



Global Financial Tightening and Implications for Latin America

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Director

ROADMAP

- I. Continued recovery in LAC in 2022H1 amid inflationary pressures
- II. Shifting global winds: tightening financial conditions and falling commodity prices
- III. Growth forecast for 2022 and 2023 and risks going forward
- IV. Policy challenges
- V. Conclusions

I. Continued recovery in LAC in 2022H1 amid inflationary pressures

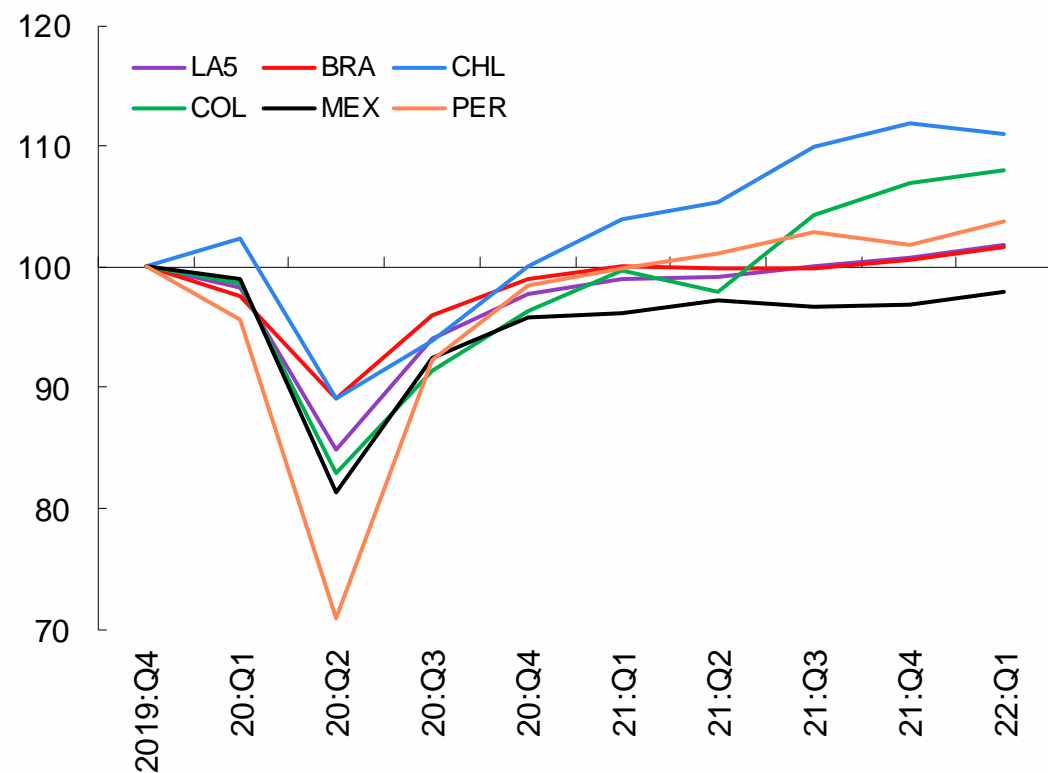
Strong (although uneven) recovery after the pandemic (shock#1) continued in early 2022...

Real GDP has reached pre-pandemic levels in all large LatAm economies (except Mexico)...

... and growth in early 2022 remained above the pre-pandemic average

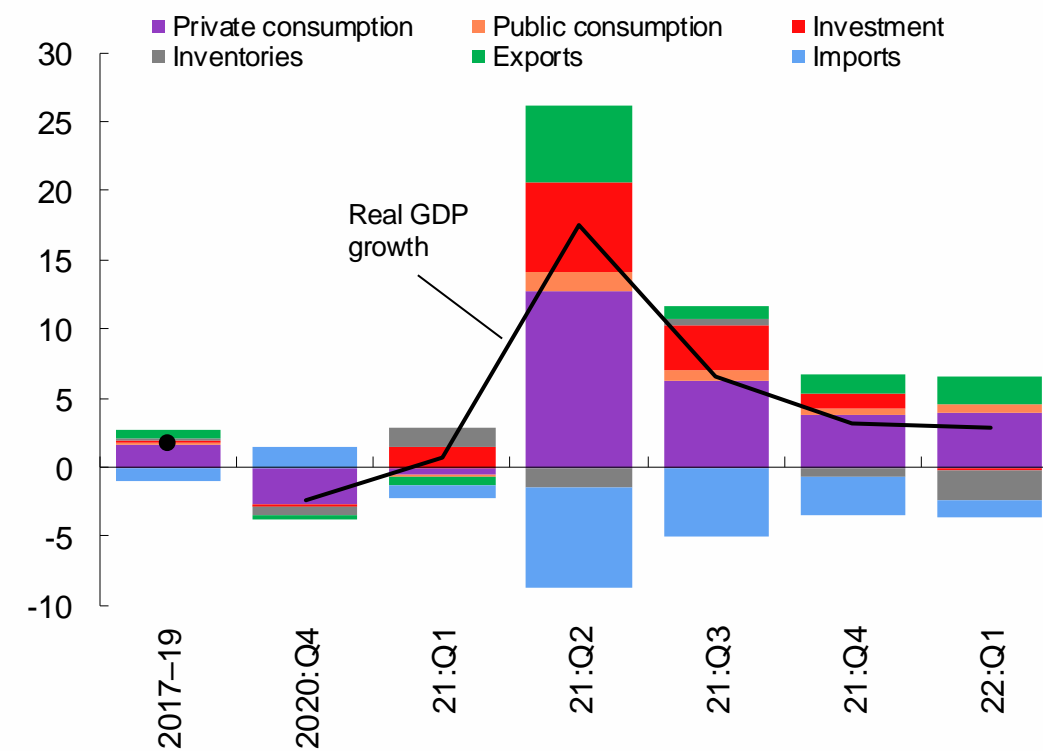
Real GDP

(Index: 2019Q4 = 100)



LA5: Contributions to Real GDP Growth

(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
 Note: LA5 is purchasing-power-parity GDP-weighted average of Brazil, Chile, Colombia, Mexico, and Peru.

Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.
 Note: Seasonally adjusted. Purchasing-power-parity GDP-weighted average of LA5 countries. Inventories include statistical discrepancies. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

... amid common, broad-based, inflationary pressures, exacerbated by the war in Ukraine (shock#2)...

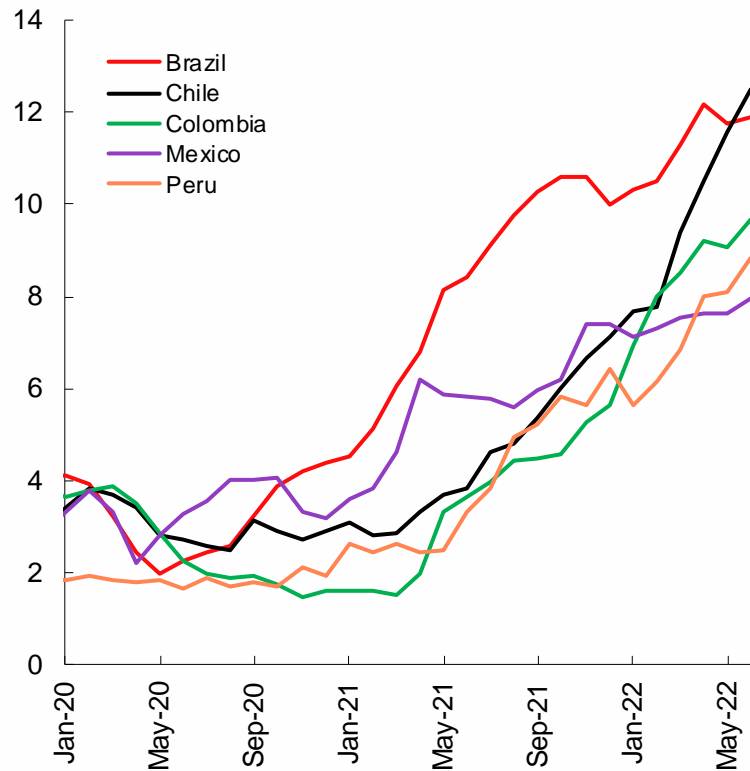
Headline inflation accelerated in 2021-22 ...

... driven by food and energy, but increasingly also core inflation

... as price pressures in core goods are followed by pressures in core services

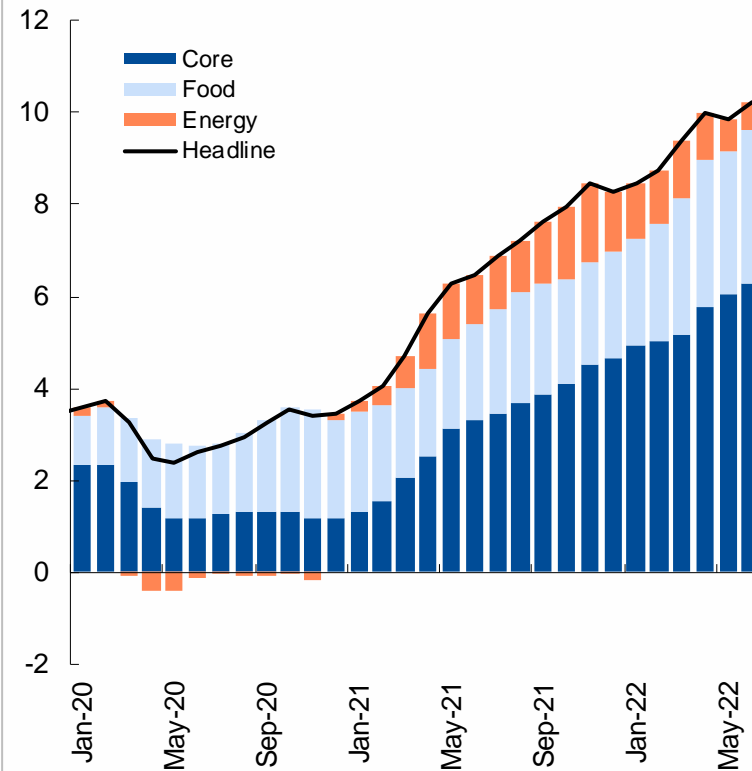
Headline Consumer Price Inflation

(Year-over-year percent change)



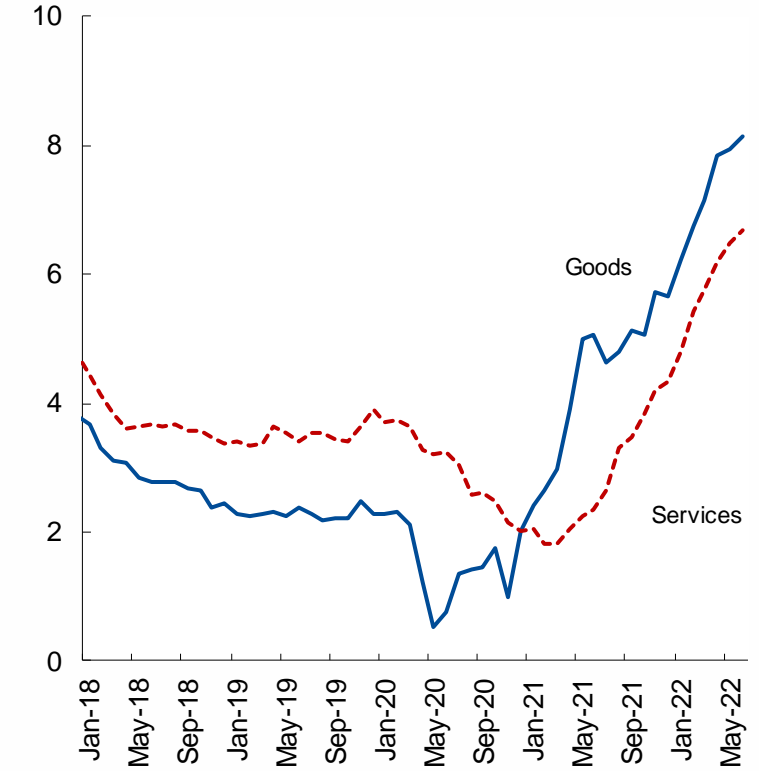
LatAm: Contributions to Headline Inflation

(Year-over-year percent change)



LatAm: Core Goods and Services Inflation

(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.

Note: Peru refers to Lima.

Sources: Haver Analytics; national authorities; and IMF staff calculations. Note: PPP-weighted average of LatAm countries (Brazil, Chile, Colombia, Mexico, Peru). Core inflation is defined as headline inflation less food and energy. Peru refers to Lima.

Sources: Haver Analytics; and IMF staff calculations.

Note: Core goods exclude food, transport, and housing items. Core services exclude transport and housing items. LatAm = Brazil, Chile, Colombia, Mexico.

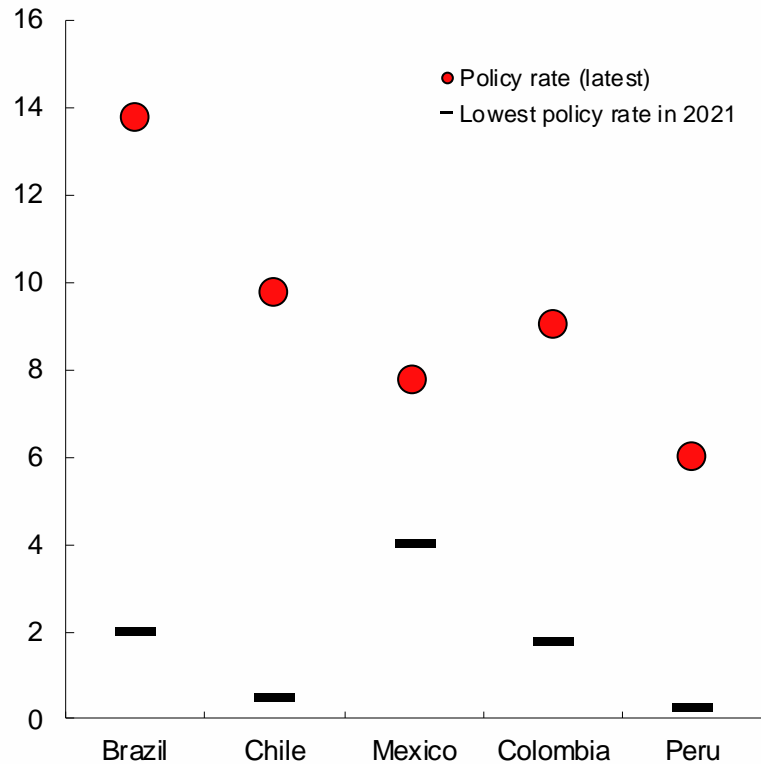
... that prompted rapid domestic monetary policy tightening

Central banks (CBs) increased policy rates swiftly to fight inflation,...

... and keep long-term inflation expectations anchored within the CB's target ranges...

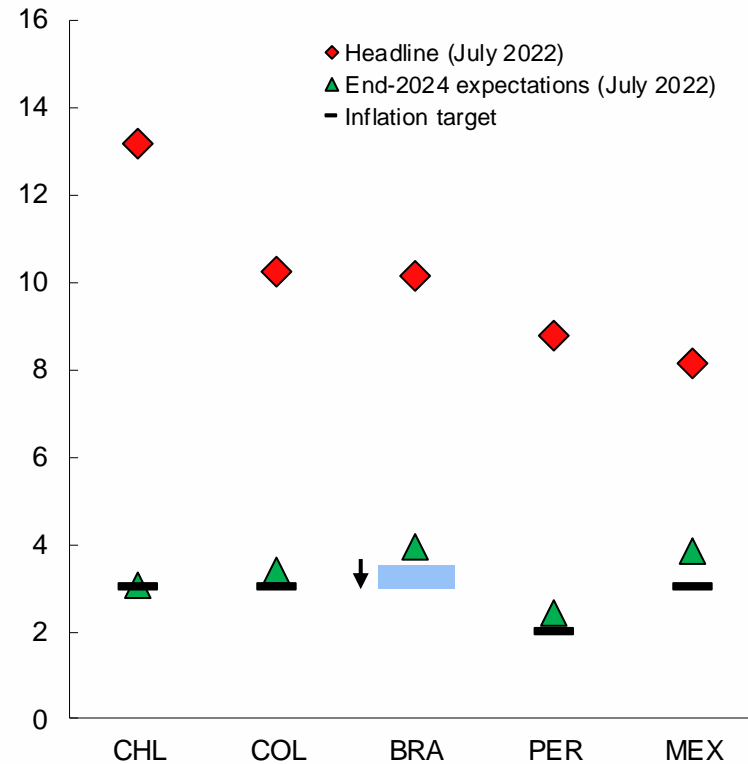
... though short-term expectations have increased notably, accentuating the risk of de-anchoring and the need for continued vigilance

Policy Rates
(Percent)



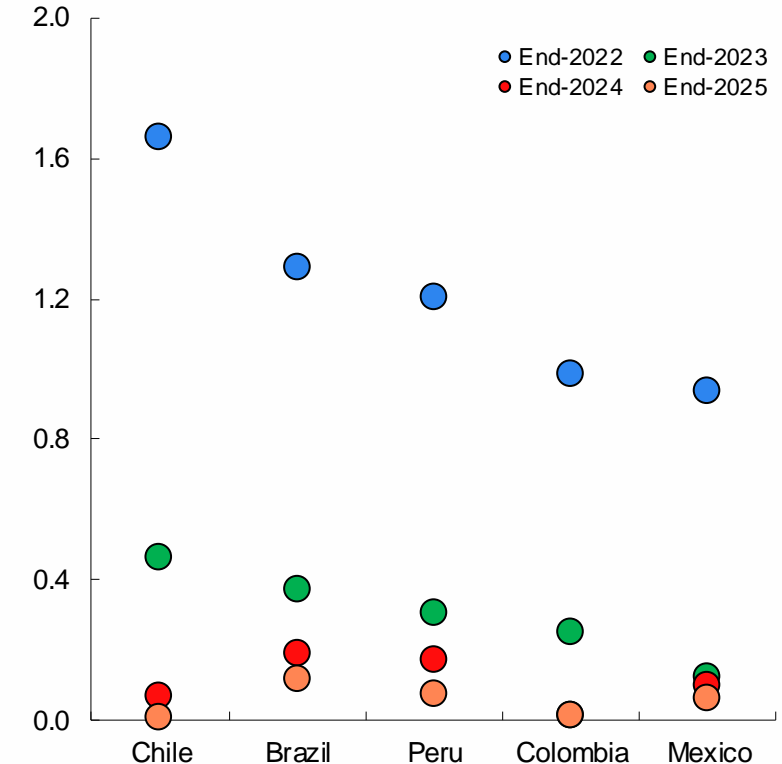
Sources: Haver Analytics; national authorities; and IMF staff calculations.

Headline Inflation and Expectations
(Percent)



Sources: Consensus Economics; Haver Analytics; and national authorities.
Note: Brazil inflation target is set to decline over time from 3.5 percent in 2022 to 3 percent in 2025.

Quarterly Revisions in Inflation Expectations, 2021–July 2022
(Percentage points)



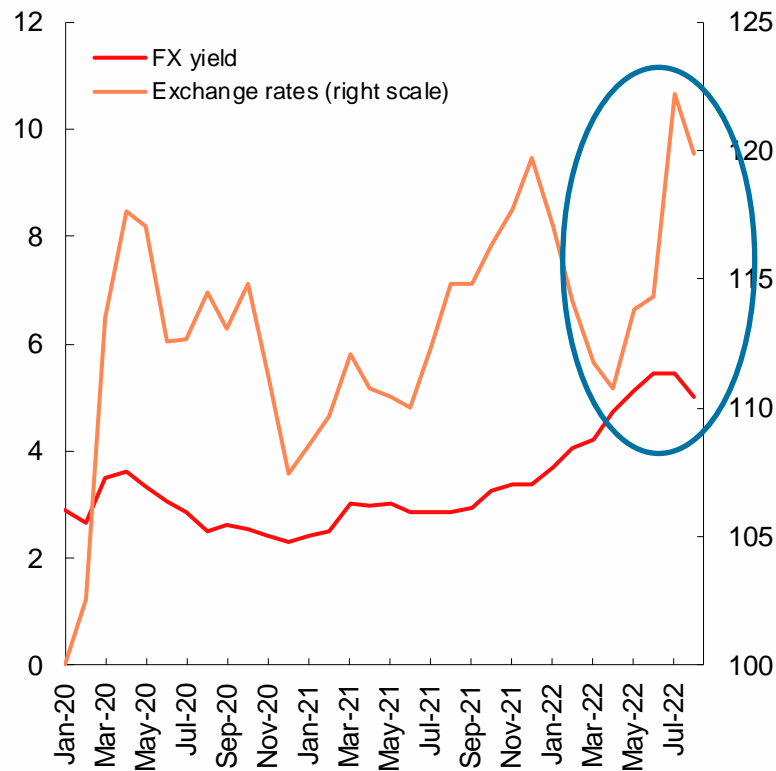
Sources: Consensus Economics; and IMF staff calculations.
Note: Average of consensus forecasts revisions for each quarter from January 2021 to July 2022.

II. Shifting global winds: tightening financial conditions and falling commodity prices

External financial conditions are tightening (shock#3)

Amid global monetary tightening, external financial conditions are tightening, leading to rising borrowing costs and currency pressures...

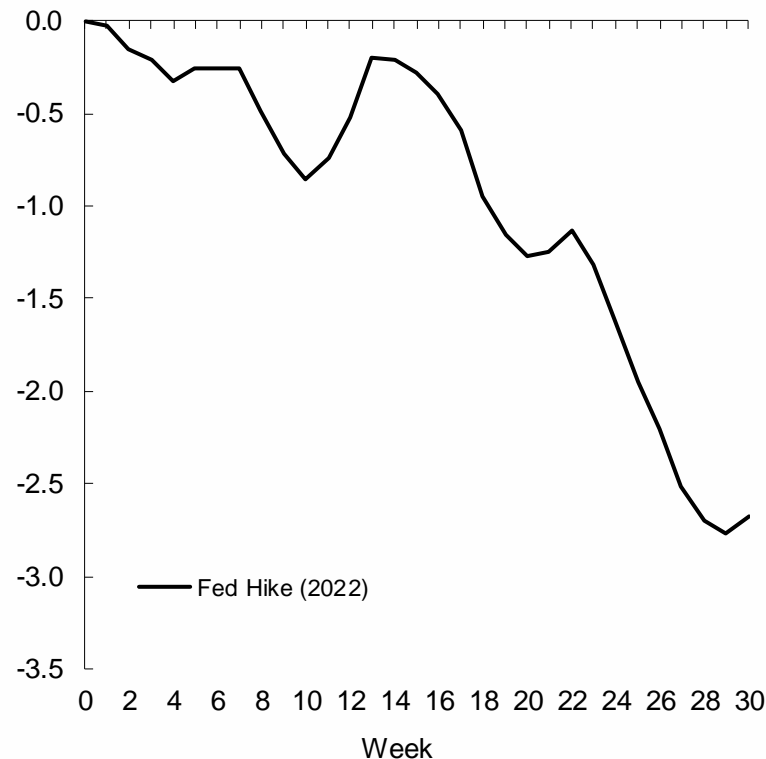
Ten-Year Bond Yields and Exchange Rates
(Left scale: percent;
Right scale: index: 1/1/2020= 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Simple average. For exchange rates, an increase denotes a depreciation. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

... as well as capital outflows in LatAm...

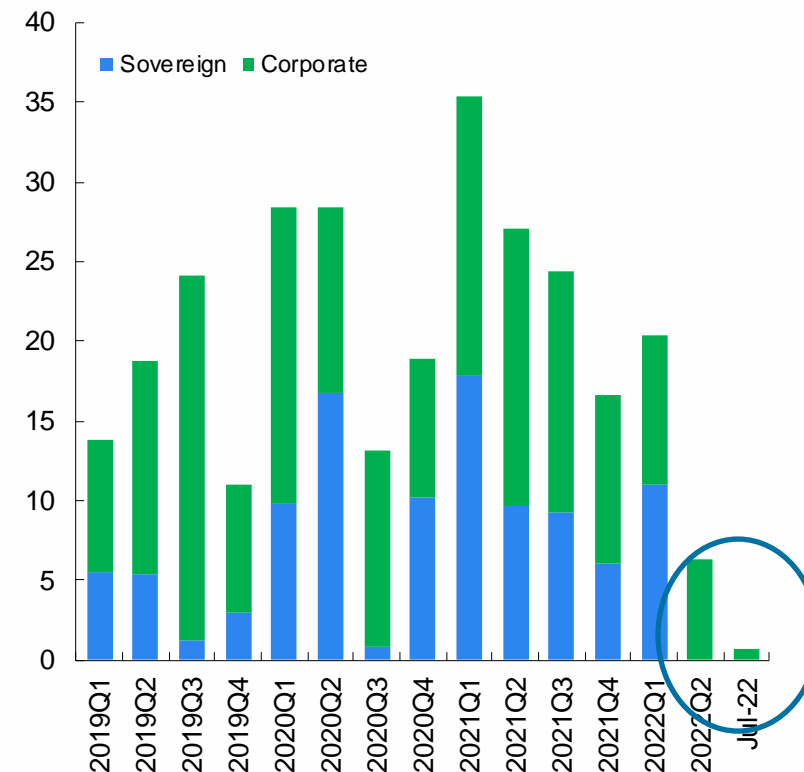
Latin America: Cumulative EPFR Flows
(Percent of initial allocation)



Sources: Emerging Portfolio Fund Research (EPFR) database; Haver Analytics; and IMF staff calculations.
Note: Fed hike (January 5, 2022).

... in fact, for the first time in the past three years, LA5 sovereigns did not place a single Eurobond in 2022Q2 and corporate issuance declined notably

LA5: Sovereign and Corporate Eurobond Issuance
(Billions of US dollars)



Sources: Bond Radar database; and IMF staff calculations.
Note: LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Historically, US monetary and financial tightening affected negatively sovereign debt markets and GDP growth in LatAm

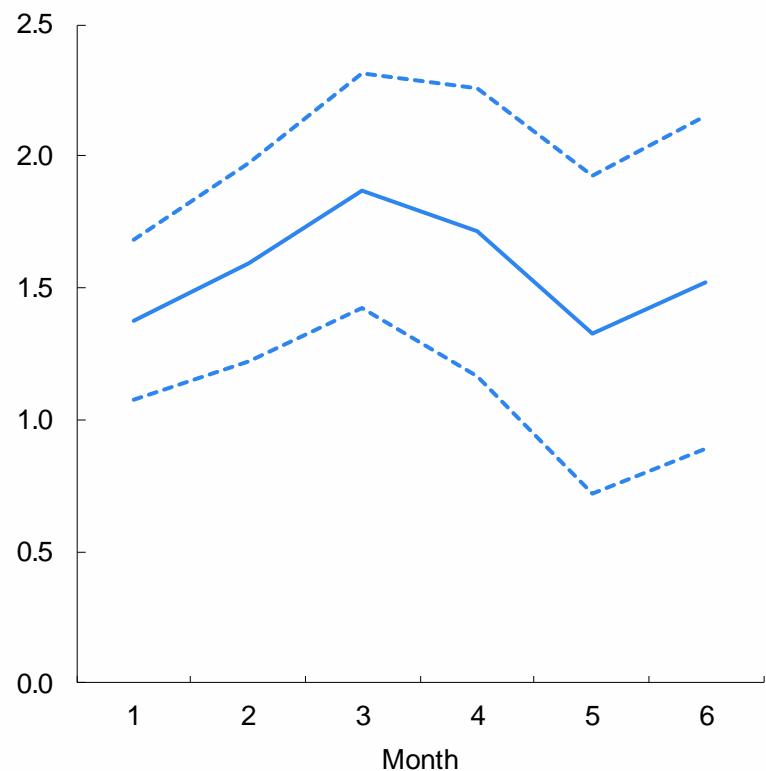
The impact on the long-term LC bond yields is more than 1-to-1 after one month...

... and an increase in risk premia of USD-denominated sovereign debt is also notable

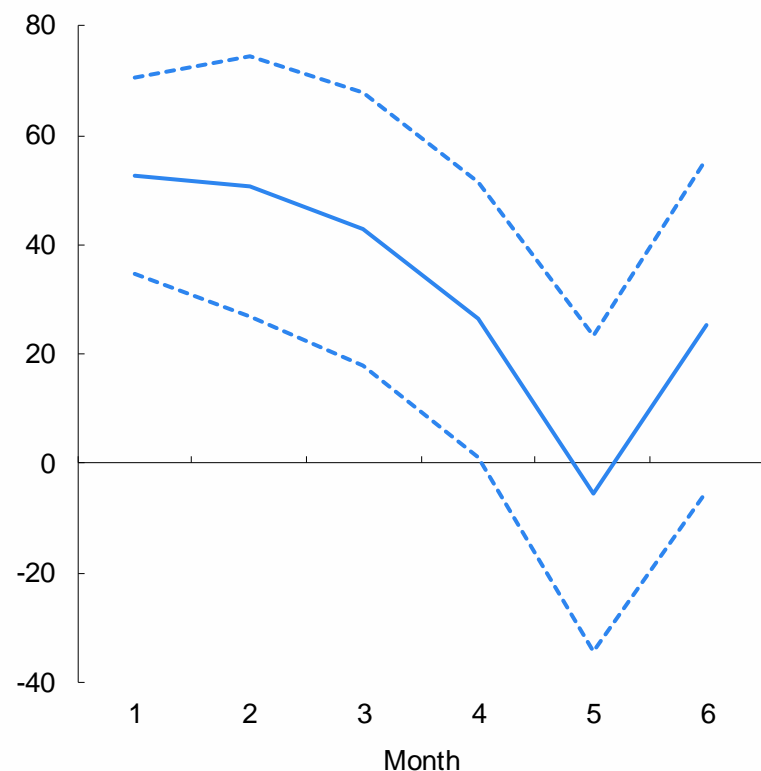
US monetary and broader FC tightening, historically, had negative repercussions for GDP growth in LatAm

Response in LatAm to a 1pp Shock to US 2-Year Bond Yield

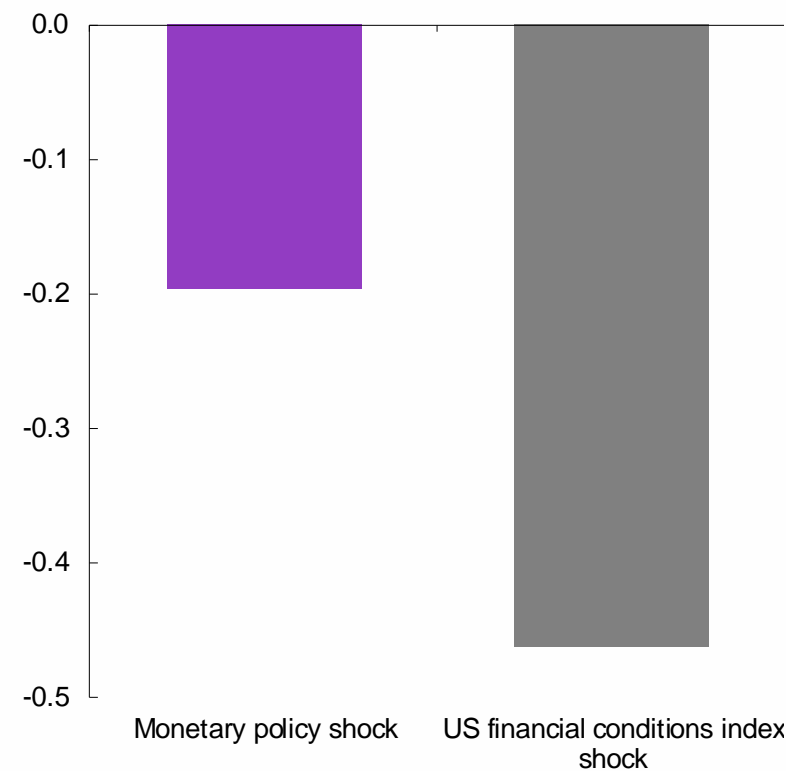
Long-term Local Currency Rates
(Percentage points; 90% confidence interval)



USD Spreads
(Basis points; 90% confidence interval)



LatAm: Impact on Real GDP of US Monetary Policy and Financial Conditions Tightening
(Impact at one year; percent)



Source: IMF staff calculations.

Note: Short-term LC rates are yields of local currency short-term bonds (3-month or shortest available maturity), long-term LC rates are yields of local currency long-term bonds (10-year maturity), USD spreads are EMBIG spreads. Point estimates are the panel local projections' impulse responses over one to six months where each of the previous financial variables for LatAm are shocked with US 2-year bond yields at month zero conditional on domestic and international controls. Sample is monthly from Jan-10 to Dec-19. LatAm = Brazil, Chile, Colombia, Mexico, Peru.

Source: IMF staff calculations.

Note: Monetary policy shock is identified as 1-day changes in US 2-year bond yields around FOMC meetings, aggregated within each quarter. USFCI shock is identified as quarter-over-quarter changes in USFCI, which is calculated following IMF (2018). Impulse responses at quarter 4 are shown.

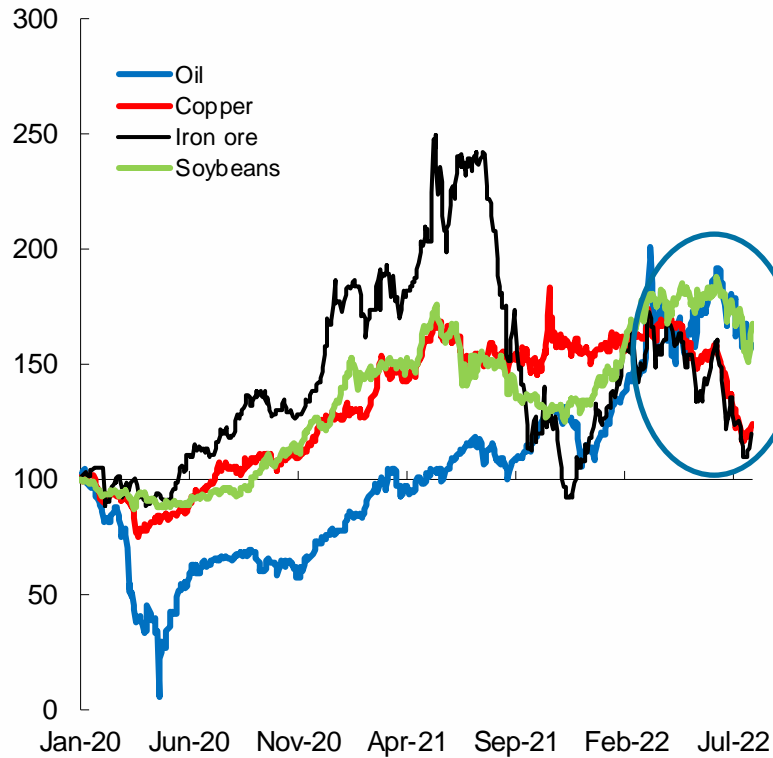
Higher commodity prices likely cushioned the impact in early 2022, but are now turning amid slower global growth and FC tightening

Some commodity prices have fallen and are expected to soften further...

... amid slower global growth along with global monetary...

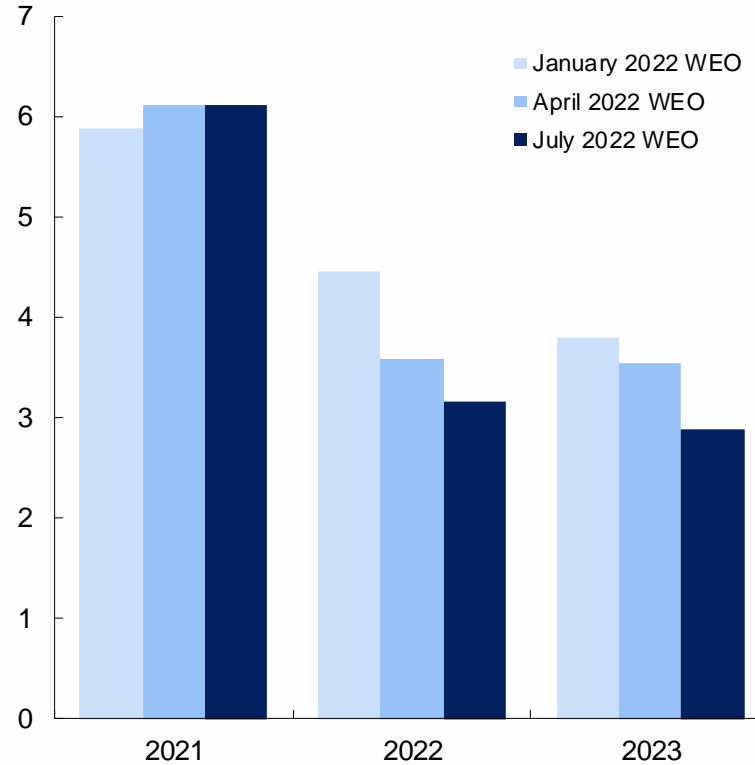
... and FC tightening, which has typically been associated with lower commodity prices

Commodity Prices
(Index: January 1, 2020 = 100)



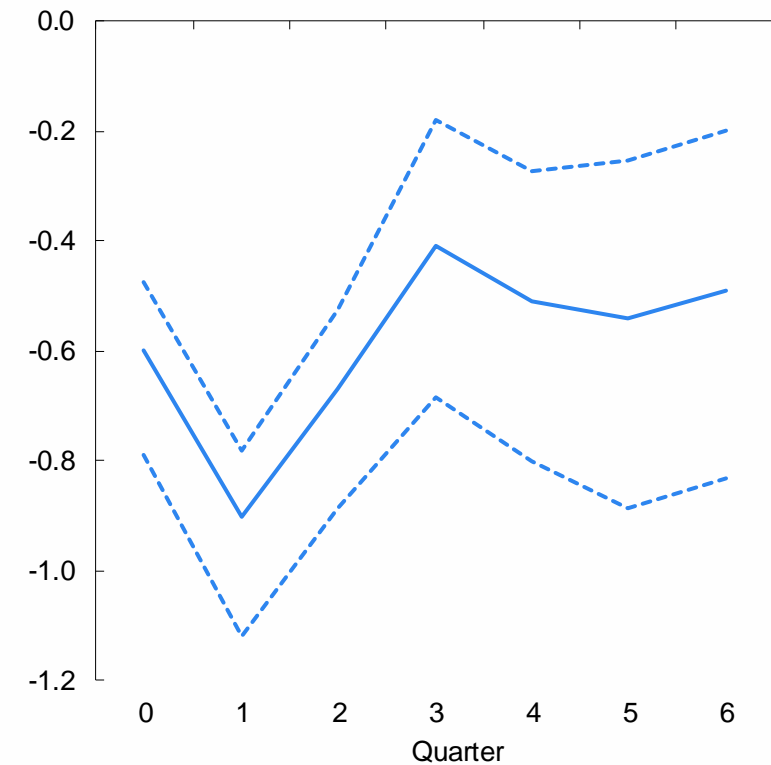
Sources: Bloomberg Finance L.P.; and national authorities.

Global Real GDP Growth
(Year-over-year percent change)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Impact of US FCI on Commodity Terms of Trade
(Percentage points of GDP; 90% confidence interval)



Source: IMF staff calculations.
Note: Measure of commodity terms of trade is commodity terms of trade index, scaled by GDP. The size of the shock is 1 standard deviation.

III. Growth forecast for 2022 and 2023 and risks going forward

We expect weaker growth in late 2022 and 2023

Western Hemisphere: Real GDP Growth (Year-over-year percent change)

	2021	Projections		Difference from April 2022 WEO	
		2022	2023	2022	2023
United States	5.7	2.3	1.0	-1.4	-1.3
Canada	4.5	3.4	1.8	-0.5	-1.0
Latin America and the Caribbean	6.9	3.0	2.0	0.5	-0.5
South America	7.2	2.8	1.9	0.5	-0.2
CAPDR	11.0	4.7	3.9	-0.1	-0.1
Caribbean					
Tourism dependent	3.0	3.4	2.9	0.2	-0.2
Commodity exporters	5.1	19.5	16.6	-0.7	0.2
LA5	6.3	2.5	1.5	0.6	-0.6
Latin America					
Argentina	10.4	4.0	3.0	0.0	0.0
Brazil	4.6	1.7	1.1	0.9	-0.3
Chile	11.7	1.8	0.0	0.3	-0.5
Colombia	10.7	6.3	3.5	0.5	-0.1
Mexico	4.8	2.4	1.2	0.4	-1.3
Peru	13.5	2.8	3.0	-0.2	0.0

Sources: IMF, World Economic Outlook database.

IV. Policy challenges

This environment poses challenges for policy makers...

- ❖ Persistent inflation along with weakening economic activity will make policymaking more challenging
- ❖ Focus on preserving macro-economic stability and social cohesion in the short term while boosting potential growth in the longer term:
 - **Monetary policy:** continue focusing on **taming inflation and anchoring inflation expectations** (clear communication is key)
 - **Fiscal policy:** “**inclusive consolidation**” is needed to **ensure debt sustainability** while protecting the most vulnerable and **preserving social cohesion**, particularly in the face of high food and energy prices
 - **Structural policies:** **need to focus on boosting potential growth**. This requires removing structural impediments to higher productivity and investment

V. Conclusions

CONCLUSIONS

- Strong growth rebound in early 2022 but continued inflationary pressures.
- Relevant shock: Global financial tightening tend to lead strong dollar, reversal capital flows, falling commodity prices, and lower global growth. All point to a weaker growth in LAC going forward
- Policy challenge: preserving macro-economic and social stability simultaneously while boosting potential growth in the longer term



Thank You

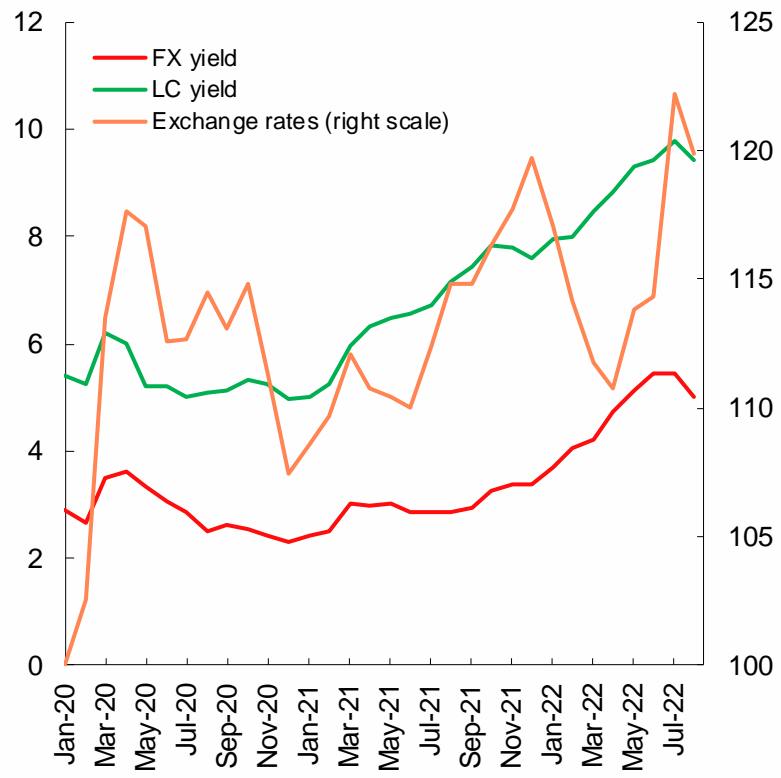
Background slides

External financial conditions have also tightened (shock#3)...

External financial conditions are tightening amid global monetary tightening, leading to rising borrowing costs and currency pressures in LatAm...

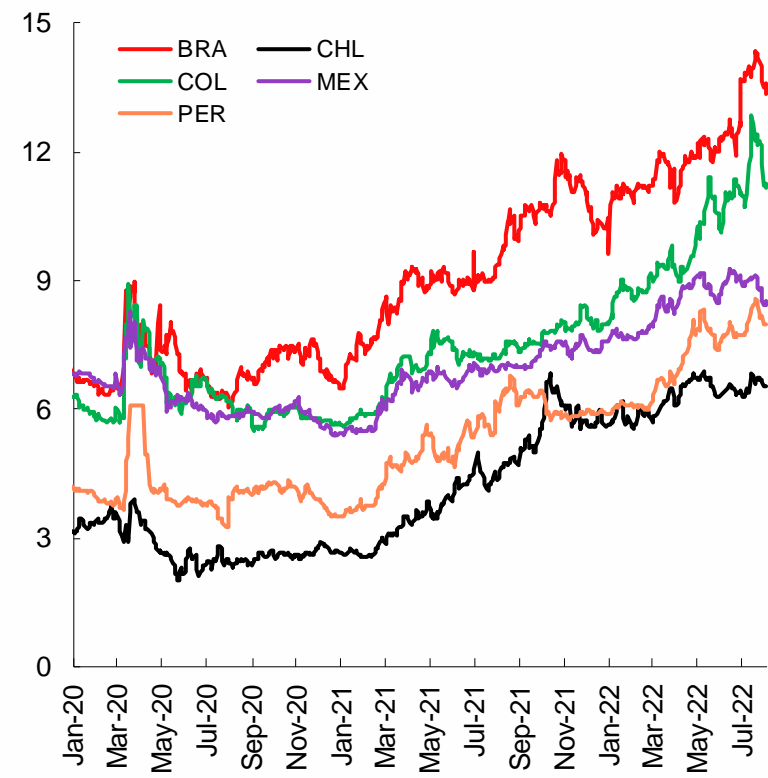
... though the impact is heterogenous

Ten-Year Bond Yields and Exchange Rates
(Left scale: percent;
Right scale: index: 1/1/2020 = 100)



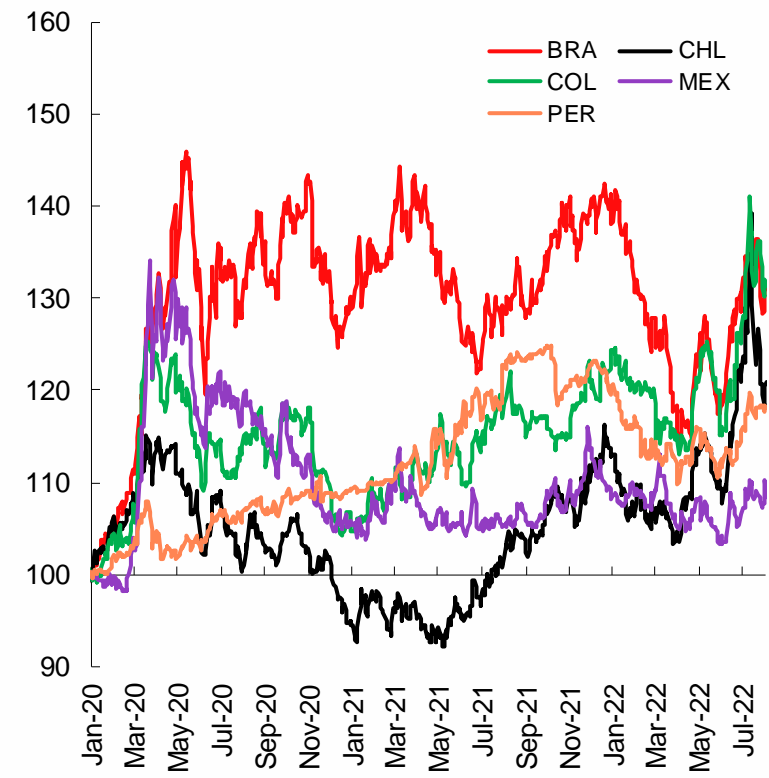
Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Simple average. For exchange rates, an increase denotes a depreciation. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Ten-Year Government Bond Yield
(Percent; local currency denominated)



Sources: Bloomberg Finance L.P.; Haver Analytics; national authorities; and IMF staff calculations.

Exchange Rates Against the US dollar
(Index: January 1, 2020 = 100)



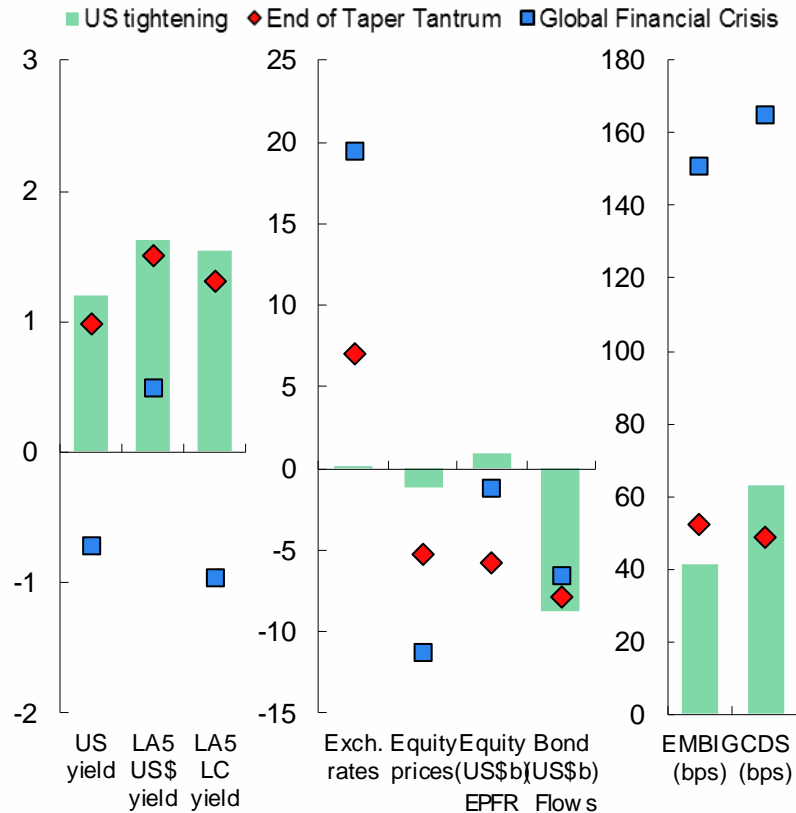
Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: An increase denotes a depreciation.

... though, so far, less than in previous episodes but enough to keep LatAm sovereigns off the bonds MKTs in the past 4 months

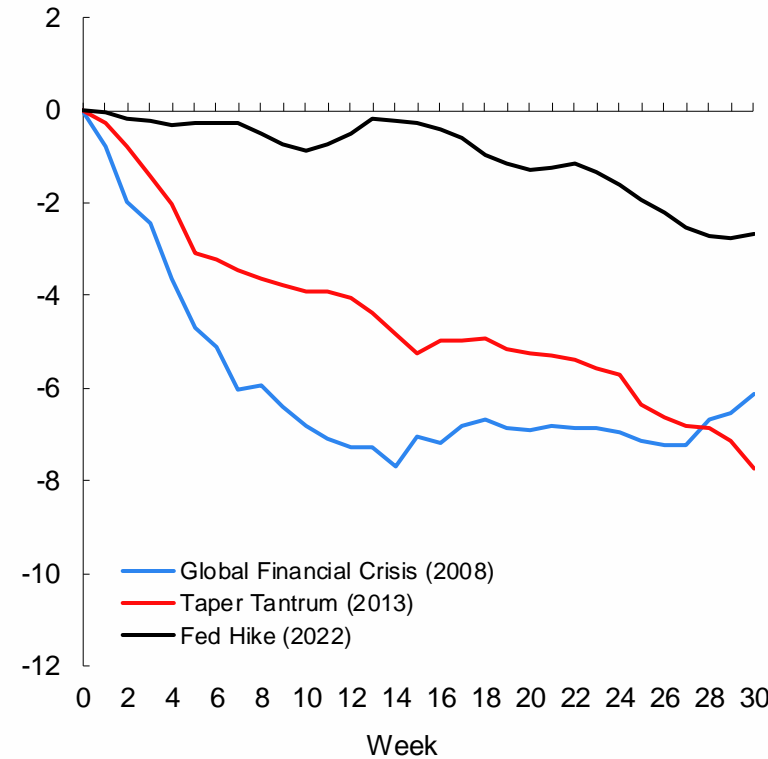
2022 US tightening has had a milder impact on financial conditions in LatAm so far, compared to GFC and Taper Tantrum, but cost of financing increased...

... and sovereign issuance dried out in Q2

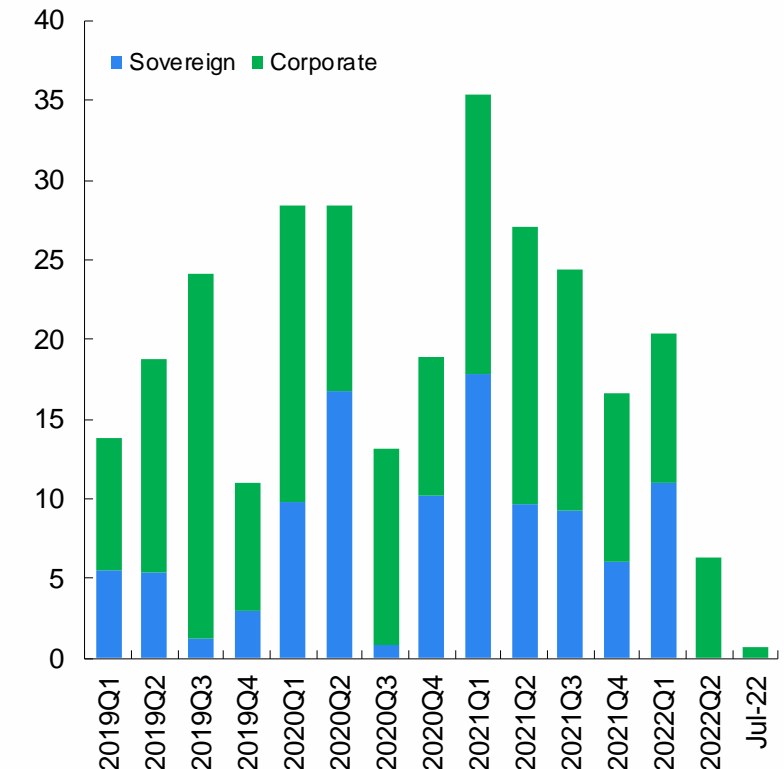
US Tightening in 2022, GFC, and Taper Tantrum (Percentage points over the indicated period; unless otherwise indicated)



Latin America: Cumulative EPFR Flows (Percent of initial allocation)



LA5: Sovereign and Corporate Eurobond Issuance (Billions of US dollars)



Sources: Bloomberg Finance L.P.; Haver Analytics; and IMF staff calculations. Note: GFC (9/15/08 to 3/31/09); Taper Tantrum (5/22 to 9/30/13); US tightening (1/3 to 8/5/22). Indicators refer to the average of LA5 countries. For exchange rates, an increase denotes a depreciation. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

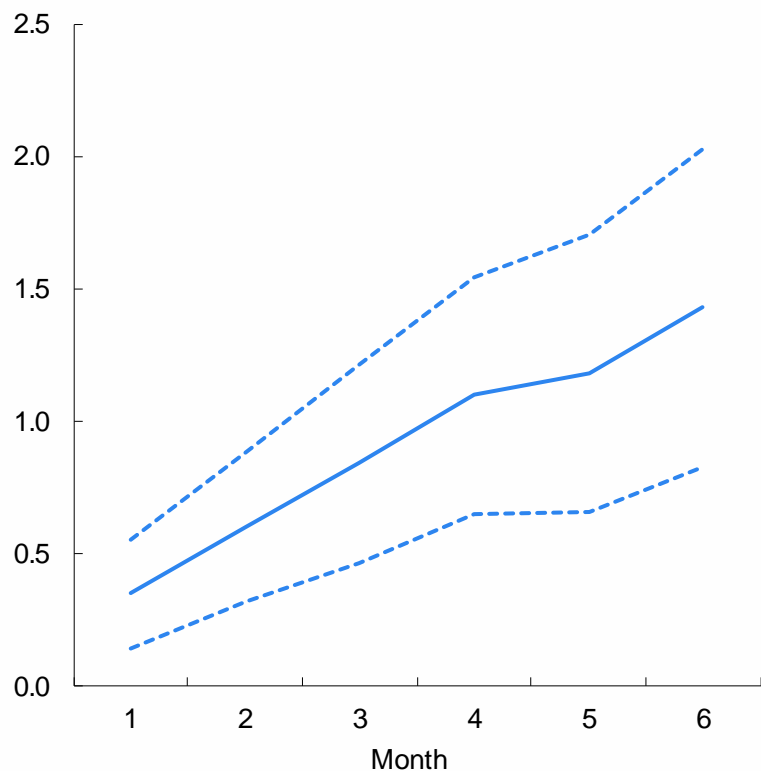
Sources: Emerging Portfolio Fund Research (EPFR) database; Haver Analytics; and IMF staff calculations. Note: Global financial crisis (9/10/2008); Taper tantrum (5/22/2013); Fed hike (1/5/2022).

Sources: Bond Radar database; and IMF staff calculations. Note: LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Historically, U.S. monetary and financial tightening generated strong spillovers to sovereign debt prices in LatAm...

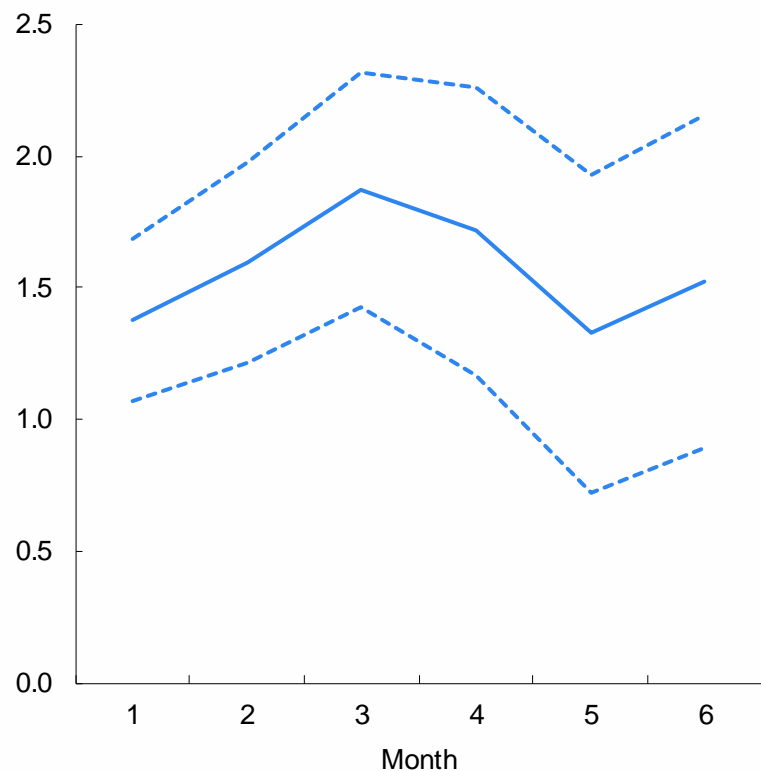
The impact on short-term bond yields is less than 1-to-1 in the short run and materializes more gradually...

LatAm Short-term Local Currency Rates Response to US 2-Year Bond Yield 1pp Shock
(Percentage points; 90% confidence interval)



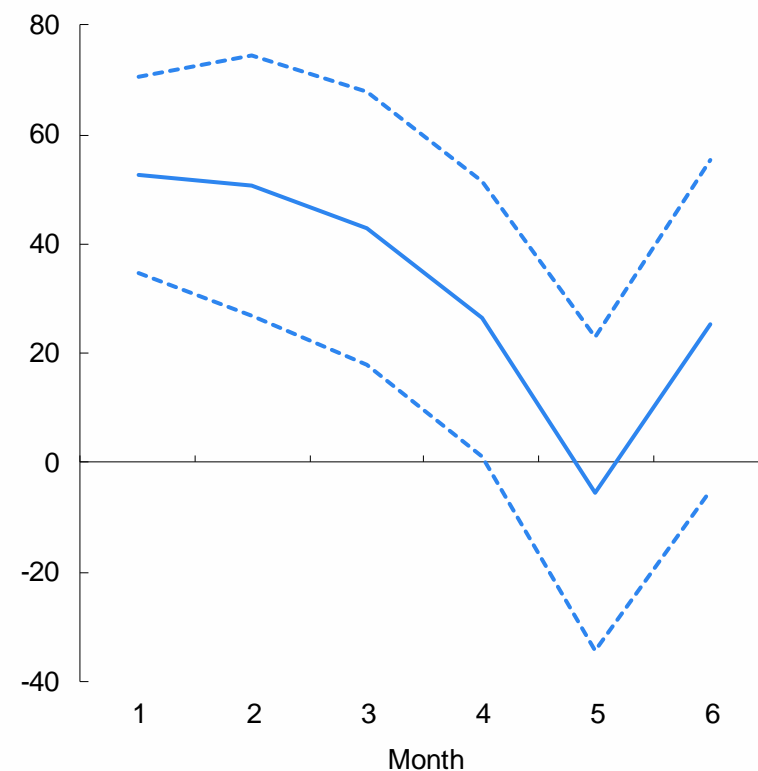
The impact on the long-term bond yields is more than 1-to-1 in the next month...

LatAm Long-term Local Currency Rates Response to US 2-Year Bond Yield 1pp Shock
(Percentage points; 90% confidence interval)



... and increase in risk premia of USD-denominated sovereign debt is also notable

LatAm USD Spreads Response to US 2-Year Bond Yield 1pp Shock
(Basis points; 90% confidence interval)



Source: IMF staff calculations.

Note: Short-term LC rates are yields of local currency short-term bonds (3-month or shortest available maturity), long-term LC rates are yields of local currency long-term bonds (10-year maturity), USD spreads are EMBIG spreads. Point estimates are the panel local projections' impulse responses over one to six months where each of the previous financial variables for LatAm are shocked with US 2-year bond yields at month zero conditional on domestic and international controls. Sample is monthly from Jan-10 to Dec-19. LatAm = Brazil, Chile, Colombia, Mexico, Peru.