

Latin America Economic Monitor

Latin America in a Demanding Global Environment: What Explains Its Resilience and What Could Put It to the Test?



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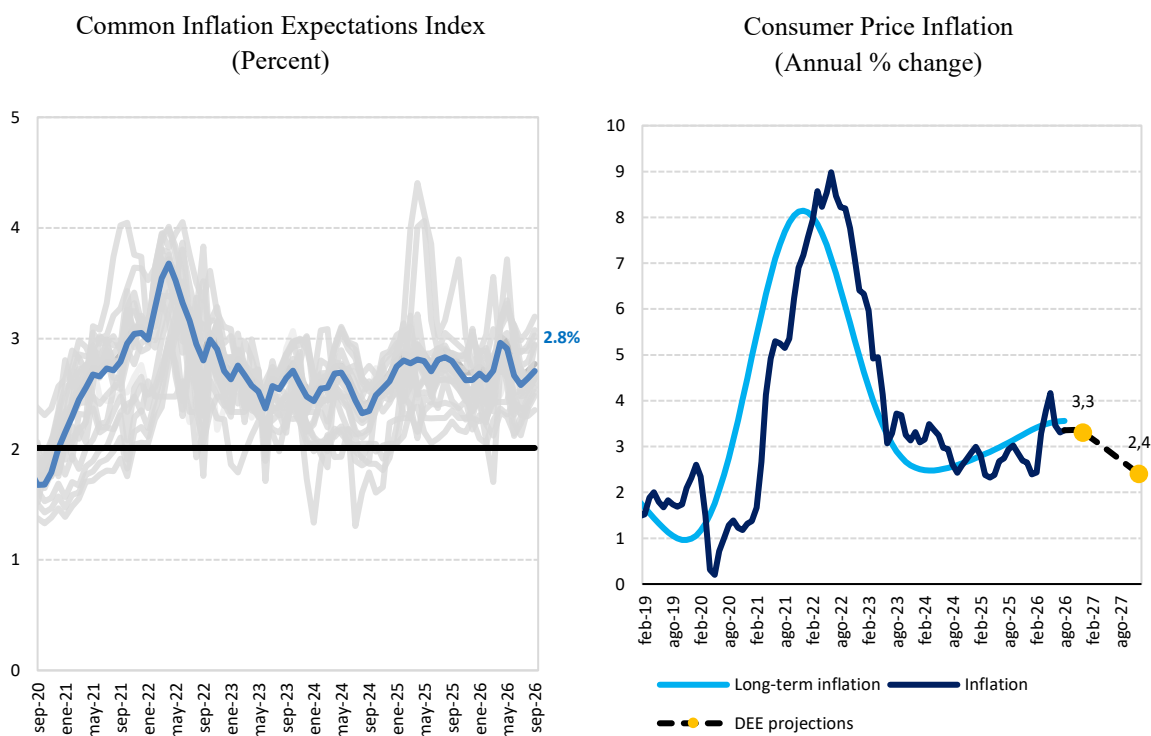
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Latin America in a Demanding Global Environment: What Explains Its Resilience and What Could Put It to the Test?

The international environment has been challenging for emerging and developing economies. Long-term interest rates stand at multi-year highs, geopolitical uncertainty remains significant, and public financing needs have risen in several of the world's major economies. This is compounded by global inflation, which has receded from its peaks and continues to converge gradually toward pre-pandemic levels, but which still faces upside risks. Our estimates of inflation expectations for the United States¹ show an uptick in recent months, in line with our estimates of long-term inflation², which provide evidence of underlying pressures (Figure 1, light blue line).

Figure 1. Inflation in the United States



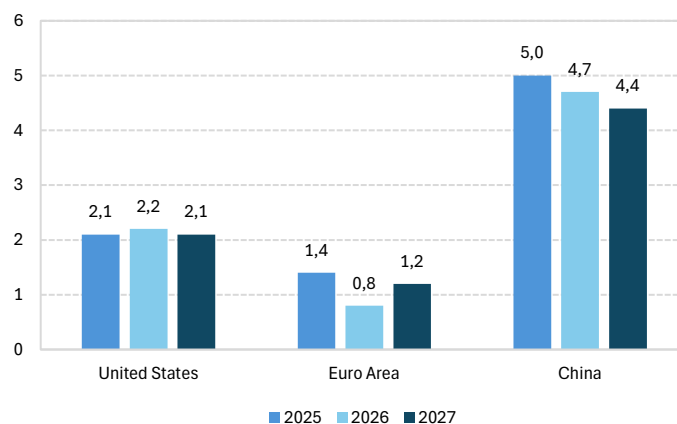
Source: DEE-FLAR estimates and calculations.

¹ See technical note [Inflación tendencial de LATAM](#) (2026). This estimate extends to the United States the methodology applied to LATAM.

² See technical note [Expectativas de inflación: un índice común para EE.UU.](#) (2026).

At the same time, global growth would show significant divergences over 2026–2027: the U.S. would continue to expand at a pace close to 2%; China would slow from 5.0% in 2025 to 4.4% in 2027 owing to weak domestic demand; and the Euro Area, which would grow by only 0.8% in 2026, would see a gradual recovery toward 2027 (Figure 2).

*Figure 2. GDP Growth Outlook
(Annual % change)*



Source: Bloomberg and DEE-FLAR projections.

Under different circumstances, this combination could have generated strong financial pressures on Latin America³. However, the region has so far shown greater resilience than might have been anticipated.

Why? The answer lies in a combination of factors: financial conditions that have remained favorable, an external sector strengthened by commodity prices, adequate external buffers (reserves, among others) in most countries, and sustained access to international private capital markets, all of which reduce the region’s vulnerability. A geographic position far removed from the centers of geopolitical conflict adds a further layer of insulation. Finally, core inflation and inflation expectations have remained contained despite the fuel price shock.

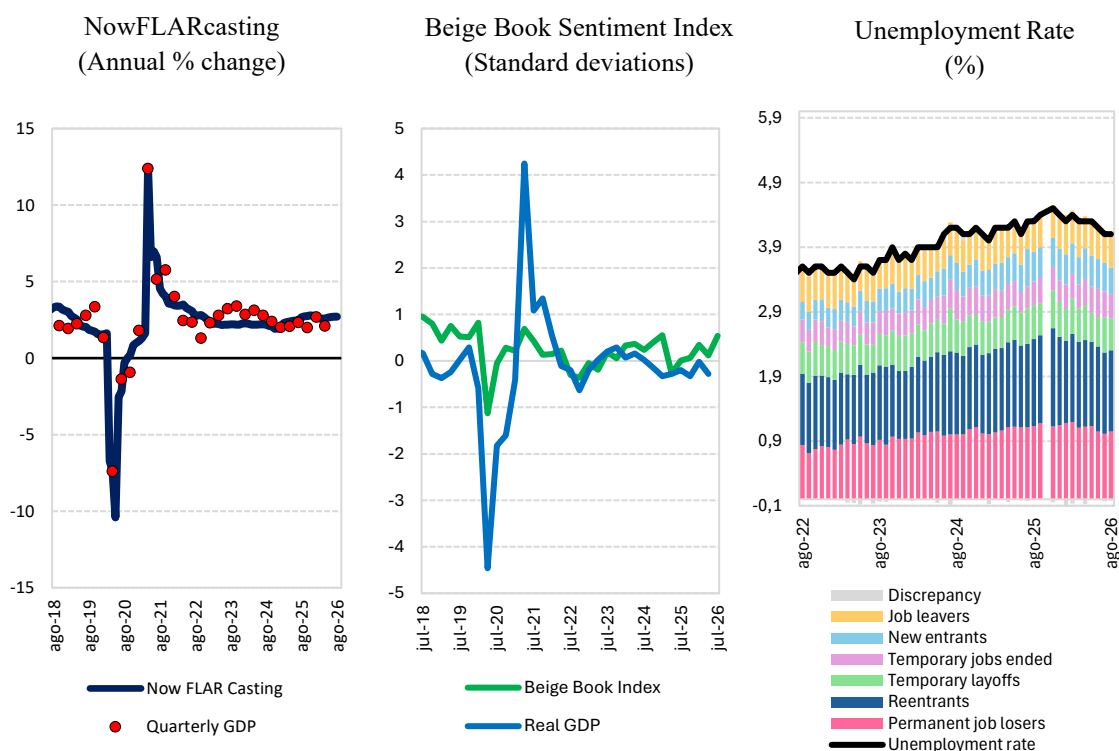
The question going forward is how long these buffers can continue to operate. The coming quarters could test them on two fronts: new supply shocks (for example, the effects of the El Niño phenomenon – ENSO – on several economies, or other shocks of external origin) and fiscal vulnerabilities that continue to build up.

³ For the purposes of this analysis, Latin America refers to Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru and Uruguay. According to IMF WEO data, in 2025 this group of countries accounted for 90.2% of the total gross domestic product of Latin America and the Caribbean.

A World of Higher Long-Term Interest Rates

The U.S. economy continues to show strength. Our nowcast and leading indicators suggest that activity remains dynamic in the short term and that the labor market remains solid (Figure 3). This reduces the likelihood of an abrupt slowdown but also contributes to keeping external financing conditions tight. U.S. inflation would close 2026 at 3.3%, and our baseline scenario envisages the Federal Reserve (Fed) ending the year with its policy rate at 4.25%, compared with 3.75% in 2025.

Figure 3. U.S. Activity and Economic Sentiment Models

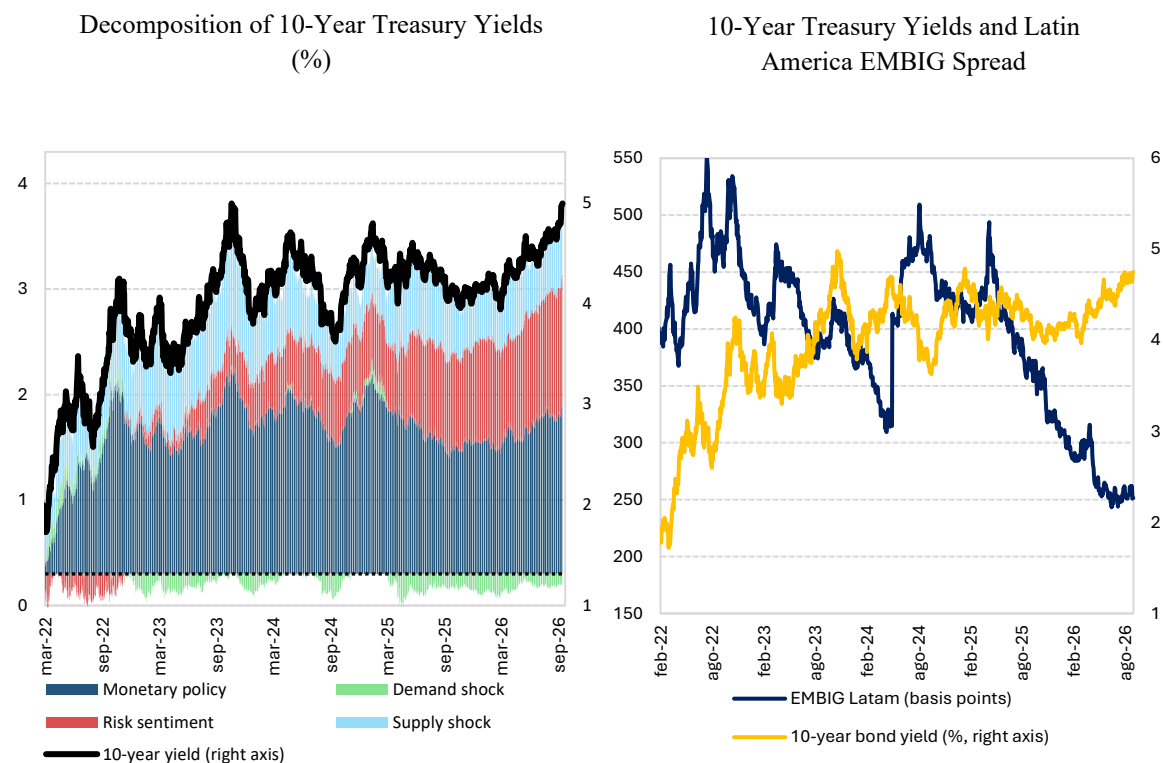


Source: DEE-FLAR estimates and calculations based on data from the Fed, FRED and Bloomberg.

Other forces are also keeping long-term rates elevated: greater fiscal financing needs, investment associated with the artificial intelligence boom, and high geopolitical uncertainty. The decomposition of the 10-year bond yield indicates that its recent increase mainly reflects heightened risk sentiment and a higher monetary policy rate (Figure 4).

This is particularly important for Latin America. U.S. Treasury yields remain a key benchmark for the cost of external financing for the region's governments and corporates.

Figure 4. 10-Year Treasury Yields and Latin America EMBIG Spread



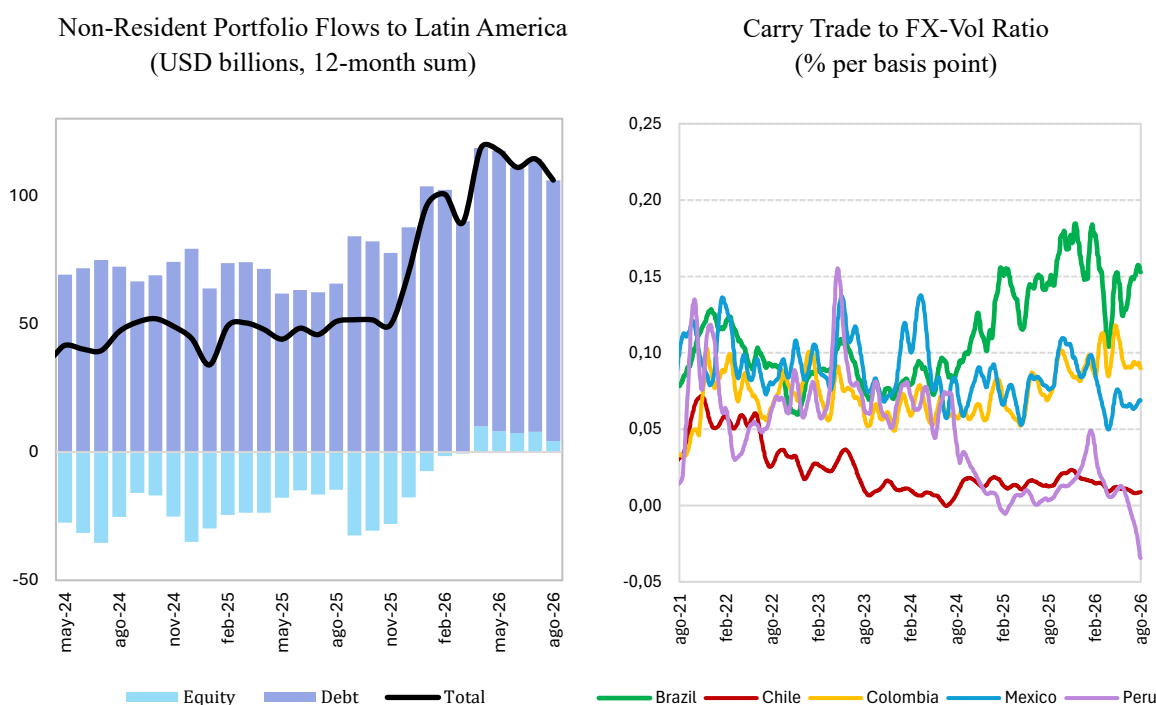
Source: Bloomberg and JP Morgan.

Buffers for Latin America

The first, and most striking, is financial. Despite the rise in risk-free rates, financing conditions in much of Latin America have not deteriorated proportionally. In several countries, the compression of sovereign spreads has absorbed part of the increase in U.S. rates. At the same time, still-attractive interest rate differentials have supported non-resident portfolio inflows into the region, mostly into debt (USD 100 billion over the past twelve months), as well as carry trade operations, especially in Brazil, Colombia and Mexico (Figure 5).

In other words, the rise in the global cost of money has not passed through one-for-one to the cost of financing in Latin America. This buffer, however, is not without risk, carry trade flows are highly sensitive to shifts in risk appetite.

Figure 5. Portfolio Flows and Carry Trade

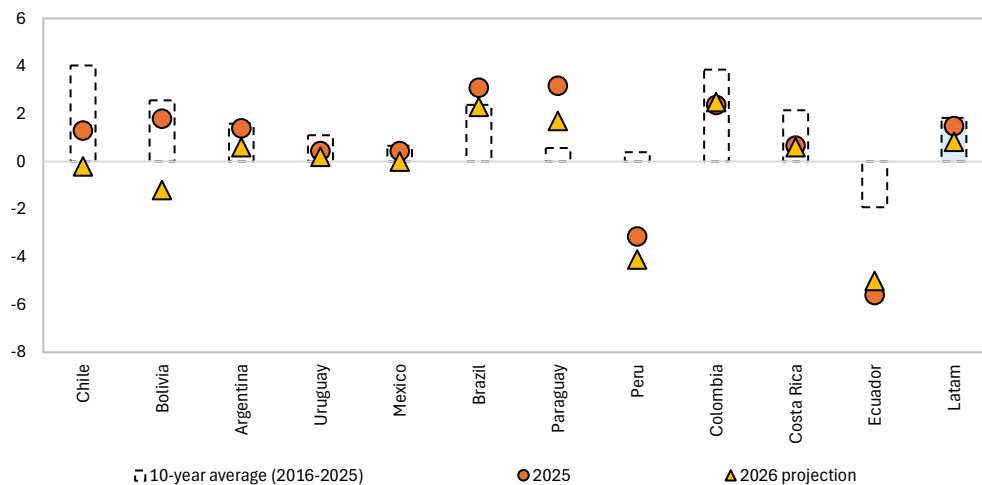


Source: IIF and DEE-FLAR estimates.

The second buffer stems from the performance of foreign trade and remittance flows. The prices of several commodities remain above 2025 levels, and the terms of trade have supported the trade balances of most countries in the region, excluding net importers. As a result, according to our projections, the regional current account deficit would narrow from 1.5% of GDP in 2025 to 0.9% in 2026 (Figure 6). The commodity tailwind, however, is partly transitory, commodity prices are projected to perform less favorably for the region next year (for example, Brent would fall from an average of USD 88 per barrel in 2026 to USD 72 in 2027).

Remittances have behaved favorably across most of the region, with Ecuador, Peru and Colombia standing out. Ecuador received USD 7.8 billion in the 12 months to June 2026 (+8.3% y/y), and the central bank projects a full-year total of USD 8 billion, equivalent to roughly 6.1% of GDP and a historic maximum. Peru's central bank forecasts 2026 remittances at around USD 5.3 billion, a new all-time high, with a further record projected for 2027. Colombia received USD 13.4 billion in the 12 months to June 2026 (+5.8% y/y), with inflows now exceeding foreign direct investment and equivalent to roughly 3.1% of GDP. Mexico is the exception. After remittances fell 4.6% in 2025, the first decline since 2013, driven by a shrinking Mexican migrant workforce in the United States, the recovery so far in 2026 has been only modest.

Figure 6. Current Account Deficit
(% of GDP)



Source: DEE calculations based on central bank data and DEE-FLAR projections.

The current account deficit for Latin America is calculated as a PPP GDP-weighted average of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru and Uruguay. Data for 2026 are DEE-FLAR projections.

The third is international reserves (IR) and access to external financing. Most economies in the region hold international reserves at or above adequate levels, according to the IMF's traditional reserve adequacy metrics, and most maintain recurrent access to international private capital markets, notably Ecuador's recent return with two issuances so far this year (USD 4 billion and USD 1 billion, respectively). In addition, Mexico, Chile and Costa Rica have IMF Flexible Credit Lines. For its part, as a component of the regional financial safety net, FLAR complements these defenses through its capacity to support its nine member economies⁴. Some countries in the region also have active swap lines with the People's Bank of China or access to the FIMA facility of the U.S. Federal Reserve.

The fourth, and no less important, is the progress made in the macro-financial policy frameworks of the region's countries, especially in monetary policy. The latter is reflected in well-anchored inflation expectations.

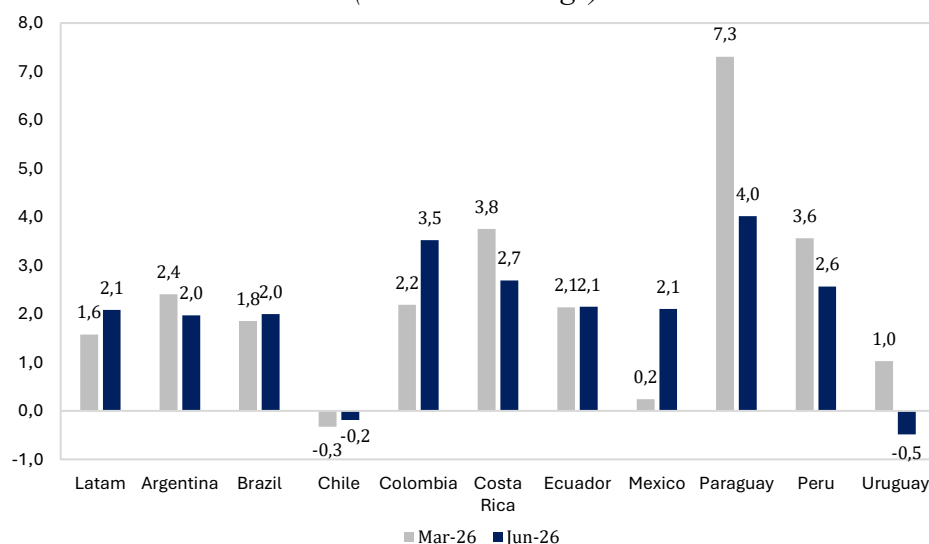
Taken together, these elements mark an important difference relative to previous episodes of global stress, this time, most countries are absorbing the external shock with buffers in place that reduce their vulnerability. However, in some economies international reserves remain below adequate levels and are not covered by the regional financial safety net; this is

⁴ Bolivia, Chile, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay and Venezuela.

therefore an area where further progress is needed to strengthen the financial resilience of Latin America as a whole.

The four buffers have allowed the region to absorb a demanding external environment without the shocks translating, so far, into a significant deterioration in economic activity. Regional growth surprised on the upside in the second quarter of 2026, rising from 1.6% to 2.1% year-on-year, driven by Colombia and Mexico (Figure 7). Our projections for Latin America point to growth of 1.8% in both 2026 and 2027.

*Figure 7. Quarterly GDP Growth
(Annual % change)*



Source: Central banks, national statistics institutes and DEE-FLAR calculations.

Latin America's growth is calculated as a PPP GDP-weighted average of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru and Uruguay.

This is not a high rate by the standards of other emerging regions or of Latin America's own history, and it marks a moderation from 2.2% in 2025. But it does point to a regional economy absorbing sizeable shocks without an abrupt slowdown, a sign of resilience, though not of immunity.

The Next Shock May Come from the Supply Side

On inflation, the picture is mixed. Despite the recent fuel price shock, its pass-through to core inflation has been limited across much of the region, while inflation expectations remain anchored, reflecting the credibility of monetary policy. Even so, consumer price inflation is projected to pick up in 2026, with several countries above their target ranges (including Brazil, Colombia and Peru), before dissipating in 2027.

A further risk clouds the outlook. El Niño is already present: the Relative Oceanic Niño Index (RONI⁵) reached 1.4 in August, and forecasts by NOAA and Columbia University’s International Research Institute for Climate and Society assign a probability of more than 90% that the episode will reach very strong intensity between November 2026 and January 2027. The most recent precedents of this magnitude, 1997–98 and 2015–16, entailed considerable economic costs for the region⁶. Its effects are particularly relevant because they can be transmitted simultaneously through agricultural output, food prices and, in some countries, power generation and energy prices.

This risk could be heightened by a potential escalation of the conflict between the United States and Iran and its effects on international energy prices.

A new food or energy price shock could delay the convergence of inflation toward targets, and policy space to respond varies across the region. This poses a challenge for policymakers, as a shock of this nature could increase inflationary pressures and limit the scope for lowering interest rates. Most central banks in the region have held or cut their policy rates since May; Colombia’s Banco de la República, by contrast, has raised its rate since January 2026.

Fiscal Vulnerability Persists

There is, however, a risk of a different and possibly more persistent nature.

Fiscal deficits remain high in several of Latin America’s largest economies, and regional public debt continues to rise; according to our estimates, it would increase from 63.3% of GDP in 2025 to 66.7% in 2026 and to around 69% in 2027, an increase of almost six percentage points of GDP in two years. The regional fiscal deficit would reach 5.4% of GDP in 2026 and narrow marginally to 5.2% in 2027 (Figure 8).

These dynamics become all the more important precisely because they are unfolding in a world of high long-term rates. The region’s interest payments rose from 3.2% of GDP in 2019 to 4.3% in 2025. With an overall deficit of around 5% of GDP, this means that more than 80% of the deficit corresponds to debt servicing costs.

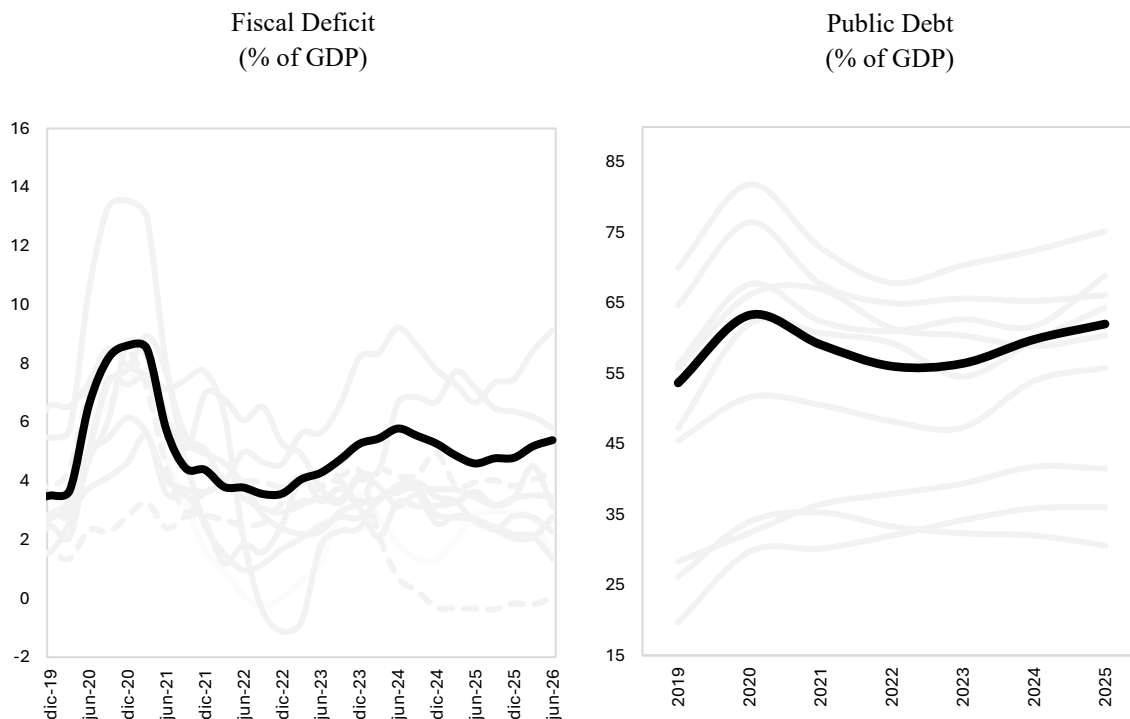
As long as spreads remain compressed and recurrent market access remains favorable, financing needs may be manageable. But a reversal in international risk perception could simultaneously raise debt refinancing costs and sovereign risk premia. Fiscal and financial risks are therefore not independent of each other. Along these lines, recent evidence (Gomez-

⁵ RONI is the official NOAA (National Oceanic and Atmospheric Administration) indicator for measuring El Niño intensity — the sea surface temperature anomaly in the Niño 3.4 region, relative to the average anomaly across the tropical belt.

⁶ See Aguirre et al. (2025), Andrian et al. (2024), Cepal (2026), among others.

Gonzalez et al., 2025) documents a bank-sovereign nexus in non-advanced economies, which can be activated when public debt levels are high and rising.

Figure 8. Latin America: Fiscal Deficit and Public Debt



Source: IMF, central banks and DEE-FLAR calculations.

Note: The level of government for Brazil, Chile, Colombia, Costa Rica and Paraguay corresponds to the Central Government or Central Administration; for Ecuador and Peru, to the Non-Financial Public Sector; for Mexico, to the Public Sector; and for Uruguay, to the Non-Monetary Public Sector.

The deficit and debt for Latin America are calculated as a PPP GDP-weighted average of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru and Uruguay. Data for 2026 and 2027 are DEE-FLAR projections.

Finally, regional fiscal averages mask considerable differences. Brazil, which holds elections in October, combines slowing growth (from 2.3% in 2025 to 1.3% in 2027) with a fiscal deficit of 8.6% of GDP and debt that would exceed 80% of GDP in 2027 in the absence of adjustment measures. Argentina, with presidential elections in 2027 and without normalized access to international markets, has reduced its deficit because of the fiscal adjustment measures implemented by the current government, and faces foreign-currency debt maturities of close to USD 24 billion next year. On the other hand, countries such as Chile, Paraguay and Peru start from considerably stronger fiscal positions.

Resilience Does Not Mean Immunity

Latin America has come a long way since the external crises that marked previous decades. More credible monetary regimes (in most cases), more flexible exchange rates, larger international reserves, a strengthened financial safety net (in several cases), and better management of macro-financial risks have together increased its capacity to absorb shocks, as recent performance again demonstrates.

But precisely because the region is holding up well, it is worth looking at where the next challenge could originate. Today, the main risk is not a single large external shock, but rather the possibility that several shocks (persistently high global interest rates, El Niño, energy price volatility, a demanding electoral calendar, or a reversal of portfolio flows) interact with domestic vulnerabilities, particularly fiscal ones.

The question for 2027, then, will be not only whether the region can continue to withstand shocks, but also how well prepared it is to preserve and strengthen these buffers before the next one arrives.

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