underlying inflation and inflation expectations) is used to calculate a set of Taylor rules, whose median and 10%-90% range in the distribution are represented in the chart.

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8 See page 6 for an estimation of the output gaps in the region's main inflation-targeting economies.

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

10 A similar approach to monetary policy in the region may be found in Alejandro Werner (2023). "Monetary policy in Latin America: The easing cycle has begun". Policy Brief 23-16. Peterson Institute for International Economics.

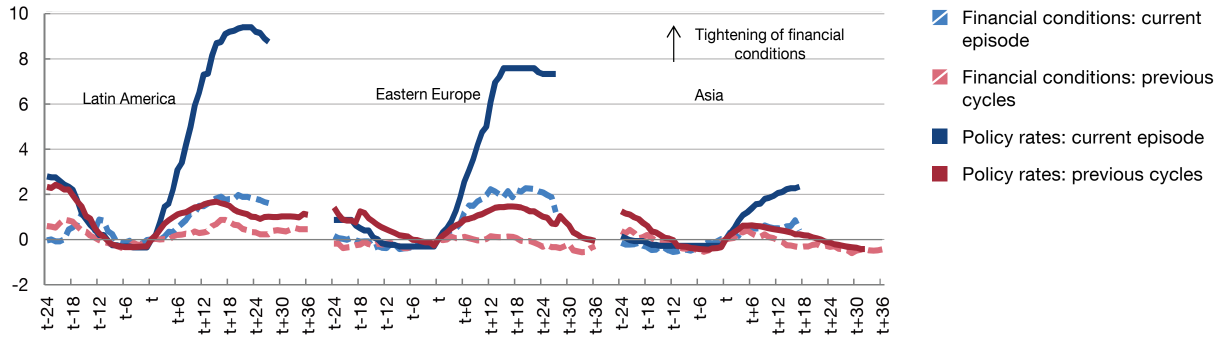
11 In line with the policy rate cutting cycle, financial conditions have begun to ease recently

— Following the start of the policy rate cutting cycle, financial conditions in the region have started to ease (see Chart 11.a), although they remain in contractionary territory. In general, financial variables continued to perform better than in the other emerging market economies (see Chart 11.b).[11] The trend observed since October 2023 (lower risk premia, better stock market performance and appreciation of exchange rates) continued in early 2024.

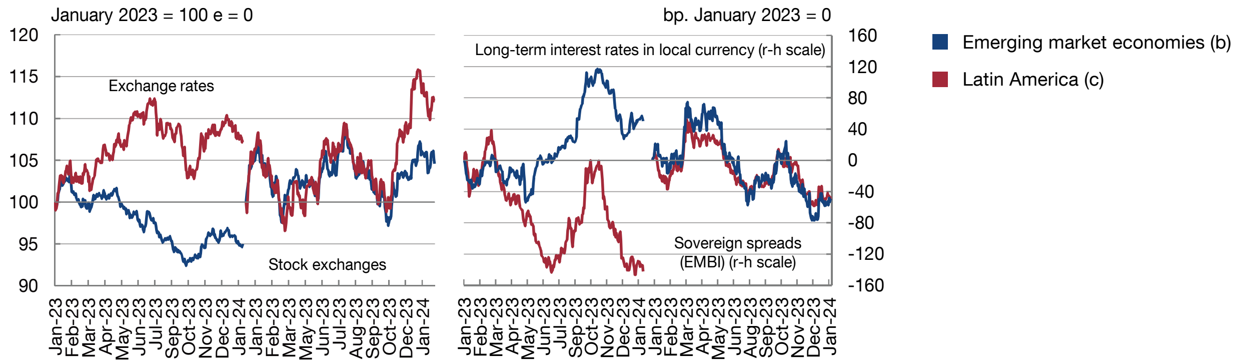
— Despite the change in the monetary policy stance, the profitability of carry trade transactions[12] continues to support this better market performance in the region, which also remains unaffected by the tensions associated with global geopolitical conflicts. In 2023 the region recorded a reduction in direct investment inflows and an increase in portfolio inflows, in line with developments in Asia, although they remain below the figures in Eastern Europe.

Chart 11

11.a Financial conditions indices and policy interest rates (a)



11.b Financial market variables



SOURCES: Banco de España, Refinitiv and national statistics.

a An increase denotes a tightening of financial conditions, and values above zero indicate that financial conditions are tighter than the historical average. t is the month when the contractionary monetary cycle begins. "Current episode" refers to the start of the latest contractionary monetary policy cycle (from April to October 2021 for Latin America, from June to October 2021 for Eastern Europe and from May to August 2022 for Asia). "Previous cycles" refers to episodes of interest rate since 2005.
b Simple average of the variables for Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Türkiye, South Korea, Malaysia, Philippines, Thailand, India and Indonesia, except in the case of sovereign spreads, where it is the simple average for the Eastern Europe, Asia, Middle East and Africa regions.
c Simple average of long-term rates in Brazil, Mexico, Chile, Colombia and Peru, or the Latin America sovereign spread (EMBI).

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11 See Report on the Latin American economy, First half of 2023. Banco de España (2023).

12 The difference between the cost of borrowing in a low-interest rate currency and the return on investments in financial assets in a high-interest rate currency (in this case the Latin American currencies).

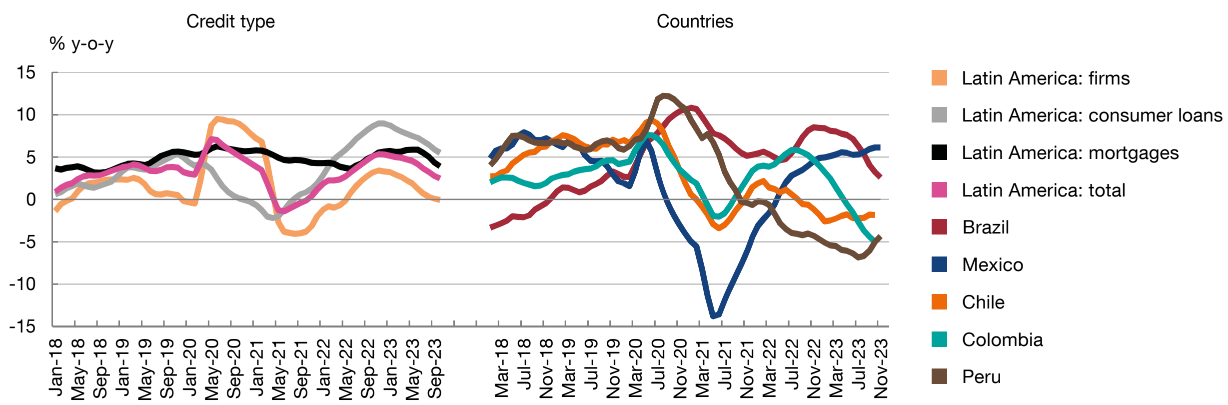
12 Credit growth moderated owing to supply and demand factors

— The growth of credit to the non-financial private sector in real terms slowed in the region in 2023. All credit segments, especially corporate and consumer loans, lost momentum (see Chart 12.a).[13] The slowdown was broad-based across countries, except in Mexico, and the three Andean economies (Chile, Colombia and Peru) posted negative year-on-year rates.

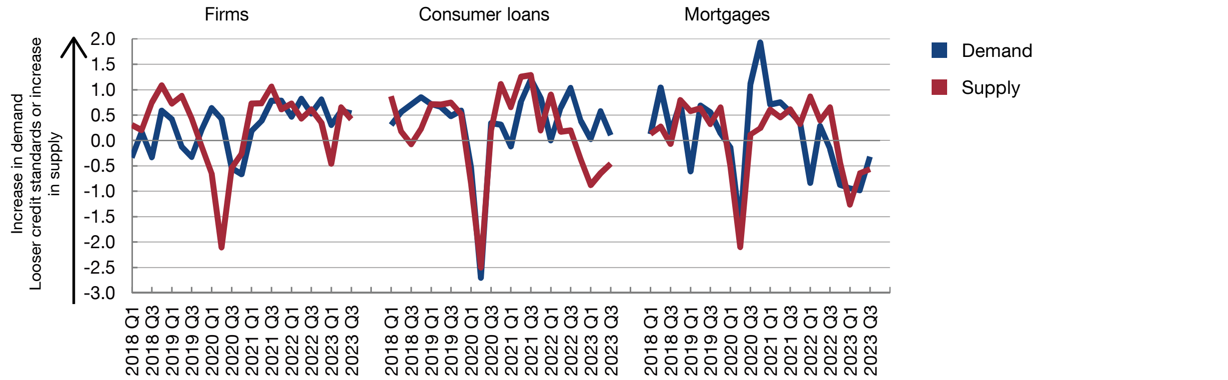
— According to surveys on credit conditions of different central banks,[14] at their cut-off date in 2023 Q3 this slowdown in credit was prompted by weaker demand, especially for mortgages, together with increasingly tight credit conditions for households (consumer loans and mortgages), which, however, have eased for firms (see Chart 12.b).

Chart 12

12.a Changes in credit to the non-financial private sector (real) (a)



12.b Credit conditions index: Latin America



SOURCES: Banco de España, Refinitiv and national statistics.

a Aggregates calculated using GDP weightings in purchasing power parity terms.

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13 See Chart 3.1 of *Regional Economic Outlook: Western Hemisphere*, of the International Monetary Fund, October 2023, including the contributions by credit type to year-on-year changes in credit in real terms.

14 See *Regional Economic Outlook: Western Hemisphere*, of the International Monetary Fund, October 2023.

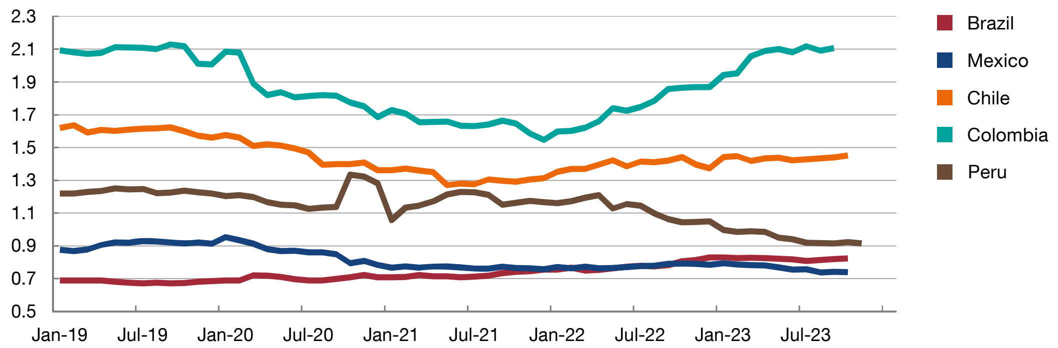
13 Bank leverage and bank exposure to the public sector remained at levels similar to those of 2019

— The banking sector's leverage, measured as the loan-to-deposit ratio, rose slightly in the region, approaching pre-pandemic levels. In Colombia, it rose substantially over the course of 2023 (see Chart 13.a), mainly owing to the over 10% fall in deposits, partly driven by regulatory changes at banks[15] which will provide support for their future resilience. Deposit growth also slowed in the rest of the region, except in Mexico.

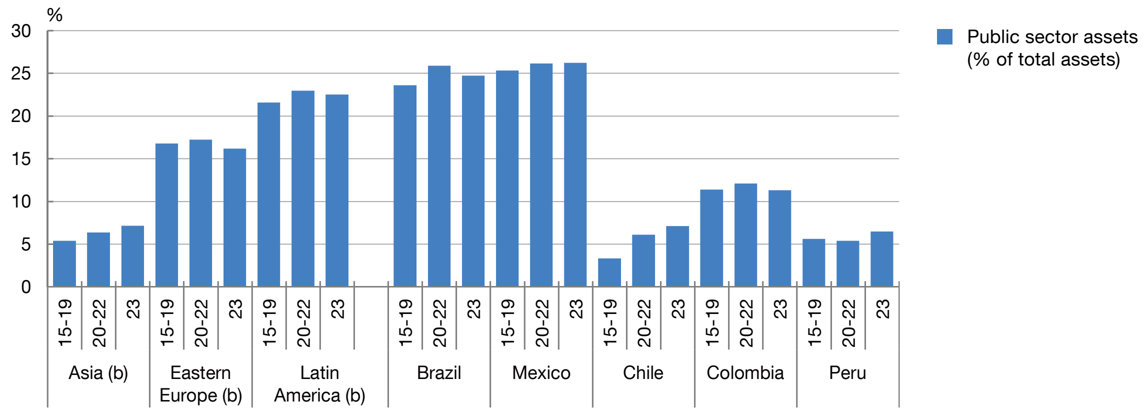
— Banks' exposure to the public sector (loans plus holdings of public debt, measured as a percentage of assets) is higher than in other emerging market economies (see Chart 13.b).[16]

Chart 13

13.a Loan-to-deposit ratio (a)



13.b Sovereign-bank nexus: public sector assets as a percentage of the total (a)



SOURCES: Banco de España, Refinitiv and national statistics.

a Total public sector assets (loans plus debt) as a percentage of domestic assets plus non-residents' assets.
b Sum of the balance sheets of South Korea, Thailand, Malaysia, India and Indonesia for Asia, Czech Republic, Hungary, Poland, Romania and Bulgaria for Eastern Europe and Brazil, Chile, Mexico, Colombia and Peru for Latin America.

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15 The sharp fall in deposits related to sight deposits, which account for more than 35% of the total, while fixed-term deposits increased by around 5% in the second half of 2023. This change in composition was in part due to the need to obtain more stable sources of funding to comply with the new net stable funding ratio (NSFR), which adapts the liquidity requirements to the Basel III regulation (see Banco de la República's *Reporte de Estabilidad Financiera* del segundo semestre de 2023.

16 As a mitigating factor, however, it is worth noting that a significant part of public debt in the assets of Latin American banking systems is short term and floating rate – tied to policy interest rates or to inflation – and is predominantly valued at market prices; accordingly they were largely unaffected by the banking turmoil linked to the resolution of Silicon Valley Bank in March 2023 (see Box 1 of the Financial Stability Report. Spring 2023, Banco de España).

14 The risks deriving from transactions with non-residents and in foreign currency appear to have declined

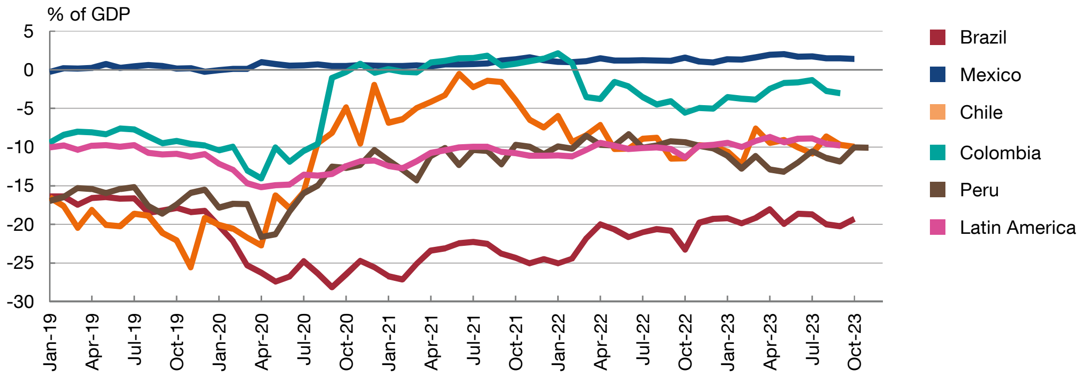
— The net external position vis-à-vis non-residents of the region's set of banks improved slightly over 2023, accounting for -9% of GDP, thanks to the decrease in negative positions in all the countries, especially Colombia (see Chart 14.a).

— A decrease was also observed in the degree of balance sheet dollarisation, with declines in loans and deposits in foreign currency as a proportion of the total, particularly in Mexico (see Chart 14.b).

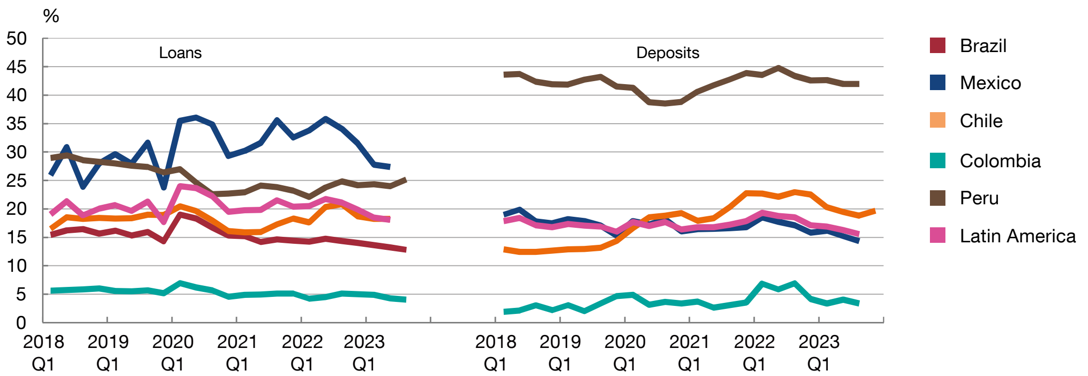
— This reduces the risks linked to exchange rate fluctuations, i.e. the risk that an exchange rate depreciation will raise the local currency value of bank liabilities, while prompting an increase in non-performing loans in foreign currency on account of greater debt servicing costs and difficulties in rolling over such loans.[17]

Chart 14

14.a Net foreign assets of the banking system (a)



14.b Balance sheet dollarisation: foreign currency loans and deposits (% of total)



SOURCES: Banco de España, Refinitiv and national statistics.

a Non-residents' assets less non-residents' liabilities, divided by GDP.

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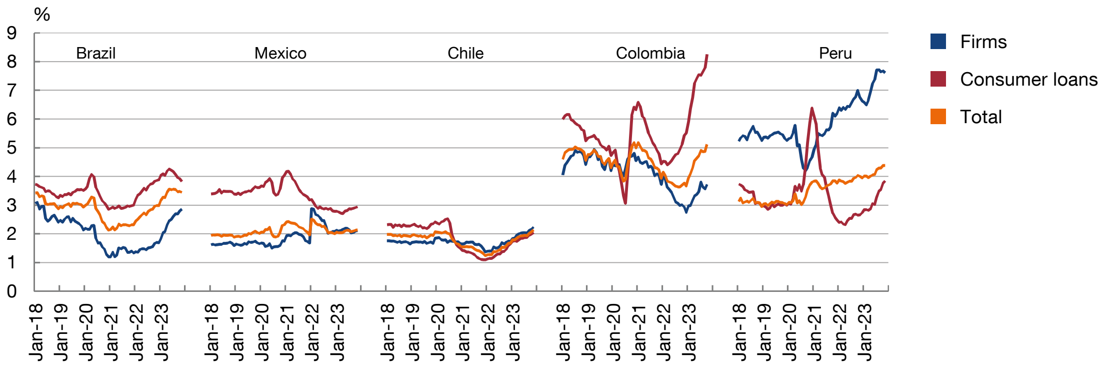
17 See Michael Chui, Ingo Fender and Vladyslav Sushko (2014), *Risks related to EME corporate balance sheets: the role of leverage and currency mismatch, BIS Quarterly Bulletin*, for a summary of the risks associated with currency mismatches on firms' and banks' balance sheets.

15 Non-performing loans increased once again, especially in the corporates segment

— Non-performing loans increased over the course of 2023 H2 in nearly all the countries, especially owing to the upsurge observed in the loans to corporations segment, to slightly above pre-pandemic levels (see Chart 15.a). The sharp rise in corporate defaults in Peru, attributable to smaller firms, was noteworthy.

Chart 15

15.a Non-performing loans (a)



SOURCES: Banco de España, Refinitiv and national statistics.

a Percentage of total loans extended.

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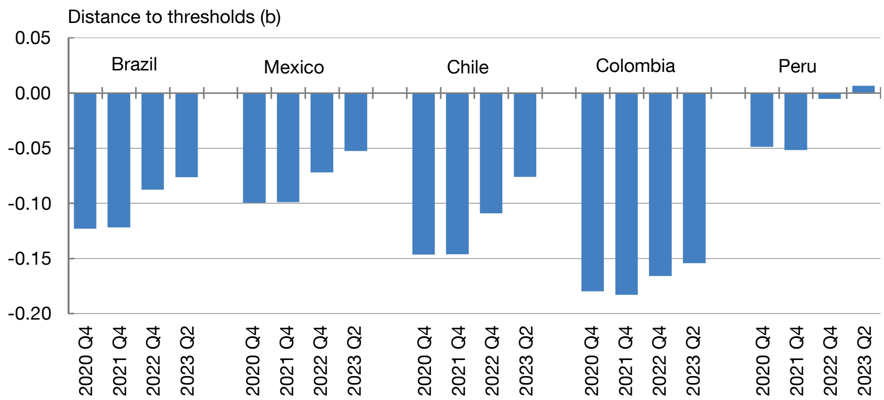
16 Banking system risks remain contained

— The macro-financial indicators of vulnerability remain contained and, in general, below the estimated reference risk thresholds (see Chart 16.a).[18]

— Also, the financial stability reports of the region's central banks generally consider that the situation of the financial systems is relatively sound.[19] The main risks identified in these reports are external and are mainly linked to a greater downward stickiness of inflation and/or fiscal risks in developed economies – causing interest rates to remain higher for longer and restricting global lending conditions – or to a greater than expected slowdown in China (see Figure 1 for more specific risks to each country's banking system).

Chart 16

16.a Vulnerability to a banking crisis (a)



SOURCES: Banco de España, Refinitiv and national statistics.

a Probability of vulnerability, estimated using a logit model for banking crises with pre-selected variables based on the emission of correct signals six quarters before a crisis (ROC curve threshold).

b The threshold is defined as the percentile above which the synthetic indicator has led to banking crises in the past, in a sample of 23 emerging market economes. See Irma Alonso-Álvarez and Luis Molina (2023), "How to foresee crises? A new synthetic index of vulnerabilities for emerging economies". Economic Modelling, Volume 125.

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18 "Indicators of vulnerability in emerging countries which are material for the Spanish banking system", second half of 2023.

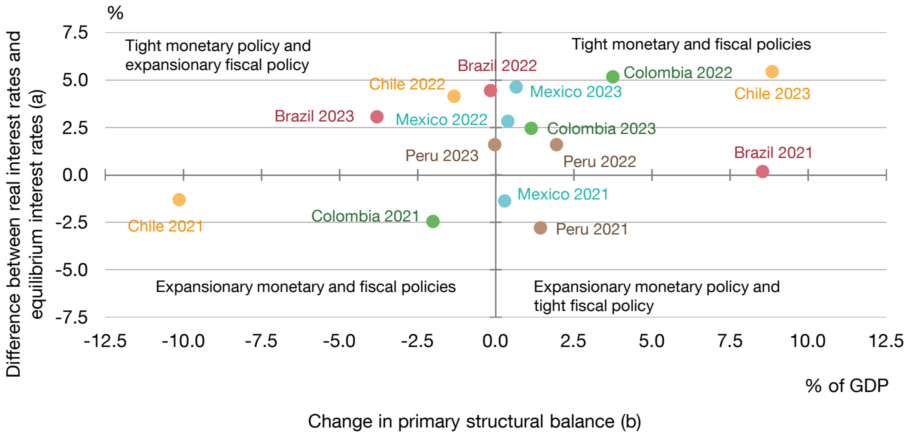
19 The aforementioned reports are available online: *Financial Stability Report* (Argentina), *Financial Stability Report* (Brazil), *Reporte de Estabilidad Financiera* (Mexico), *Financial Stability Report* (Chile), *Reporte de Estabilidad Financiera* (Colombia) and *Reporte de Estabilidad Financiera* (Peru).

17 The fiscal policy stance has eased in countries that undertook greater fiscal consolidation

— The fiscal policy stance was expansionary in 2023 in Brazil and Chile. The fiscal impulse was virtually zero in Peru, slightly contractionary in Mexico, and significantly negative – more than 3.5 pp of GDP – in Colombia, which thus achieved a positive primary structural balance. The monetary policy stance was also tighter in Mexico and Colombia than in 2022 (see Chart 17.a).

Chart 17

17.a Monetary and fiscal policy stance



SOURCES: Refinitiv and IMF (Fiscal Monitor October 2023).

a Real interest rates calculated as the difference between policy interest rates and one-year-ahead inflation expectations (year-end data), drawn from central bank surveys. Equilibrium interest rates, drawing on estimates of the region's central banks.

b Difference in the primary structural balance compared with the previous year (drawn from the October 2023 IMF Fiscal Monitor). An increase in the balance denotes a tighter policy and a decrease a more expansionary policy.

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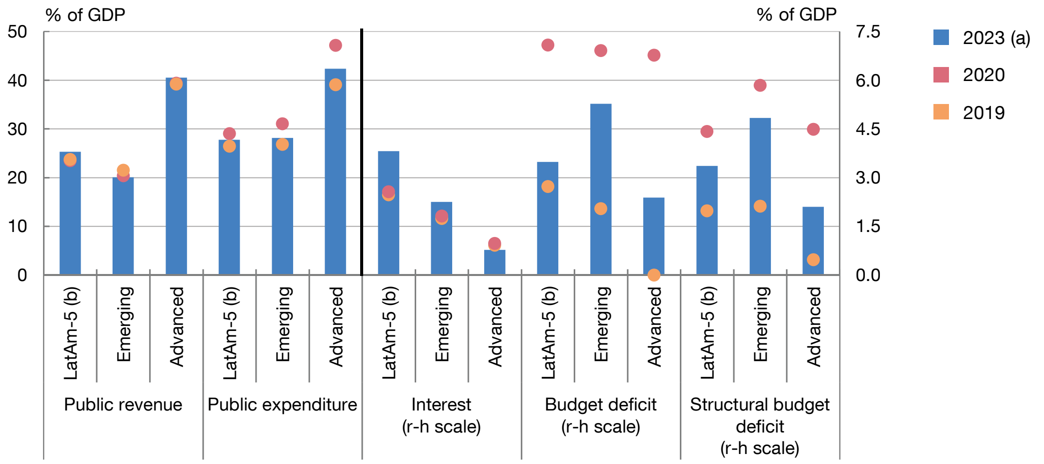
18 Structural deficits persist and the interest burden is growing, keeping public debt high…

— Most of the region's main economies now appear to have withdrawn the fiscal stimulus measures adopted in response to the COVID-19 pandemic, although structural public deficits remain widespread. In the last two years the interest burden has risen (see Chart 18.a).

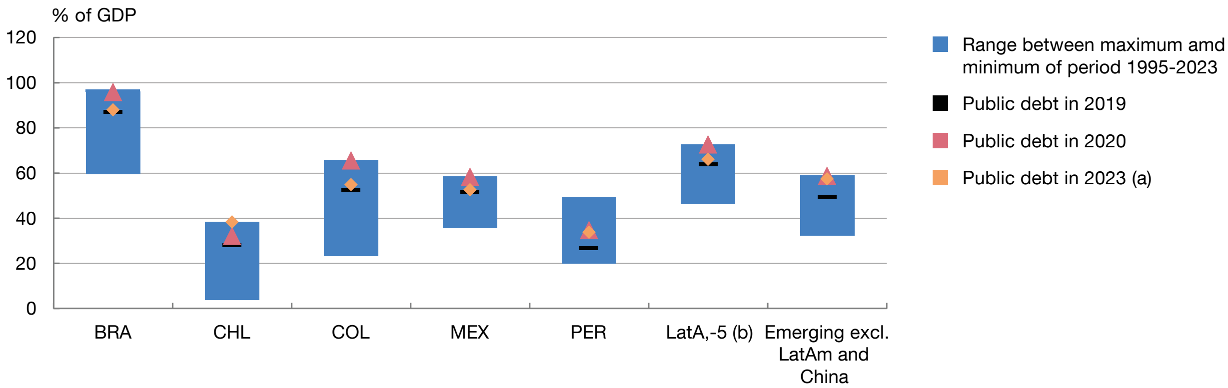
— Public debt in Latin America is broadly above the average of the last two decades. It is also slightly higher than that of the other emerging market economies, although the region has managed to converge towards debt levels similar to the pre-pandemic figures faster (see Chart 18.b).

Chart 18

18.a Fiscal indicators



18.b Gross public debt



SOURCES: IMF and Banco de España.

a WEO estimates, IMF October 2023.
b Brazil, Chile, Colombia, Mexico and Peru.

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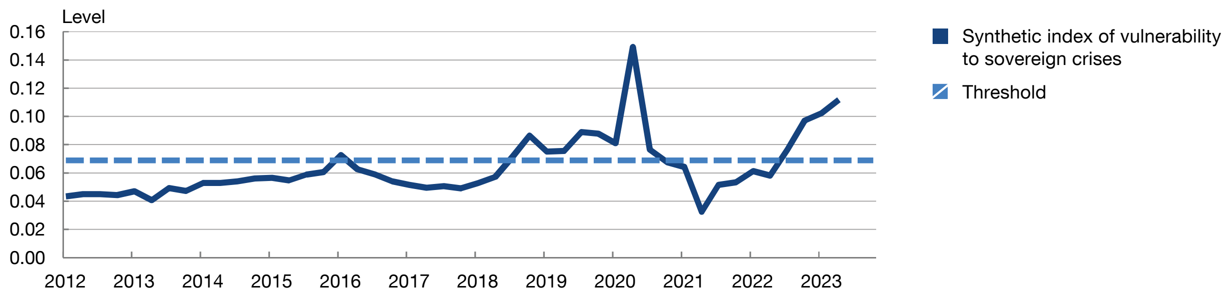
19 …and this, added to the low growth rates expected, renders public finances more vulnerable

— The synthetic indicator of public finance vulnerability has continued to head upwards in recent quarters (see Chart 19.a), as economic activity has slowed and both public debt levels and interest rates have remained high.

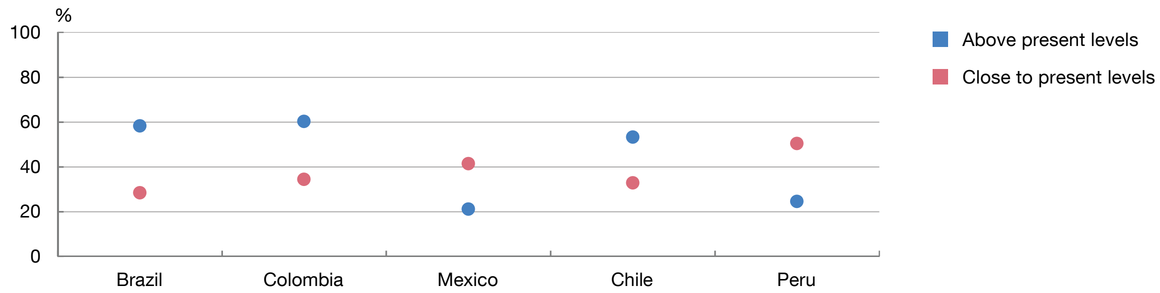
— Some simulation exercises[20] of future public debt trajectories show, for most of the region's main economies, a high probability of the public debt-to-GDP ratio being above its current levels in ten years' time under inertia scenarios, that is, assuming there is no economic policy response (see Chart 19.b).

Chart 19

19.a Synthetic vulnerability index: Latin America (a)



19.b Probability of public debt standing at different levels in 10 years' time (b)



SOURCE: Banco de España.

a Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Ecuador and Uruguay. The synthetic vulnerability indicator denotes the probability of vulnerability, estimated using a logit model for sovereign crises with pre-selected variables based on correct signals issued six quarters before a crisis (ROC curve threshold). An increase in the synthetic indicator denotes an increase in the probability of a crisis occurring.

b The threshold for each country is its public debt-to-GDP ratio (expressed as a percentage) in 2023, drawing on IMF WEO estimates (88% for Brazil, 38% for Chile, 55% for Colombia, 53% for Mexico and 34% for Peru). "Above present levels" denotes the probability of public debt standing more than 5 pp above its 2023 level in each country. "Close to present levels" denotes the probability of public debt standing up to 5 pp above or below its 2023 level in each country.

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20 Using the methodology devised by M. Alloza, J. Andrés, J. Pérez and J. Rojas. (2020). "Implicit public debt thresholds: An operational proposal". *Journal of Policy Modeling,* Vol. 42, pp. 1408-1424.

20 Given the vulnerability of public finances, the use of fiscal rules to ensure their sustainability gains particular importance

— The region's main economies have one or more fiscal rules, which seek to ensure that public finances are on a stable and sustainable footing and that public funds are managed transparently. They do this by setting limits and rules on debt levels, deficits and public expenditure and revenue (see Table 1).

— As a result of the COVID-19 pandemic, these fiscal rules were suspended or modified or escape clauses were introduced. Most of the region's economies have now reinstated their fiscal rules or a reformed version thereof. Some have proposed tax reforms or public expenditure reforms, seeking to strengthen the fiscal policy framework.

Table 1
Fiscal rule frameworks in Latin America (a)

	Brazil	Chile	Colombia	Mexico	Peru
	Types of fiscal rules before the COVID-19 pandemic				
Public expenditure	✓	x	x	✓	✓
Public revenue	x	x	x	x	x
Budget balance	✓	✓	✓	✓	✓
Public debt	✓	x	x	x	✓
	Escape clauses before the COVID-19 pandemic				
	✓	x	✓	✓	✓
	Types of responses to the COVID-19 pandemic				
	Use of escape clauses envisaged in the rules	Adjustment and reformulation of macro-fiscal parameters	Temporary suspension of fiscal rules in place	Adjustment and reformulation of macro-fiscal parameters	Temporary suspension of fiscal rules in place
	Current situation (2023)				
	New framework in place (b)	Gradual return to previous fiscal rule	New framework in place (c)	Fiscal rule previously in place	Gradual return to previous fiscal rule

SOURCES: CEPAL, Banco de España.

a For more information on the use and design of fiscal rules, see H. Davoodi, P. Elger, A. Fotiou, D. García-Macia, A. Lagerborg, R. Lam and S. Pillai (2022), "Fiscal Rules Dataset: 1985-2021". International Monetary Fund.
b In Brazil, the new fiscal rule put into place introduces a primary balance target and greater flexibility for real primary spending growth.
c In Colombia, the debt thresholds and the formula used to calculate the minimum value allowed for the structural net primary balance were not modified. However, some clauses were introduced, among other things, to ensure greater flexibility in case of an extraordinary event, and the Autonomous Fiscal Rule Committee, a technical and independent body that monitors compliance with the fiscal rule, was created.

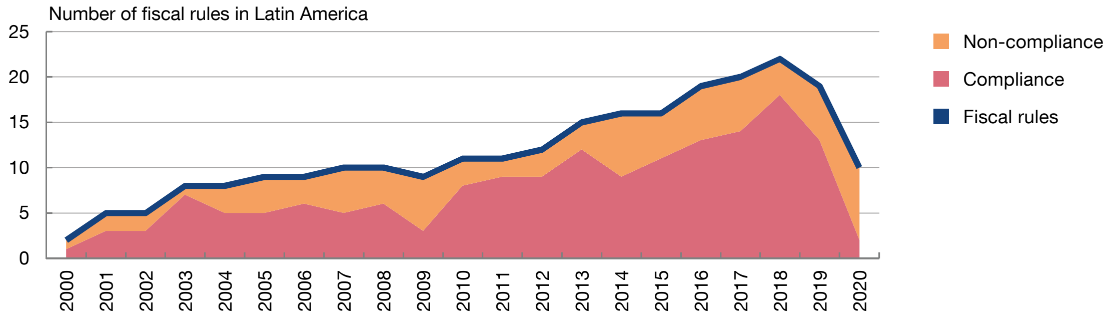
21 Such fiscal rules, if complied with, and especially if accompanied by structural reforms, should lead to a stable public debt dynamic in the region in the medium term

— However, in some economies in the region, past evidence shows that there has been some non-compliance with fiscal rules. It also shows that, in some cases, compliance was achieved after the fiscal rule targets were changed to make them more attainable (see Chart 21.a).

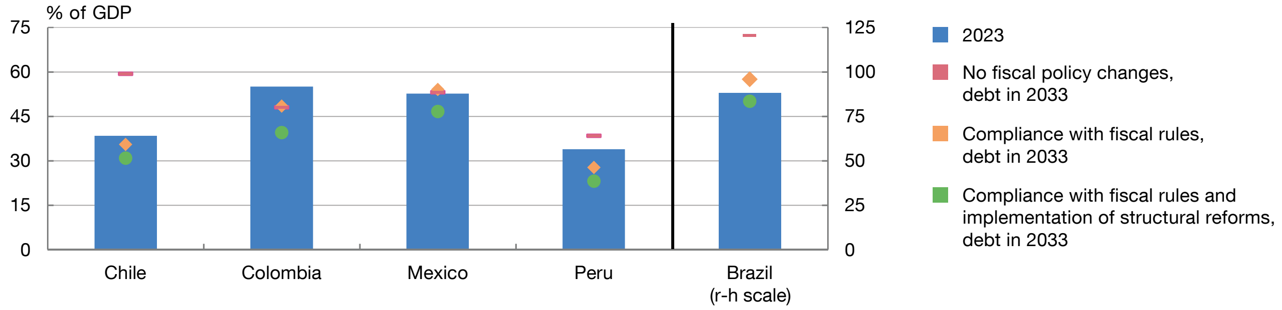
— Some simulation exercises show that compliance with the current fiscal rules would have a positive impact on the public debt dynamic, especially as compared with inertia scenarios under which it is assumed that fiscal policy remains unchanged (see Chart 21.b). Nevertheless, in some cases the simulations show debt rising above its present levels, with other factors, such as the growing interest burden along the simulation horizon, offsetting the positive impact of the fiscal rules. For this reason, structural reforms are needed to strengthen the fiscal rules, including reforms that make product market regulations more effective, encourage international trade, attract quality foreign direct investment and improve the infrastructure network.[21]

Chart 21

21.a Fiscal rules and compliance (a)



21.b Public debt in 2023 and in different simulation scenarios (b)



SOURCES: Valencia and Ulloa-Suarez (2022), Banco de España.

a Compliance with fiscal rules follows the methodology established in Valencia and Ulloa-Suarez. (2022). “Numerical Compliance with Fiscal Rules in Latin America and the Caribbean”. IDB Working Paper Series, 1345.

b The simulations use the debt sustainability analysis framework described in I. Kataryniuk, R. Lorenzo Alonso, E. Martinez Casillas and J. Timini. (2023). “An extended debt sustainability analysis framework for Latin America”, Documentos Ocasionales, Banco de España. Forthcoming. The scenarios are constructed using data up to 2022 and IMF forecasts for 2023 and 2024, and are based on the model from 2025 onwards. Under the compliance with fiscal rules scenario, the primary balance is anchored to the specific fiscal rule targets or multi-year macroeconomic frameworks published by the region’s governments. The combined scenario of compliance with fiscal rules and structural reforms assumes that, in addition, structural reforms are implemented that boost potential GDP growth in line with the estimates presented by J. Bailliu and C. Hajzler. (2016). “Structural Reforms and Economic Growth in Emerging-Market Economies”. *Bank of Canada Review.*

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21 For an analysis of possible reforms focused on management of public finances and the public finance architecture, see Aida Caldera, Paula Garda and Alberto Gonzalez-Pandiella. (2023). “How can Latin American countries improve their medium-term fiscal frameworks for better public finances?”. OECD blog.

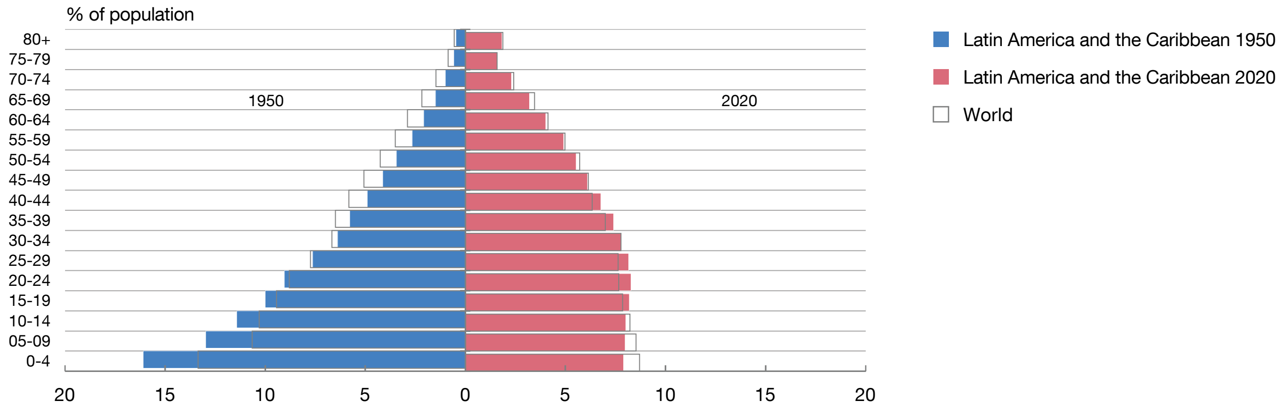
22 There is scope for reforms to help the region tackle challenges such as demographics and climate change

— There is ample room for fresh structural reforms in Latin America, in view of the region's low potential growth. In this respect, long-term growth essentially depends on developments in the working-age population, and the countries of the region face gradual population ageing[22] (see Chart 21.a) and net emigration (see Chart 21.b and Box 3). The United Nations estimates that by 2050 the fertility rate in the region will have dropped to 1.7 births per woman, below the world average of 2.1.

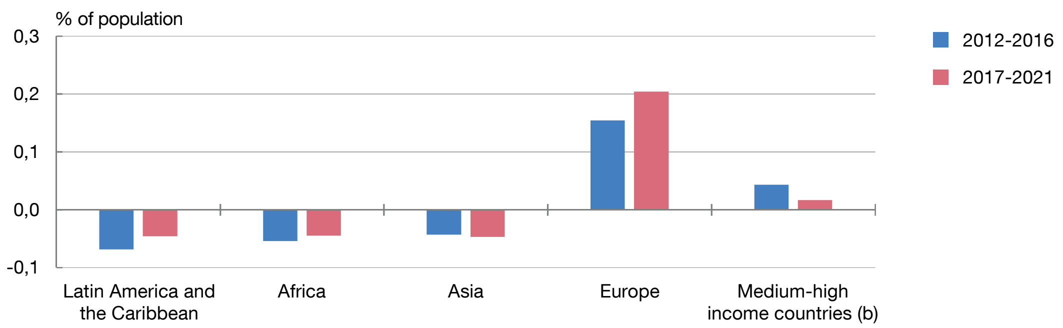
— Moreover, the region is subject to high climate-related risks stemming from climate change and the increase in both the frequency and the severity of natural disasters, all of which have a negative impact on economic activity. In consequence, as in other regions, there could be potential for climate risk insurance cover (see Box 2).

Chart 22

22.a Population pyramid: Latin America and the Caribbean (a)



22.b Net migration flows



SOURCE: United Nations.

a The population pyramids illustrate the population structure by age group (as a percentage of the total population) in the region and worldwide.
b As defined by the United Nations.

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22 See Juan Carlos Berganza, Rodolfo Campos, Enrique Martínez-Casillas and Javier J. Pérez. (2020). "The end of the demographic dividend in Latin America: challenges for economic and social policies". *Economic Bulletin – Banco de España,* 1/2020, Analytical Articles.

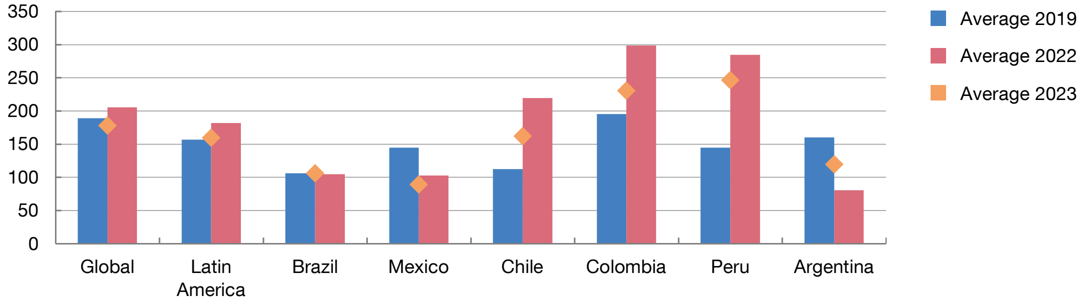
23 The recent easing of social and political unrest in the region could pave the way for these reforms

— Economic policy uncertainty decreased in 2023 in the countries of the region where it had risen most in previous years, with the notable exception of Argentina (see Chart 22.a and Box 1).

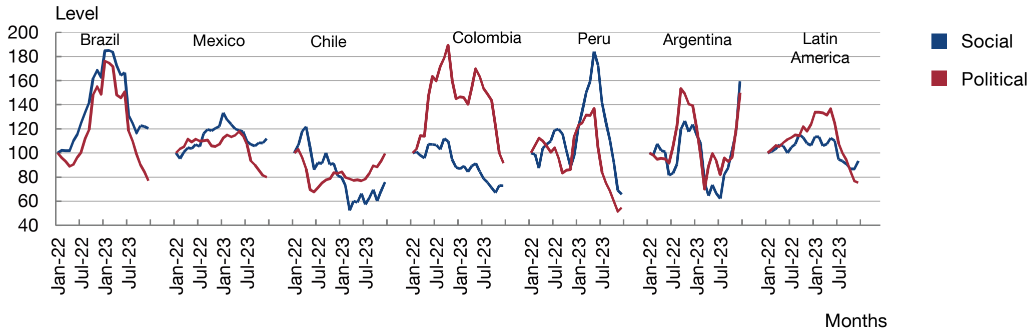
— Despite local peaks in several countries in 2023 H1 – in Brazil after the storming of Congress, in Peru when president Castillo was ousted from power, and in Colombia when reports of irregular campaign financing by the president triggered a crisis – political and social unrest declined in the year, save in Argentina and Chile, to lower levels than in early 2022 (see Chart 22.b). This new setting could be conducive to a more favourable climate for the approval of structural reforms that would help boost potential growth.[23]

Chart 23

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



23.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?". Documentos de Trabajo, 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 Indices of social and political unrest are based on words relating to social and political unrest in local and international newpapers (see Erik Andres-Escayola, Corinna Ghirelli, Luis Molina, Javier J. Pérez and Elena Vidal. (n.d.). "Fundamental spreads for inflation targeters in Latin America". Mimeo).

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23 IMF Blog, "Latin America Can Boost Economic Growth by Reducing Crime".

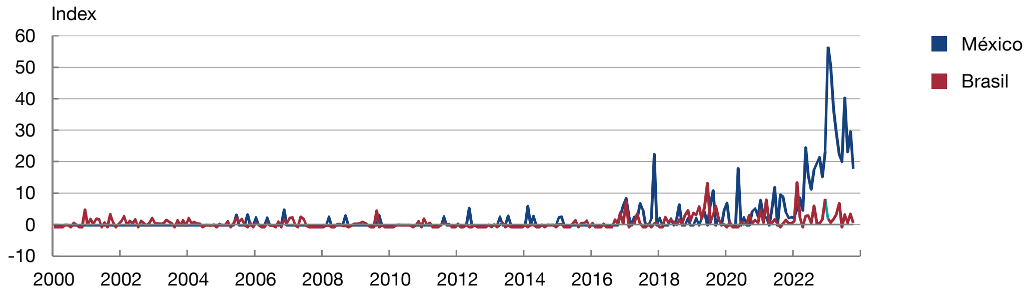
24 Moreover, some Latin American countries could benefit in the medium term from the complex global geopolitical situation, if certain incipient multinational offshoring trends materialise

— Rising trade barriers among the major global economies could prompt changes in the way in which firms operate worldwide.[24] For instance, they could spur nearshoring or friend-shoring, relocating productive activity to nearby or politically friendly countries, especially ones that are well integrated in global value chains and have a strong manufacturing sector. The marked increase in media reports on Mexico and the United States in this respect suggests greater interest than in other countries of the region, for instance compared with Brazil (see Chart 23.a).

— These movements are also reflected in various recent surveys conducted by the region's central banks. For instance, in a Banco de México survey[25] that records an increase in the number of firms reporting a positive impact on their activity, despite indicating that it is a complex process and that human capital would be needed, along with investment in the necessary infrastructure to ensure the correct functioning of the production process and subsequent product distribution. In consequence, most firms expect to reap the benefits in the medium to long term.[26]

Chart 24

24.a Frequency of local press references to words relating to protectionist policy and their interplay with decisions to offshore business from the United States (a)



SOURCE: Banco de España.

a The index measures the frequency of news items on restrictive trade policies and their interplay with decisions/intentions to offshore business to Mexico and Brazil from the United States. The frequency of news items is calculated as the fraction of articles in the main Mexican and Brazilian newspapers in the period January 2000 to October 2023 that contain words relating to restrictive trade policies and decisions/intentions to offshore business, and that refer to the United States, normalised by the total number of articles published in those newspapers. To facilitate the comparison of values, the indicators are standardised (taking as reference the period 2000-2014).

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24 Demosthenes Ioannou and Javier J. Perez (eds.). (2023). "The EU's Open Strategic Autonomy from a central banking perspective. Challenges to the monetary policy landscape from a changing geopolitical environment". Occasional Paper Series, 311. European Central Bank.

25 See, for example, "Opinión empresarial sobre la relocalización de las empresas hacia México", an extract from the Banco de México's *Reporte sobre las Economías Regionales,* April–June 2023. Recuadro 1, pp.9-11.

26 These movements are also reflected in surveys conducted by the central banks of some developed countries, and by several euro area central banks. See the European Central Bank survey (multinationals) and the Bundesbank and Banca d'Italia surveys (domestic firms).

Table 2
Latin America: main economic indicators

	2007-2021 average	2022	(October 2023 WEO) 2023	2024	2025	2022 Q1	Q2	Q3	Q4	2023 Q1	Q2	Q3	Q4
GDP (change on previous period) (a)													
Latin America and the Caribbean (b)	1.9	3.6	2.3	2.3	2.4	1.0	1.1	0.9	-0.2	1.0	0.2	0.7	—
Argentina	1.4	5.2	-2.5	2.8	3.3	0.8	1.7	0.4	-1.7	0.8	-2.7	2.7	—
Brazil	1.7	2.9	3.1	1.5	1.9	1.0	1.3	1.1	-0.1	1.4	1.0	0.1	—
Mexico (c)	1.4	3.0	3.2	2.1	1.5	1.6	1.0	1.2	0.7	0.6	0.9	1.1	—
Chile	3.1	2.4	-0.5	1.6	2.3	-0.8	-0.3	-1.1	0.1	0.5	-0.3	0.3	—
Colombia (c)	3.5	7.3	1.4	2.0	2.9	1.2	1.6	0.9	-1.6	2.2	-1.0	0.2	—
Peru	4.4	2.7	1.1	2.7	3.1	1.0	0.0	0.8	-0.1	-0.9	-0.1	-0.1	—
CPI (year-on-year rate) (a)													
Latin America and the Caribbean (b)	5.8	9.8	13.8	10.7	7.3	8.8	10.0	9.2	8.0	7.5	5.9	5.4	5.1
Argentina	22.4	72.4	121.7	93.7	54.1	52.8	61.0	77.6	91.8	102.0	113.0	125.9	172.8
Brazil	5.6	9.3	4.7	4.5	3.0	10.7	11.9	8.7	6.1	5.3	3.8	4.6	4.7
Mexico	4.2	7.9	5.5	3.8	3.1	7.3	7.8	8.5	8.0	7.5	5.7	4.6	4.4
Chile	3.4	11.6	7.8	3.6	3.0	8.3	11.5	13.7	13.0	11.8	8.7	5.6	4.6
Colombia	4.0	10.2	11.4	5.2	3.6	7.8	9.3	10.8	12.6	13.3	12.4	11.4	10.0
Peru	3.0	7.9	6.5	2.9	2.1	6.2	8.3	8.6	8.4	8.6	7.4	5.5	3.7
Budget balance (% of GDP) (a) (d)													
Latin America and the Caribbean (b)	-4.1	-3.7	-4.6	-4.5	-3.2	-3.6	-3.6	-3.7	-3.6	-4.3	-4.7	-5.2	—
Argentina	-3.8	-3.8	-4.0	-3.7	-1.9	-3.7	-4.0	-4.0	-3.8	-4.2	-4.3	-4.3	—
Brazil	-5.5	-4.6	-7.1	-6.0	-5.3	-3.1	-4.1	-4.2	-4.6	-6.0	-6.3	-7.5	—
Mexico	-3.1	-3.5	-3.9	-5.4	-2.6	-3.2	-3.0	-3.3	-3.4	-3.7	-4.2	-4.5	—
Chile	-1.3	1.1	-1.6	-1.3	-0.7	-6.3	-2.0	0.4	1.1	0.8	-1.8	-2.3	—
Colombia	-2.8	-4.2	-3.5	-2.4	-2.6	-6.5	-5.6	-6.0	-4.2	-3.7	-2.6	-2.2	—
Peru	-0.8	-2.2	-2.2	-1.8	-1.2	-2.1	-1.2	-1.8	-2.2	-2.8	-3.7	-3.5	—
Public debt (% of GDP) (a)													
Latin America and the Caribbean (b) (b)	56.9	62.0	68.1	68.3	68.7	61.8	60.0	60.0	59.2	59.3	—	—	—
Argentina	60.2	84.8	89.5	79.9	76.8	69.7	60.5	64.3	67.6	70.4	—	—	—
Brazil	73.4	72.9	88.1	90.3	92.4	76.4	75.6	74.2	71.7	71.5	72.1	73.4	—
Mexico	48.9	50.0	52.7	54.7	55.1	51.2	50.2	49.7	48.3	48.8	48.1	48.9	—
Chile	17.3	38.0	38.4	41.2	42.4	36.4	36.8	37.3	38.0	37.0	36.7	37.3	—
Colombia	44.9	56.6	55.0	55.1	55.4	58.0	57.2	58.3	59.7	58.2	56.2	55.6	—
Peru	26.4	33.8	33.9	34.0	33.5	33.4	33.6	34.2	33.8	32.8	32.1	32.4	—
Current account balance (% of GDP) (a) (d)													
Latin America and the Caribbean (b)	-1.8	-2.9	-1.8	-1.5	-1.4	-2.2	-2.6	-3.1	-2.8	-2.7	-2.4	-1.8	—
Argentina	-0.9	-0.6	-0.6	1.2	0.8	0.9	0.2	-1.0	-0.7	-1.3	-2.2	-2.6	—
Brazil	-2.4	-3.0	-1.9	-1.8	-1.9	-2.2	-2.6	-3.0	-2.7	-2.7	-2.6	-1.9	—
Mexico	-1.2	-1.3	-1.5	-1.4	-1.1	-0.8	-1.3	-1.4	-1.2	-1.7	-1.3	-0.7	—
Chile	-2.8	-9.0	-3.5	-3.6	-3.5	-8.1	-9.7	-10.0	-9.0	-6.6	-4.4	-3.4	—
Colombia	-3.8	-6.2	-4.9	-4.3	-4.3	-6.2	-6.2	-6.4	-6.2	-5.6	-4.9	-3.4	—
Peru	-2.3	-4.1	-1.9	-2.1	-1.7	-3.2	-3.3	-3.9	-4.0	-2.9	-1.9	-0.7	—
External debt (% of GDP) (a)													
Latin America and the Caribbean (b)	37.7	34.4	42.7	40.5		37.9	35.4	34.4	34.2	34.0	33.5	32.6	—
Argentina	41.4	43.8	—	—		52.6	48.8	45.1	44.1	43.1	43.1	44.0	—
Brazil	29.0	35.5	—	—		39.7	36.5	35.4	34.9	34.7	35.1	34.1	—
Mexico	13.5	13.9	—	—		16.5	15.0	14.7	13.9	13.6	12.4	11.4	—
Chile	55.4	77.6	—	—		76.5	74.5	74.3	77.4	74.9	72.7	70.4	—
Colombia	33.1	53.6	—	—		53.5	51.3	50.5	53.3	55.1	56.0	55.2	—
Peru	34.1	41.8	—	—		45.0	43.4	42.6	41.8	41.5	40.8	39.1	—
MEMORANDUM ITEMS: Aggregate of emerging market economies excluding Latin America and China (IMF, October 2023 WEO)													
GDP (year-on-year rate)	4.1	4.7	3.7	4.2	4.5								
CPI (year-on-year rate)	7.1	13.3	11.8	10.6	8.3								
Budget balance (% of GDP)	7.1	-3.9	-4.8	-4.6	-4.3								
Public debt (% of GDP)	42.0	56.0	57.6	57.8	58.6								
Current account balance (% of GDP)	0.7	2.0	0.3	0.2	-0.1								
External debt (% of GDP)	27.6	26.7	27.1	26.2	—								
Share of global GDP, in PPP (%)	31.7	32.5	32.7	33.1	33.5								

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 4-quarter moving average.

Figure 1
Recent developments in Latin American banking systems and the risks to financial stability according to the region's central banks

MEXICO

Geographical/political risk

Tighter global financial conditions due to heightened geopolitical tensions.

Credit risk

Rise in credit risk in lending to firms and households due to higher probability of default and stronger default correlation.
Higher market risk due to balance sheet adjustment towards assets that are more sensitive to changes in interest rates.

Resilience of the financial and fiscal system

Unexpected adjustments to sovereign and Pemex ratings.
Systemic event affecting the global financial system.
More frequent and sophisticated cyber attacks amid higher geopolitical risk.
Greater climate-related risk, especially due to low portfolio diversification (concentration of all types of risk at institutions).

COLOMBIA

Geographical/political risk

Exposure to sudden changes in global financial conditions due to greater geostrategic risks.

Credit risk

Materialisation of credit risk due to increase in non-performing loans, particularly consumer credit, after the sharp rise in loans in 2021-2022.
Expectations of an increase in corporate credit risk due to the deceleration in activity and higher for longer policy interest rates due to the downward stickiness of inflation.
Lower growth of trading partners.
Fall in sales of new housing that undermines the real estate sector's ability to pay.
Climate-driven inflation (El Niño).

Foreign exchange risk

Significant foreign investor presence in peso-denominated markets amplifies the economy's vulnerability to changes in global financial conditions.

Resilience of the financial and fiscal system

Low bank profitability, decrease in net contributions and in the liquidity of the related investment funds, and increase in balance sheet risk due to rise in interest rates.
Decrease in sight deposits due to regulatory changes related to Basel III liquidity ratios.

PERU

Geographical/political risk

Heightened geopolitical tensions.
Low business confidence and social unrest.

Credit risk

Moderate increase in credit risk due to a less favourable economic setting, greater social unrest and the fallout from extreme weather events (El Niño).
Decrease in credit risk in lending to large firms due to their lower demand for financing.

Resilience of the financial and fiscal system

Pension fund withdrawals have led to them having suboptimal portfolios and to lower liquidity in the sol-denominated debt market.
Possible sharp correction of domestic asset prices in the event of fresh fund withdrawals.

SOURCE: Banco de España.

Figure 1

Recent developments in Latin American banking systems and the risks to financial stability according to the region's central banks (cont´d)

BRAZIL

Geographical/political risk

Concern over extreme asset revaluation scenarios due to central bank balance sheet adjustment.
Systemic financial sector events in the advanced economies.
Climate-related risks in the most exposed sectors (agriculture, mining, construction, hydroelectric energy).

Credit risk

Increase in the materialisation of credit risk due to agents' high indebtedness.
Households' ability to pay still being squeezed, although default rates are expected to decline.
Less risk materialised at large firms following the *Lojas Americanas* episode.
Decrease in micro- and small enterprises' ability to pay.

Foreign exchange risk

Low foreign exchange risk and the financial system would cope with it smoothly.

Resilience of the financial and fiscal system

Lower concern over fiscal and government debt sustainability, although it remains one of the most important risks.
Higher concern over cyber security and the use of new technologies in the banking sector.

CHILE

Geographical/political risk

Effects of geostrategic conflicts on commodity prices.

Credit risk

Deterioration in household financial position associated with a fresh downturn in the labour market.
Risk of asset price reversal.
High costs, weak demand and tight financing conditions in the real estate sector.

Resilience of the financial and fiscal system

Liquidity risk due to the maturity of the Conditional Financing Facility for Increased Loans (FCIC) programmes launched during the pandemic, which account for 8% of liabilities and are scheduled to mature in April and July 2024.
Basel III convergence, scheduled for 2025, prompting frictions.
Market depth shallow by historical standards and with low ability to absorb external shocks.
Must not deviate from the fiscal consolidation path, particularly in light of the outlook for the sovereign rating being revised to "negative" due to weakened political and economic consensus.
Operational risk due to growing digitalisation of banking.

ARGENTINA

Geographical/political risk

Less favourable financial conditions due to geopolitical risks.

Credit risk

Domestic context (weaker economy and greater market volatility) may prompt greater risk materialisation in 2024.
Higher liquidity risk at institutions due to greater volatility of peso-denominated deposits and a shortening of their terms.

Resilience of the financial and fiscal system

Public and private sector very highly leveraged, price bubbles in certain market segments and recent emergence of non-bank financial intermediation, which tends to behave procyclically.
Operational risks linked to technological innovation and growing use of crypto assets, which limit countries' monetary sovereignty, make capital flows more volatile and give rise to spillovers between markets.
High climate-related risks, particularly due to droughts (the effect is analysed in a box to the report, noting that the central bank will foster and monitor compliance with the National Sustainable Finance Strategy).

SOURCE: Banco de España.

Box 1

RECENT ECONOMIC POLICY MEASURES IN ARGENTINA

Economic problems facing Argentina

Since 2011 Argentina has seen an extended period of economic stagnation (see Chart 1) and fiscal deterioration (see Chart 2). The latter was mainly driven by higher government spending, although falling tax revenue was another contributing factor. No growth for over a decade pushed the poverty rate[1] from 29% in 2017 H1 (first year available) to 40% in 2023 H1. While the unemployment rate is relatively low (5.7% in 2023 Q3), some private analysts believe that almost one-half of employment is informal.[2]

Chart 1
GDP. Country comparison

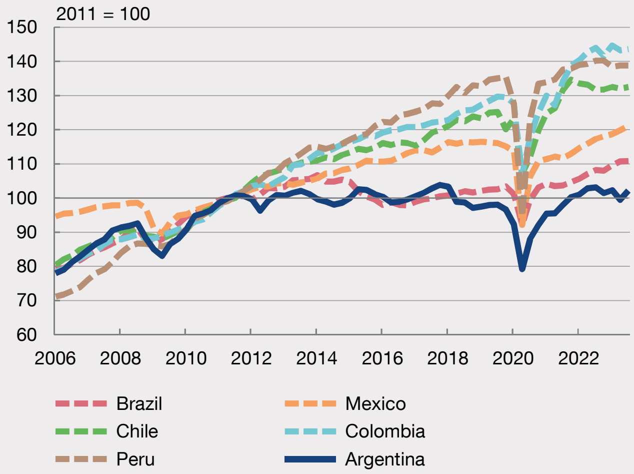


Chart 2
Budget balance

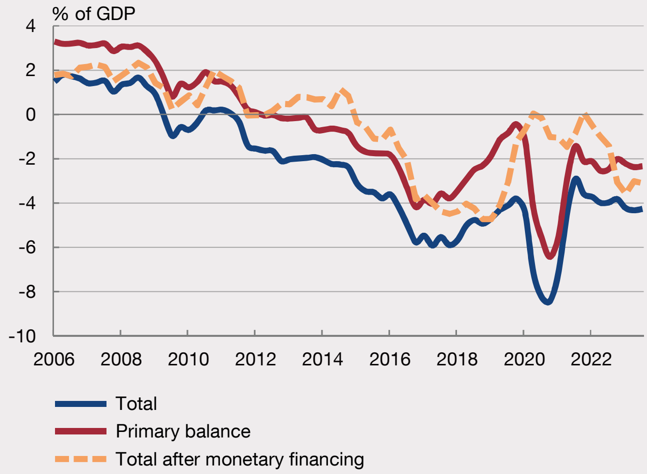


Chart 3
Central bank transfers to the Treasury and inflation

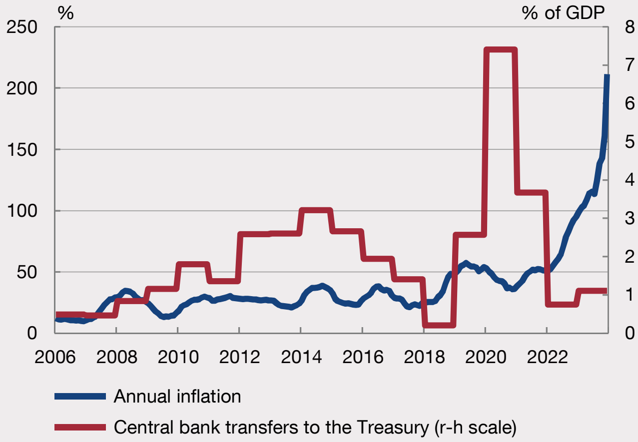
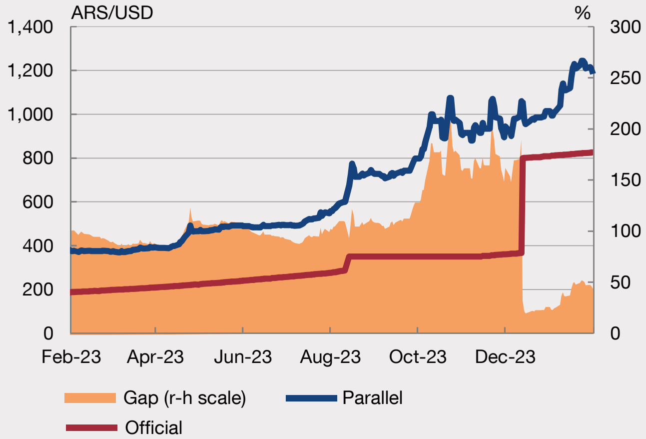


Chart 4
Exchange rate and FX gap (percentage difference between the market and official exchange rates)



SOURCES: Refinitiv and Banco de España.

1 The poverty rate is measured as the percentage of the population in large urban centres whose income does not cover basic food and non-food needs as defined by the National Institute of Statistics and Censuses (INDEC). The poverty line varies over time according to the general price level and changes in the relative prices of goods.

2 Informal employment is defined as dependent employment and self-employment without making social security contributions. The INDEC does not calculate an official informal employment rate. However, private estimates calculated using INDEC data exist. The source most cited in the media is the *Barómetro de la Deuda Social Argentina* (Argentinian Social Debt Barometer) published by Universidad Católica Argentina. In its latest report (E. R. Donza. (2023). Escenario laboral en la Argentina del pos-COVID-19. Persistente heterogeneidad estructural en un contexto de leve recuperación del mercado de trabajo (2010-2022). Documento estadístico - Barómetro de la Deuda Social Argentina, (1st ed.) EDUCA), the informal employment rate was estimated to be 49.8% in 2022.

Box 1

RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

Unable to raise funding on the financial markets and, above all, after abandoning the International Monetary Fund (IMF) programme,[3] the Argentine Treasury has increasingly had to turn to monetary financing. This has triggered, with some lag, an acceleration in the inflation rate (see Chart 3) and a depreciation of the Argentine peso (see Chart 4). In 2023 Q3 the current account deficit in the balance of payments stood at 2.6% of GDP. Turning to government debt, the relative share of official creditors has increased since Argentina was shut out from

Chart 5
Government debt, by creditor

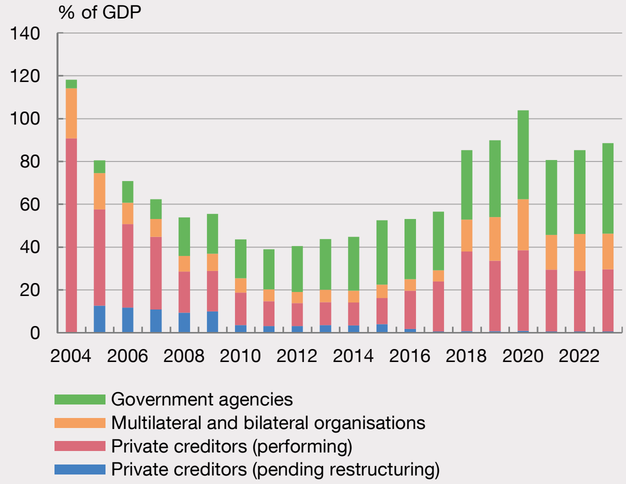


Chart 6
Government debt, by currency

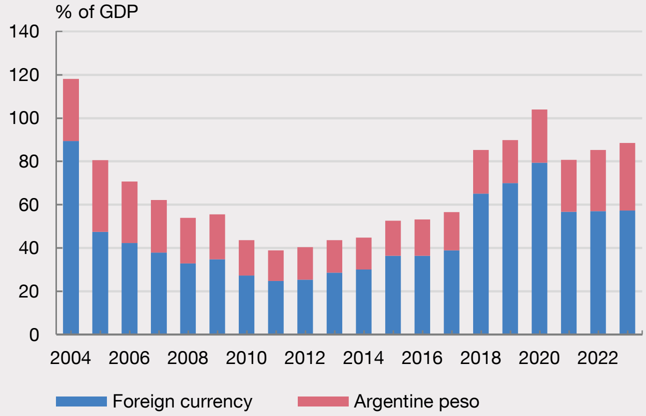


Chart 7
Repayments to the IMF falling due

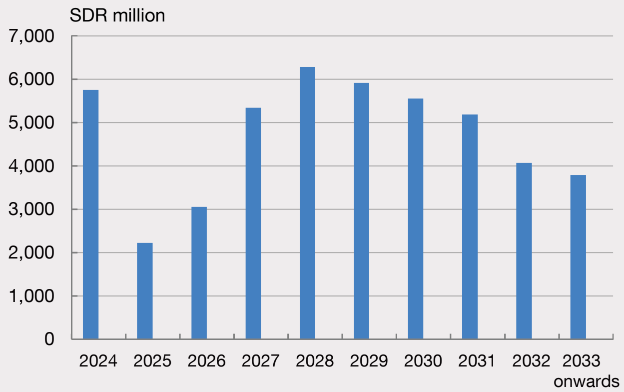
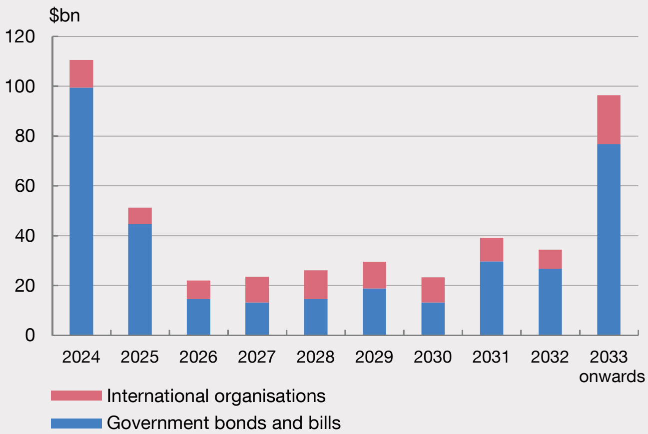


Chart 8
Repayments of central government debt falling due



SOURCES: Ministerio de Economía (Argentina) and IMF.

3 The IMF programme had gone significantly off track due to the previous administration's failure to achieve the objectives (see "Argentina: Fifth and Sixth Reviews Under the Extended Arrangement Under the Extended Fund Facility, Request for Rephasing of Access, Waivers of Nonobservance of Performance Criteria, Modification of Performance Criteria and Financing Assurances Review-Press Release; Staff Report; and Statement by the Executive Director for Argentina"), but a new agreement has been reached with Argentina to bring the programme back on track, disbursing $4.7 billion (see press release and "Argentina: Seventh Review under the Extended Arrangement under the Extended Fund Facility, Requests for Rephasing of Access, Extension of the Arrangement, Waivers of Nonobservance of Performance Criteria, Modification of Performance Criteria, and Financing Assurances Review-Press Release; Staff Report; and Statement by the Executive Director for Argentina").

Box 1
RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

international markets[4] (see Chart 5). Most government debt is denominated in foreign currency (57.2% of GDP), while peso-denominated debt amounts to 31.2% of GDP (see Chart 6). Sizeable portions of Argentina's government debt with the IMF (see Chart 7) and private creditors (see Chart 8) are set to fall due.

The first policies implemented by the new Government

Faced with this situation, the new Argentine Government that took office on 10 December 2023 put forward a fiscal consolidation plan that aims to take the primary fiscal balance from an estimated deficit of 3% of GDP in 2023 to a surplus of 2.1% of GDP in 2024. Debt interest payments amount to around 2% of GDP. The budget would therefore be balanced and there would be no need to turn to monetary financing. The fiscal consolidation plan (see Table 1) envisages hikes to the tax on FX access *(Impuesto PAIS),*[5] levied on non-essential imports, and to taxes on non-agricultural exports. According to official estimates, these two measures combined will raise tax revenues by 1.8% of GDP. The plan also envisages the unwinding of a personal income tax reform, expected to boost tax revenues by 0.4% of GDP, and a fresh tax amnesty that could raise 0.5% of GDP. Under the plan, government spending would be cut by 2.9% of GDP. The main items affected include transport and energy subsidies (0.7% of GDP), public works (0.7% of GDP), transfers to provinces (0.5% of GDP), pension benefits (0.4% of GDP) and social programmes (0.4% of GDP). The plan also foresees a 0.5% of GDP cut to government operating costs and a 0.3 percentage point of GDP increase in unspecified social spending for vulnerable households. The tax hikes and the tax amnesty must be passed into law.[6] The reduction in the real value of pensions, which would rise less than inflation, requires that the indexation formula currently in force in Argentina be eliminated by law.

In December the Government also devalued the official exchange rate[7] from 366 pesos to the dollar to 800 pesos to the dollar (see Chart 4) and announced that it would continue the devaluation at a "crawling rate" of 2% per month. Given that monthly inflation of over 2% is expected, this rate of depreciation will lead to currency appreciation in real terms

Table 1
Fiscal policy measures expressed as a % of GDP

	2023	Adjustment in 2024
Revenue		
Taxes on international trade	2.4	1.8
Other taxes	8.2	0.4
Tax amnesty		0.5
Expenditure		
Subsidies	2.3	-0.7
Capital investment	1.5	-0.7
Transfers to provinces and state-owned enterprises	0.9	-0.5
Pensions	7.6	-0.4
Social assistance	3.3	-0.4
Government operating costs	4.0	-0.5

SOURCES: Ministerio de Economía (Argentina) and IMF.

4 Argentina was cut off from international markets, but has remained able to place government debt on the domestic market.

5 This tax, called *Impuesto Para una Argentina Inclusiva y Solidaria* (tax for an inclusive and solidary Argentina) was introduced in 2019. It affects certain foreign-currency transactions, including card purchases and payments for travel services abroad, music or film streaming platforms, messaging services, insurance and IT services.

6 These tax measures were part of an Omnibus bill that the Government had sent to Congress, but were withdrawn to be debated separately on an as yet unspecified date.

7 The fixed official exchange rate had led to a widening gap between the official and market exchange rates.

Box 1

RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

over the coming months. The Government announced that, for the time being, it would keep the multi-tiered exchange rate system, with several official exchange rates and a free-floating rate, but only temporarily and it expects to converge towards a free market in the future. The devaluation of the peso drove up inflation. Meanwhile, the increase in the official exchange rate had a positive impact on the central bank's international reserves, which started to grow in the days following the devaluation. The dollarisation announcements made during the election campaign are yet to materialise in specific legislative proposals.

In addition to these measures, intended to remedy the budget deficit and the depleted international reserves, the Government issued an Emergency Decree[8] that seeks to eliminate some of the impediments to long-term economic

Chart 9
Sovereign spread

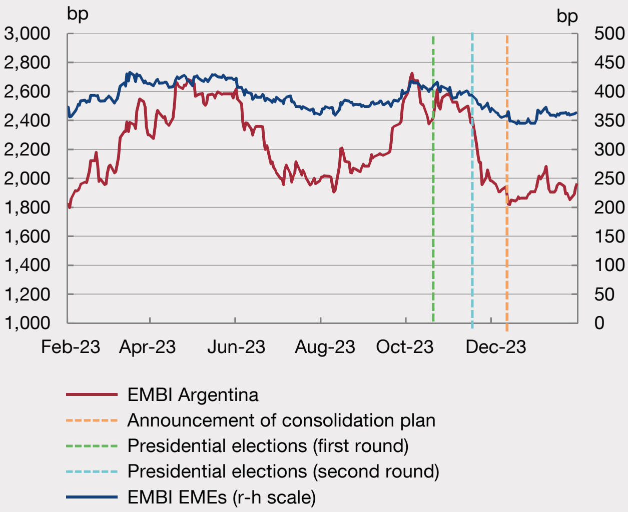


Chart 10
Buenos Aires stock market

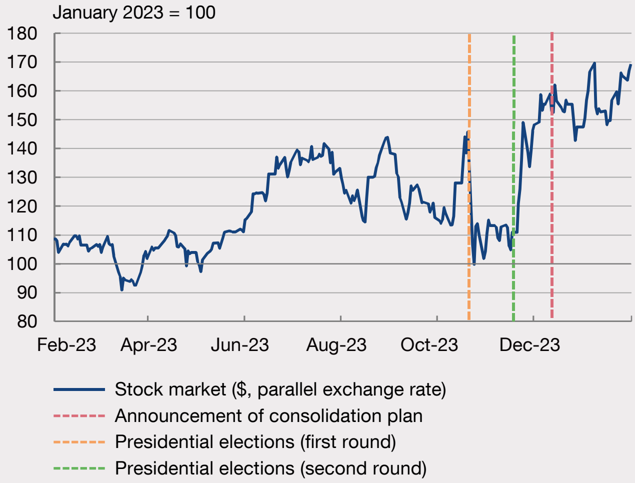


Chart 11
Exchange rate

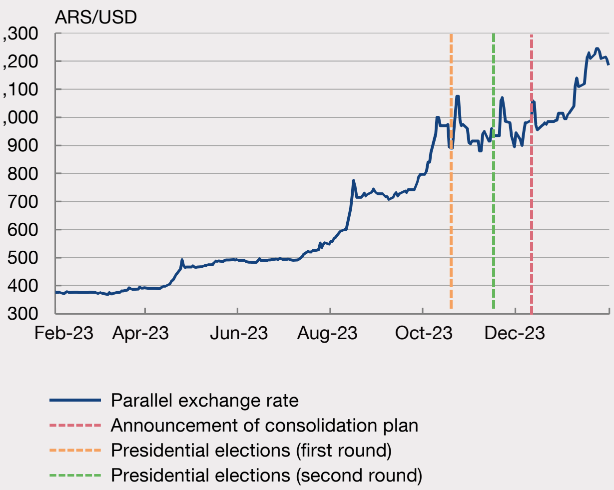
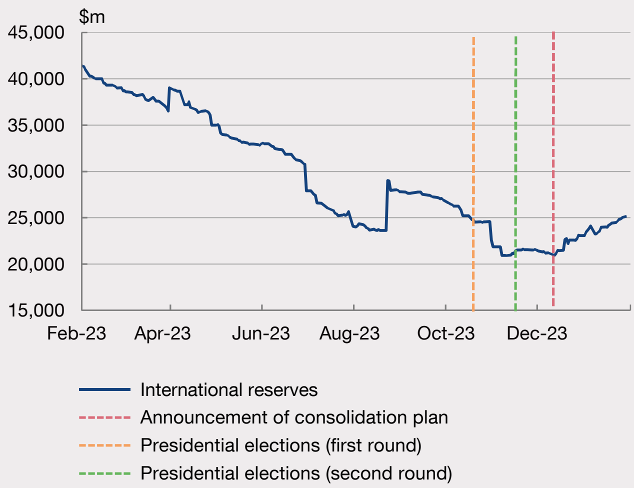


Chart 12
International reserves



SOURCES: Refinitiv and Banco de España.

8 Issuance of emergency decrees *(decretos de necesidad y urgencia)* is an exceptional power conferred on the Government to be used in the face of an emergency. They enter into force without having to pass through Congress. However, the decree can be overturned if both houses vote against it. Emergency decrees cannot legislate on taxation, criminal or electoral matters.

Box 1

RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

growth. The measures envisaged in the decree include changes to the labour market and the deregulation of a variety of goods markets,[9] e.g. pharmaceutical and air transport, among others, and a substantial liberalisation of imports and exports,[10] which no longer require permits to be granted. The rental market has been deregulated, thereby allowing the parties to stipulate indexation mechanisms in the contracts. The Government also

Table 2
Exposure of Spain
Shares of the material third countries in the variables of Spain's external position (2022)

Share (%)	Argentina	Brazil	Chile	Colombia	United Kingdom	Mexico	Peru	Türkiye	United States	Aggregate of the material third countries
Total bank assets	1.14	9.28	3.85	1.16	22.44	10.21	1.38	2.92	12.05	64.44
Loans	0.82	9.36	3.69	1.33	26.12	9.78	1.66	3.16	11.12	67.05
Debt securities	3.04	11.99	3.37	0.61	3.22	14.50	0.70	3.06	15.41	55.89
Equity instruments	0.84	3.14	0.10	0.42	14.26	2.94	0.05	0.86	18.29	40.90
Derivatives	0.01	2.40	7.44	0.62	30.44	5.31	0.13	0.12	13.20	59.67
Total bank liabilities	1.41	6.93	3.39	1.20	25.75	11.20	1.51	2.88	11.10	65.37
Deposits	1.57	7.26	3.01	1.28	25.52	11.66	1.65	3.19	10.66	65.79
Derivatives	0.02	1.46	8.17	0.39	32.88	5.76	0.17	0.18	15.66	64.69
Shorts	0.01	15.64	0.17	0.92	3.95	13.56	0.34	0.00	12.07	46.66
Exports of goods	0.31	0.92	0.46	0.38	5.47	1.34	0.20	1.74	4.86	15.67
Imports of goods	0.50	1.99	0.35	0.34	2.46	1.30	0.38	2.18	7.40	16.91
Exports of services (a)	0.83	1.02	0.79	—	14.08	1.65	—	0.55	8.10	28.87
Imports of services (b)	0.59	0.97	0.34	—	9.01	1.31	—	1.03	9.28	23.70
Tourism exports	—	—	—	—	—	—	—	—	—	29.44
Tourism imports	—	—	—	—	—	—	—	—	—	21.39
Exports in value added (c)	0.31	1.22	0.43	0.11	4.73	1.07	0.14	0.57	5.15	13.72
Imports in value added (c)	0.39	0.46	0.20	0.07	4.53	1.80	0.04	0.69	1.36	9.53
Spanish FDI in	2.62	6.71	3.43	1.62	18.10	8.84	0.77	1.25	14.72	58.05
FDI in Spain by	0.11	0.36	0.01	0.34	12.63	2.64	0.08	0.00	3.52	19.69
Active portfolio investment in Spanish debt securities in (d)	0.05	—	0.26	—	3.94	—	0.02	0.04	9.04	14.74
Active portfolio investment in Spanish equity in (e)	0.01	—	0.01	—	2.05	—	0.01	0.00	9.32	11.90

SOURCES: Banco de España, United Nations Conference on Trade and Development (UNCTAD) and Ministerio de Industria, Comercio y Turismo.

a The aggregate of Colombia and Peru is 1.84.
b The aggregate of Colombia and Peru is 1.17.
c 2019 data.
d The aggregate of Brazil, Colombia and Mexico is 1.40.
e The aggregate of Brazil, Colombia and Mexico is 0.50.

9 Companies no longer have to go through a registration process before being able to engage in certain activities and other entry barriers to competition are eliminated.

10 Most imports by firms were subject to non-automatic imports licensing, requiring prior approval by the Secretariat of Trade. Exports of certain products, e.g. some cuts of meat, were also banned.

Box 1
RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

submitted to Congress an Omnibus bill that sought further economic deregulation and paved the way for the privatisation of several state-owned enterprises or the transfer of shares to employees, but withdrew it upon verifying that it did not have the parliamentary support required for the bill to be passed in its entirety.

Many of the measures adopted by the Government coincide with recommendations by the IMF in its latest Article IV report.[11] For instance, it recommended reducing energy subsidies, eliminating monetary financing of the fiscal deficit, depreciating the official exchange rate of the peso and streamlining the foreign exchange system. The IMF report also mentions the need to improve the long-term sustainability of the pension system and envisages a more gradual fiscal consolidation without cutting government investment.

The Emergency Decree is in force, save for its labour market provisions, which have been suspended by the courts of first instance. The Government has, however, appealed this decision. Both the decree and the parliamentary reading of the Omnibus bill have sparked strikes and demonstrations and could heighten the social unrest in the country (in contrast to the easing of tensions in the rest of the region).

Financial market response

The markets have remained largely unmoved in the wake of the announcement of the different pieces of legislation. This is likely because the goal of a balanced budget was part of President Milei's election campaign. The largest market movements were actually observed upon his victory in the second round of the presidential elections on 19 November 2023, with the sovereign risk premium narrowing (see Chart 9) and the Buenos Aires stock market index (measured in dollars) picking up markedly (see Chart 10). The parallel exchange rate initially depreciated, but this movement reversed a few days later (see Chart 11). International reserves (see Chart 12) did not undergo significant changes immediately after the elections, but they have followed an upward path since the fiscal consolidation package was announced. However, in this case, developments are likely linked to the simultaneous announcement of the slashing of the official exchange rate, which

Chart 13
Exposure of the Spanish financial system for CCyB purposes (a)

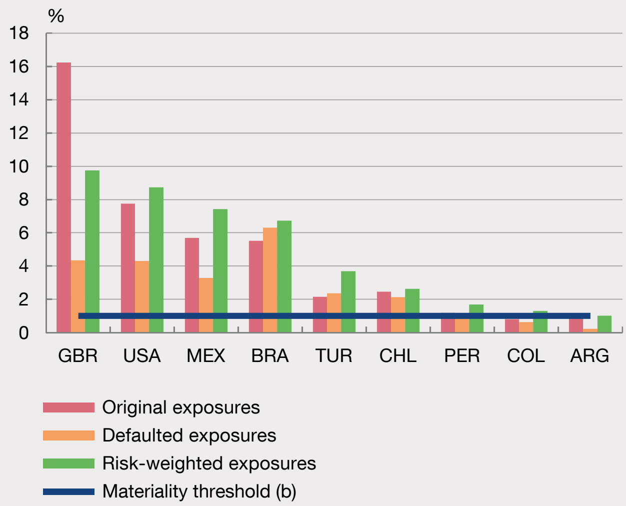
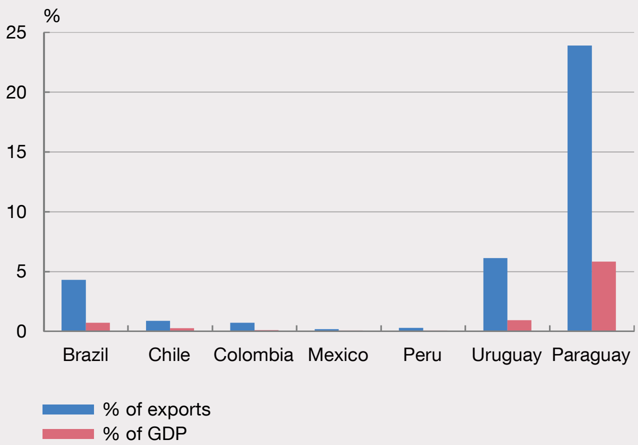


Chart 14
Exports to Argentina



SOURCES: Banco de España and Refinitiv.

a Credit and other claims on households and non-financial corporations, excluding public entities and financial institutions.
b 1% of any type of exposure.

11 Argentina: Staff Report for 2022 Article IV Consultation and request for an Extended Arrangement under the Extended Fund-Facility-Press Release; Staff Report; and Staff Supplements.

Box 1
RECENT ECONOMIC POLICY MEASURES IN ARGENTINA (cont'd)

dissuaded importers from purchasing dollars from the central bank and encouraged exporters to settle currency at the official exchange rate.

Spain's exposure and possible impact of the measures announced on countries in the region

Argentina has been considered a material third country for the Spanish banking sector for countercyclical capital buffer (CCyB) purposes since 2023, as the bank assets held by Spanish banks in Argentina surpass the threshold value. However, Spain's exposure to the country is very low (see Chart 13). The sharp devaluation of the official exchange rate has actually placed Argentina below the threshold used to determine the material third countries for Spain. The percentage shares of bank assets and liabilities are currently the lowest of all the material third countries for Spain. The Spanish economy's trade exposure to Argentina is also low, with Spanish exports to and imports from Argentina accounting for less than 1% of Spain's trade flows in both directions. Spain's highest exposure is in foreign direct investment (FDI) (2.6% in Argentina) (see Table 2).

The impact of the announced measures on activity in other countries in the region is uncertain. Should they have contractionary effects, the countries potentially most affected are the Common Market of the South (Mercosur) countries, especially Paraguay and Uruguay, which have closer trading ties with Argentina, and, to a lesser extent, Brazil (see Chart 14).

Box 2
THE LATIN AMERICAN INSURANCE MARKET[1]

The banking and insurance sectors play key roles in the process of capital formation in economies, through the savings-investment nexus. The banking sector (as an intermediary between savers and borrowers) and the insurance sector (as a protector against and pooler of risks through its different business segments) support the smooth functioning of the different sectors of the real economy. In addition, Latin America is particularly exposed to significant risks stemming from climate change and natural disasters. These can have an adverse impact on activity, making it imperative that adequate insurance coverage is available for such risks.

The Latin American insurance sector in global perspective

The depth of the banking industry's penetration in an economy is typically gauged using the credit-to-GDP ratio, while for the insurance sector the usual metric is the penetration ratio (premiums/GDP). As Charts 1 and 2 illustrate, there is a close correlation between the penetration of these sectors and a country's level of economic development. In the case of Latin American economies, these sectors are broadly of a size that would be expected based on the countries' GDP per capita.

For instance, in 2022 the insurance sector's average penetration ratio in Latin America was 3.01% (1.74% in non-life insurance and 1.27% in life insurance), having followed a rising trend over the last decade driven mainly by life insurance and to a lesser extent by non-life insurance (although the latter continues to account for the bulk of the regional aggregate).[2] By contrast, the average penetration ratio in the benchmark advanced economies was 3.6% for non-life insurance and 4.5% for life insurance. However, the Latin American penetration ratio is slightly higher than that of other emerging economies. Behind this regional picture lies cross-country heterogeneity. For instance, Puerto Rico has the highest penetration ratio in the region (16.4% of GDP), due to the significant role played by insurance companies in the country's health system. In 2022, the countries with the next highest penetration ratios were Chile (4.3%), Colombia (3.2%) and Brazil (3.1%), all standing above the regional average, albeit only slightly in the case of Colombia and Brazil (see Chart 3). These stronger penetration ratios contribute to Latin America having a comparatively more developed insurance market than other emerging regions.

All told, the Latin American insurance sector has grown significantly over the last few decades. Indeed, its share in the global insurance market rose from 1.8% in 1980 to 2.6% in 2022, while in the same period Latin American GDP shrank by 2.3 percentage points (pp) as a proportion of the world economy, from 8.6% to 6.3% (see Chart 4). However, this growth has not been linear, with Latin America's share in the global insurance market shaped by the region's economic cycle. For instance, the Latin American share grew by 1.9 pp during the commodities boom (2003-2013), but shrank in periods of lower economic growth (since 2013) or during economic and financial crises in the region (e.g. the 1980s, known as "the lost decade"), a trend compounded by currency depreciation in the countries typically associated with such cyclical events.

In 2021 and 2022, stronger than expected economic growth fostered the development of non-life insurance in Latin America, while positive real interest rates gave an additional boost to life insurance, particularly in the Brazilian market which accounts for a substantial portion of the regional aggregate (34.8% of total premiums). Indeed, Brazil has made significant headway in developing its life insurance segment (putting it on a par with developed countries), thanks to public policies aimed at fostering saving through such products.[3]

Insurance activity and public policy

One significant factor behind the penetration differences across Latin American countries is the introduction of explicit public policies aimed at harnessing the insurance mechanism as a means of attaining key social objectives. An example of this is the involvement of the private

1 Box prepared in collaboration with Ricardo González (MAPFRE Economics).

2 The main insurance business lines tend to be grouped into two large segments: (i) non-life insurance, which includes motor, health, home, commercial and industrial insurance (covering risks such as fire, damage, theft or civil liability) and other general insurance (including credit, accident or funeral insurance), and (ii) life insurance, which includes protection against the risk of death, savings insurance plans and temporary or lifetime annuity schemes. For reference purposes, in 2022 motor insurance accounted for 17.1% of all premiums in Latin America (17.5% in Spain), compared with 3.4% for occupational accident insurance (0% in Spain, where it is covered by social security), 14.4% for health (16.3% in Spain) and 22.8% for other non-life insurance (28.3% in Spain). Meanwhile, the life insurance business accounted for 42.3% of all premiums in Latin America (37.9% in Spain, where it also has a low level of development).

3 MAPFRE Economics (2020), *Elements for the development of life insurance*, Madrid, Fundación MAPFRE.

Box 2

THE LATIN AMERICAN INSURANCE MARKET (cont'd)

insurance sector in social security systems, such as pensions (through the provision of annuities), compulsory health insurance coverage, health care and compensation for occupational accidents or disease (see Chart 3). The most striking case is Puerto Rico, which has a private sector-run compulsory health insurance system, similar to that in the United States. Such mechanisms also have a strong influence on penetration levels in other markets, most noticeably Chile and Uruguay, due to the role played by private insurance firms in the countries' pension systems (in both cases increasing penetration by 1.4 pp in 2022), and Colombia and Argentina, due to private sector coverage of occupational accidents.

The determinants of insurance market growth in the medium term

In addition to each country's public policies, economic growth and level of economic and social development, insurance market growth can be shaped by insurance protection "gaps", meaning areas where there is sub-optimal coverage of certain eventualities or where new, hard-to-measure risks – such as those stemming from

Chart 1
Banking sector penetration

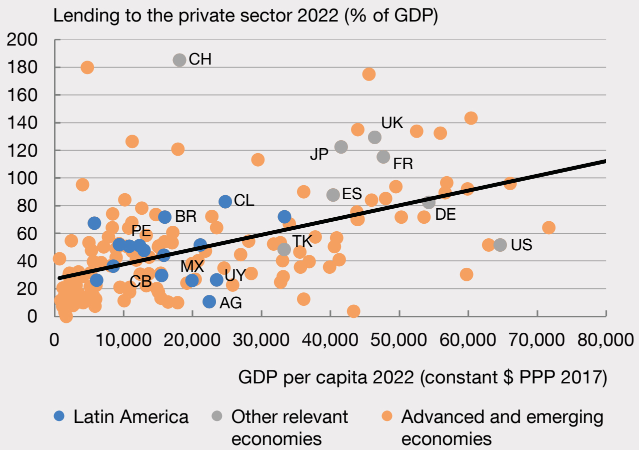


Chart 2
Insurance sector penetration

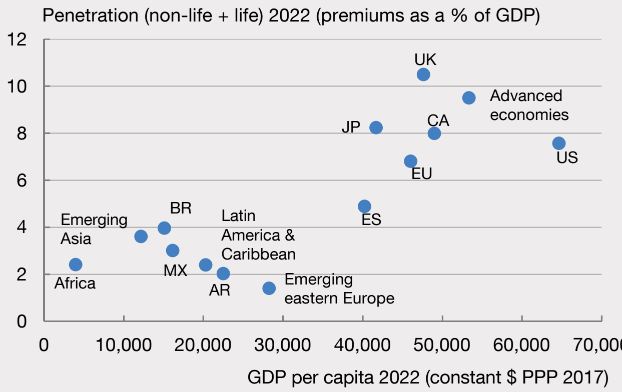


Chart 3
Insurance penetration adjusted for the effect of premiums linked to social security systems, 2022 (premiums as a % of GDP)

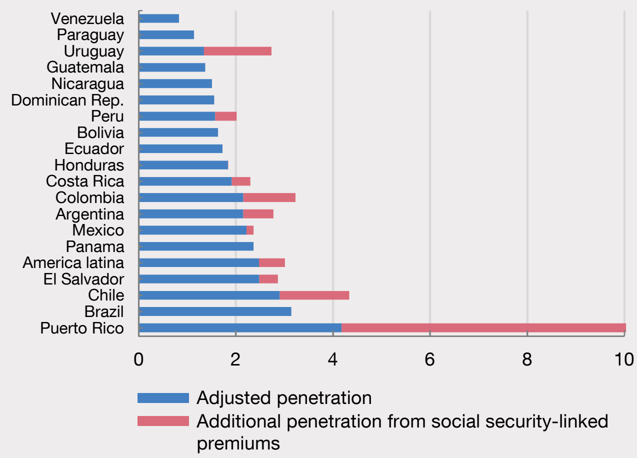
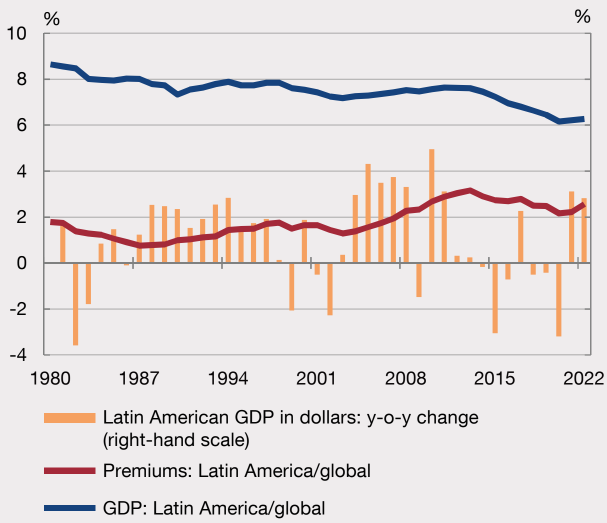


Chart 4
Share in global insurance premiums (%)



SOURCE: MAPFRE Economics (with data from the region's supervisory authorities and from the IMF, Swiss Re, EIOPA, ICEA, BoE, NAIC, LIAJ, SUSEP, CNSF and Haver Analytics).

Box 2
THE LATIN AMERICAN INSURANCE MARKET (cont'd)

climate change – have emerged that may not be fully covered by the existing insurance offering.[4] According to some studies, factors such as sustained economic growth, controlled inflation, rising disposable income, the general development of the financial system, an efficient regulatory framework and public policies aimed at driving financial inclusion and education could all bolster insurance penetration over the medium term.[5]

4 Examples of such risks are those posed by climate change (ECB and EIOPA, 2023, *Policy options to reduce the climate insurance protection gap)* and those linked to the impact of natural disasters (see, for example, EIOPA, *Dashboard on insurance protection gap for natural catastrophes).*

5 MAPFRE Economics (2023), *The Latin American Insurance Market in 2022,* Madrid, Fundación MAPFRE.

Box 3

AN OVERVIEW OF IMMIGRATION FROM CENTRAL AMERICA, PANAMA AND THE DOMINICAN REPUBLIC (CAPDR) TO SPAIN[1]

The share of immigration to Spain accounted for by migrants from Central America, Panama and the Dominican Republic (CAPDR)[2] has been growing in recent years. According to the most recent population figures,[3] there were 450,000 CAPDR-born residents in Spain in 2021, accounting for 6.2% of all foreign-born residents in the country, practically double the figure of a decade earlier (3.3%) (see Table 1).

These dynamics reflect a relative shift in CAPDR emigration flows (at least in terms of legal migration) towards Spain and away from this group's main traditional destination country, the United States (see Chart 1).[4] As a result, Spain has become the second biggest destination for Central American and Dominican migrants overall, after the United States (see Chart 2).

The determinants of migration flow dynamics

Migration flow dynamics are shaped by both economic conditions in the destination countries (pull factors) and social and economic conditions in the countries of origin (push factors). Accordingly, immigration flows from the CAPDR region to Spain have likely been driven, first, by Spain's improving economic conditions since 2013 and, second, by bouts of social and political unrest in Honduras and Nicaragua (the main Central American countries of origin) and several natural disasters.[5]

Going forward, migrant flows to Spain could increase as a result of recent agreements reached with some Central American countries. For instance, in 2021 an agreement was signed with the Honduras Government[6] to promote

Table 1
Spain: resident population and immigrant inflows

	Total foreign-born residents (a)				Total immigrant inflows			
	2011	2015	2019	2021	2011	2015	2019	2021
	6,282,208	5,883,891	6,549,309	7,254,797	371,335	342,114	750,480	887,960
Proportion of total Spanish population (%)	13.5	12.7	14.0	15.3				
Distribution by country of birth (%)								
CAPDR	3.3	4.2	5.4	6.2	6.5	6.5	9.2	5.5
Central America and Panama	1.1	1.5	2.7	3.6	3.5	4.2	7.7	4.1
Dominican Republic	2.2	2.7	2.7	2.6	3.0	2.4	1.5	1.4
EU27 excl. Spain	28.6	27.7	23.8	21.5	28.8	24.3	13.1	17.7
Europa excl. EU27	9.5	10.0	9.2	9.0	9.5	11.1	7.9	8.6
Africa	17.1	17.3	17.7	17.9	13.0	12.7	14.7	17.6
North America	1.4	1.6	1.7	1.7	3.0	3.4	2.5	2.5
South America	32.5	30.7	32.8	34.4	20.0	22.1	38.3	29.3
Asia	5.8	6.2	6.9	7.0	9.7	8.5	6.8	7.0
Oceania	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1

SOURCE: INE (Continuous Household Survey, migration statistics).

a Figures at 1 January of the reference year.

1 Box prepared in collaboration with the Executive Secretariat of the Central American Monetary Council.

2 The CAPDR group comprises the Spanish-speaking countries of Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama) and the Dominican Republic.

3 Data from the National Statistics Institute (INE) Continuous Household Survey 2023 and the Organisation for Economic Co-operation and Development (OECD) Migration Statistics 2023.

4 For the United States, the migrant flow data only include the number of foreigners granted resident status, whereas for Spain the data also include illegal immigrants.

5 Juan Fernando Izaguirre Silva (2018). *"Emigración y remesas a Centromérica"*. SECMCA.

6 https://www.inclusion.gob.es/web/cartaespana/-/acuerdo-espana-honduras-de-migraciones.

Box 3

AN OVERVIEW OF IMMIGRATION FROM CENTRAL AMERICA, PANAMA AND THE DOMINICAN REPUBLIC (CAPDR) TO SPAIN (cont'd)

circular migration (where immigrants commit to returning to their countries of origin), while a similar agreement was reached with Guatemala in January 2023. In addition, the shift in Central American migrant flows towards Spain could be spurred further by the agreement signed in 2023 between the United States, Canada, Mexico and Spain to promote regular migration from Central and South America. In particular, Spain will be involved in an initiative whereby the United States will set up regional processing centres in several countries in order to reinforce the

Chart 1
CAPDR immigration to Spain and the United States

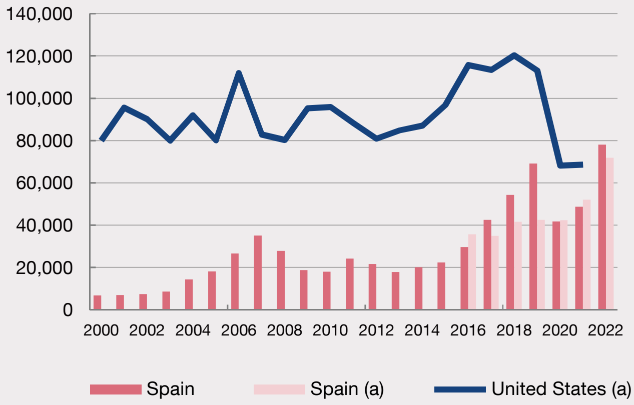


Chart 2
Destination of CAPDR emigrants (%) (b)

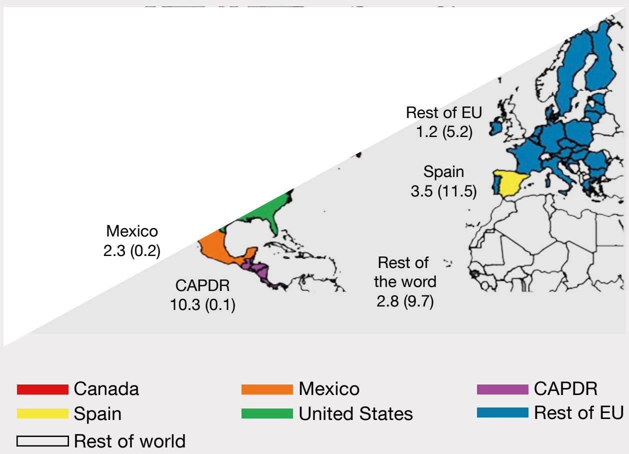


Chart 3
Proportion of women in immigrant inflows, by country/region of birth (2019)

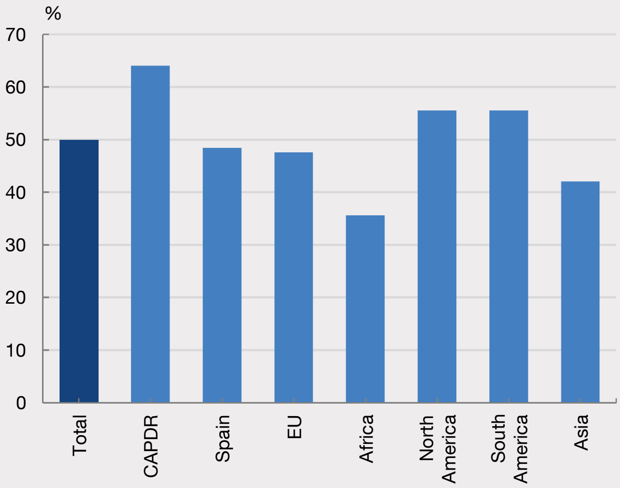
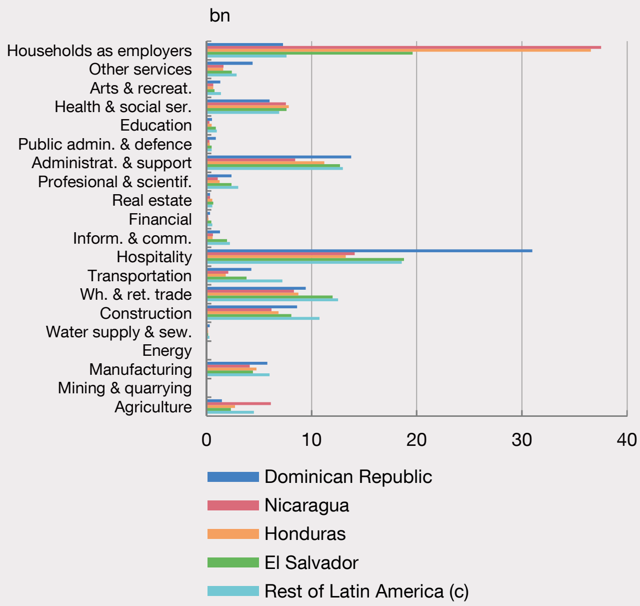


Chart 4
Foreigners registered with social security. Distribution by sector



SOURCES: INE, Ministerio de Inclusión, Migraciones y Seguridad Social, United Nations and OECD.

a Data for immigrants granted resident status.
b Data in brackets: Dominican Republic.
c Aggregate of Colombia, Ecuador, Peru and Venezuela.

Box 3
AN OVERVIEW OF IMMIGRATION FROM CENTRAL AMERICA, PANAMA AND THE DOMINICAN REPUBLIC (CAPDR) TO SPAIN (cont'd)

channels for regular and orderly migration and reduce irregular migration.[7] With this same goal in mind, several amendments were made to Spanish immigration law in 2022, which made it easier for foreign students to stay in Spain, streamlined the certification of occupations with labour shortages and introduced new opportunities for irregular migrants to legalise their status.[8]

Profile of the migrants

Migrants to Spain from CAPDR countries have a somewhat different profile to those from other regions.

For instance, the percentage of women (64% in 2019) is considerably higher than for migrants to Spain as a whole (around 50%) (see Chart 3). According to social security registrations data, approximately half of the Central American and Dominican women registered in Spain are domestic workers, with particularly high percentages among Honduran and Nicaraguan women.

Furthermore, CAPDR migrants to Spain are younger than those from other countries: in 2019, around 40% of such immigrants were aged 20-29, some 12 pp more than the figure for all immigrants to Spain in that year.

In addition to the domestic work sector, the economic sectors with the highest shares of CAPDR immigrants are hospitality, wholesale and retail trade and administrative and support services (see Chart 4).

7 https://www.lamoncloa.gob.es/serviciosdeprensa/notasprensa/inclusion/Paginas/2023/270423-acuerdo-migracion-regular-america.aspx.
8 OECD *International Migration Outlook 2023.*

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