

## Latin America Sector Roundup Q4 2023

# Uneven Trends Amid Rising Crosscurrents

Oct. 24, 2023

*This report does not constitute a rating action*

### Key Takeaways

- LatAm's economic resilience is facing headwinds. We expect below-trend growth in every major economy in the region next year amid softer demand from key trading partners and continued tight monetary policy. The region will likely return to its traditionally low potential growth rates in 2025 and 2026.
- El Niño phenomenon will cause a downturn of uneven nature throughout the region--many sectors could be disrupted because of flash floods and adverse weather conditions. However, some issuers could benefit, considering better hydrology conditions.
- We expect strains will continue intensify for LatAm issuers as economy slows, while inflationary pressures and high interest rates linger.

*(Editor's Note: This report is an expansion of the "Sector Trends" section from our "Credit Conditions Emerging Markets Q4 2023: Enduring Risks" report, published Sept. 26, 2023.)*

Economic resilience and debt markets' reopening, albeit at high interest rates, have supported credit conditions across LatAm. However, except for the outlook revision on Brazil to positive and related rating actions in June, rating activity remains net negative in the region, reflecting tight financing conditions and margin compression across many sectors. We expect challenges will continue to amplify for LatAm issuers as economy remains subdued, while inflationary pressures and high interest rates remain for a longer period.

We expect below trend growth across LatAm in 2024, but economic performance will be uneven. El Niño phenomenon will be a key factor behind this trend. For Chile and Peru, El Niño increases hurdles due to the prevalence of flash floods causing disruption among various sectors, including mining, agriculture, and fishing, with the respective shock to related economic activity. In Colombia, the dry weather weighs on agriculture but also on utilities. El Niño phenomenon is associated with a milder hurricane season in the Atlantic Ocean, but increases the probability of cyclones in the Pacific Ocean, which also raises uncertainty for Mexico's tourism sector. On the positive side, some sectors benefit from heavier rainfall, especially as some energy costs fall.

Issuers throughout the region will also face common difficulties, as we expect tight financing conditions will likely prevail in 2024, despite the anticipated monetary easing. We expect

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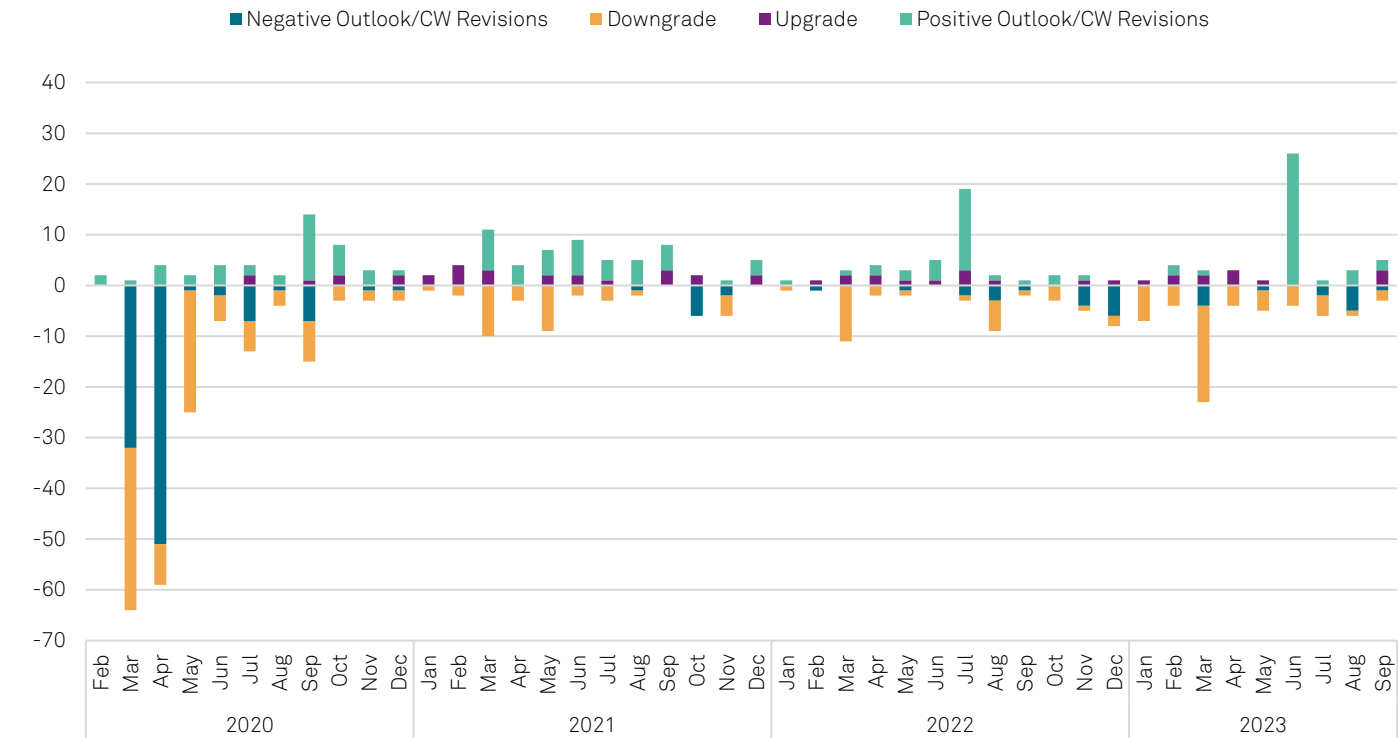
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issuances to pick up over the coming quarters as debt maturities approach. Nevertheless, debt costs will be significantly higher than in the past five years. Consequently, we expect that highly leveraged corporations will struggle, and the number of defaults will continue rising among the lower rated issuers.

Two additional factors that will likely dent the region's economic prospects are the expected global slowdown, which will likely have a deeper pernicious effect on countries that depend heavily on exports, like Mexico and Chile. A second factor is inflation. While it has peaked in the region, risks of renewed pressures remain, given ongoing developments in the oil and food markets.

Chart 1

Following the June outlook revision on Brazil to positive, the rating activity remains net negative  
Number of rating actions in LatAm



Data as of Sept. 30, 2023. Source: S&P Global Ratings Research & Insights.  
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## Macroeconomic Outlook

### Shifting Gears To Below-Potential Growth In 2024

**We increased our 2023 real GDP growth forecast for the region to 1.6% from 1.1%, but lowered our 2024 projection to 1.2% from 1.5% previously.** The main upward growth revisions in LatAm are for Brazil and Mexico. We made the steepest downward growth revisions for Argentina and Peru. We expect below-trend growth in every major economy in the region next year. This is because of softer demand from key trading partners, and continued tight monetary policy. We expect the region to return to its traditionally low-potential growth rates in 2025 and 2026.

Table 1

#### LatAm: GDP growth and S&P Global Ratings forecasts

	2020	2021	2022	2023f	2024f	2025f	2026f
Argentina	(9.9)	10.7	5.0	(3.5)	(1.0)	2.0	2.1
Brazil	(3.6)	5.3	3.0	2.9	1.2	1.8	2.0
Chile	(6.4)	11.9	2.5	0.0	2.0	2.8	2.9
Colombia	(7.3)	11.0	7.3	1.4	1.9	2.8	3.0
Mexico	(8.8)	6.1	3.9	3.0	1.7	2.0	2.1
Peru	(11.1)	13.5	2.7	0.9	2.4	2.8	3.0
LatAm 6	(6.9)	7.6	3.9	1.6	1.2	2.1	2.2

Note: The LatAm GDP aggregate forecasts are based on PPP GDP weights. f--S&P Global Ratings forecast. Source: S&P Global.

**The factors that have fueled growth in Mexico and Brazil in 2023 will have a slimming effect in 2024.** Mexico has benefited from continued U.S. consumer strength, but we expect demand to soften in the coming quarters. The challenges facing the U.S. consumer will be more apparent in the coming quarters, namely the depletion of excess household savings, the resumption of student-loan repayments in October, and continued high interest rates. For Brazil, the boost from strong agricultural production is unlikely to be repeated next year, and fiscal consolidation plans will slow domestic demand.

**We lowered our growth projections for Argentina, Peru, Colombia, and Chile.** In those countries, GDP growth contracted in the second quarter relative to the first quarter. Social unrest and the impact of El Niño took a toll on activity in Peru. Chile's economy also took a hit from El Niño, with large floods occurred in August across the regions that produce key agricultural exports. Colombia's upward adjustments to fuel prices, as part of a process to converge to international energy prices, has prevented from starting the disinflation process that's taking place among its regional peers. The outlook on Argentina is highly uncertain given the upcoming presidential election and its implications for economic policy, but we now expect GDP to decline in 2023 and 2024.

**Inflation peaked in the region and will continue to decline in the coming months, but the potential for the resumption of the rise in energy and food prices is a main risk.** The median headline CPI in LatAm halved to 5.4% year-over-year in August 2023 from its 10.8% peak in June 2022. Most of the disinflation process has been driven by lower energy and food prices. Volatility in energy prices has increased in recent months, and El Niño caused prices on certain food items to rise, especially in South America. If both factors persist, the process of disinflation in the region could falter.



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**Chile, Brazil, and Peru have started cutting interest rates, and we expect the rest of the large economies in the region will start doing so in the first half of 2024.**

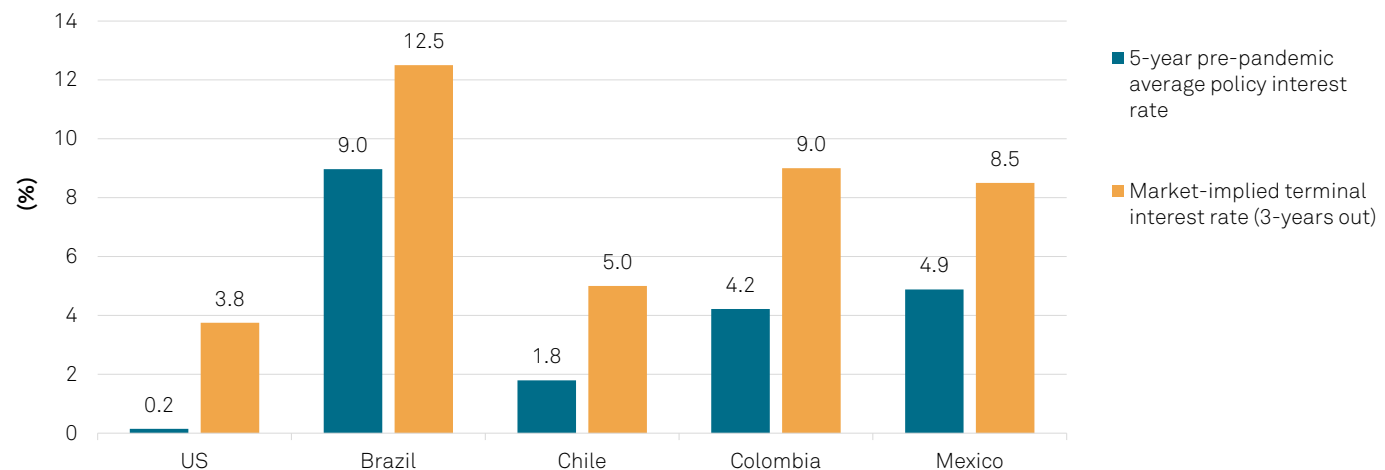
Chile's central bank began lowering its benchmark interest rate in its late-July meeting, after hinting of doing so during its June monetary policy meeting. The Brazilian central bank followed suit in August, as inflation dynamics improved markedly in recent months. We expect most other major central banks to start lowering interest rates toward early 2024, once there's greater visibility regarding the beginning of monetary policy easing in the U.S.--we expect the Fed to start cutting rates around the middle of 2024.

**However, the recent rise in long-term U.S. Treasury yields and renewed strength in the U.S. dollar could slow or delay interest rate cuts in LatAm.**

Weaker exchange rates could push up inflation expectations, forcing central banks to be more cautious toward easing policy. Higher U.S. interest rates have also lifted interest-rate curves in the region, making it more difficult for central banks to cut interest rates without triggering depreciatory pressure on their currencies.

Chart 2

**Market-implied policy rates**



Note: market-implied interest rates are based on interest rate swaps, rounded to the nearest 25 bps. As of Oct. 6, 2023. Sources: Haver Analytics and S&P Global Ratings. Copyright 2023 © by Standard & Poor's Financial Services LLC. All rights reserved.

**The "new normal" for interest rates is likely to be higher than what it was during the last decade.**

Structural factors, such as supply-chain reorientation, energy transition, and geopolitical fragmentation, will lift prices, and consequently, interest rates. Elevated interest rates, in the absence of higher growth expectations, could discourage investment. Lower levels of investments could keep productivity growth weak in the coming years.

**The potential for slower-than-expected growth in China and the U.S. are key downside risks for the region.**

The initial rebound of China's economy, after lifting pandemic-related restrictions in late 2022, seems to be losing steam. This could dampen demand for key commodities that LatAm exports. While the U.S. economy continues to show resilience due to strong labor market dynamics, tight monetary conditions could cause a rapid deterioration in demand, with adverse implications for key trading partners, such as Mexico.

## Financing Conditions

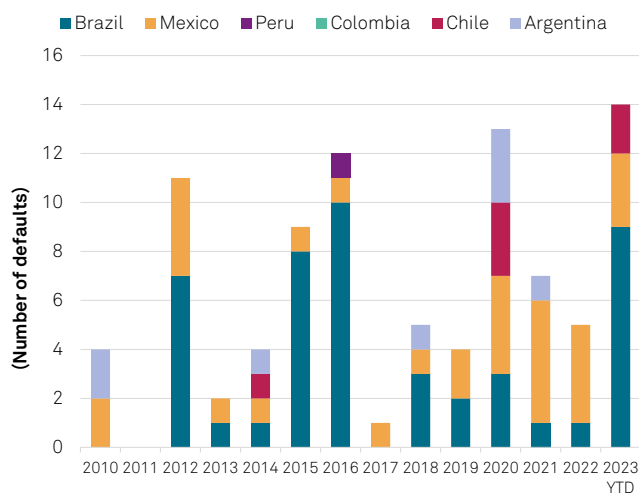
### Higher-For-Longer Narrative Kicks In

**Financing costs entrench the likelihood of higher-for-longer interest rates in the U.S.** Despite the recent monetary policy easing in Chile, Brazil, and Peru, LatAm countries are grappling with the U.S. tight monetary policy to rein in inflation, which is maintaining international financing costs at high levels. LatAm countries' 10-year yields were 60 basis points (bps) higher on average in September than in August 2023, while the corporate effective yield rose about 9% as of October 19 from 8.3% in September 19. Moreover, the strong U.S. dollar has led to currency depreciations and recent equity outflows. The protracted scenario of high interest rates and tight financing conditions is stressing LatAm corporations' credit quality, resulting in 14 defaults across the region out of the total of 15 across emerging markets so far this year, with nine occurring in Brazil. Although the pace has slowed, the year-to-date default count is already the highest compared with full-year historical records (chart 3). Distressed exchanges and missed interest payments account for the bulk of recent defaults, triggered by liquidity strains, refinancing risk, and necessary capital restructuring.

**Bond issuance remains subdued.** The significant cost of financing is depressing international issuance volumes, tracking along the historically low trend of 2022 (chart 4). Domestic markets are still active, although they can't fully compensate for the foreign issuance decrease and may become more selective, given weak activity and still high uncertainty ahead. Nonetheless, refinancing risk remains contained, as the maturity wall is likely to peak in 2027, with speculative-grade debt maturities at 35% through 2024, mainly in Brazil's oil and gas and financial institutions sectors (63% through 2027). Currency depreciation could pose complications for LatAm issuers, since out of \$42 billion set to mature by 2024, 62% are denominated in U.S. dollars.

Chart 3

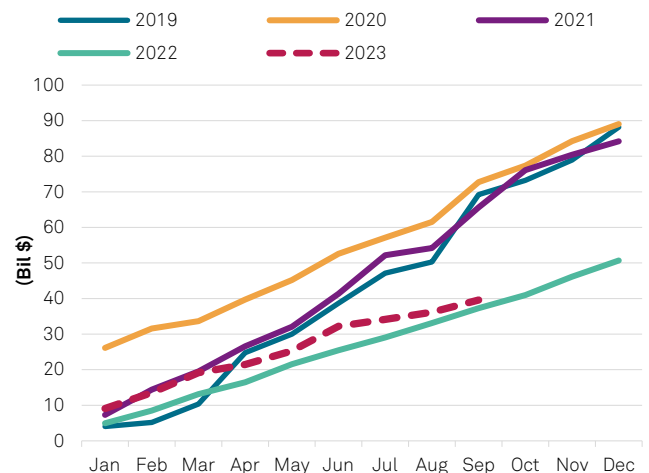
#### 60% defaults located in Brazil year to date



Data as of Sept. 30, 2023. Excludes sovereigns, includes confidential issuers.  
Sources: S&P Global Ratings Credit Research & Insights.

Chart 4

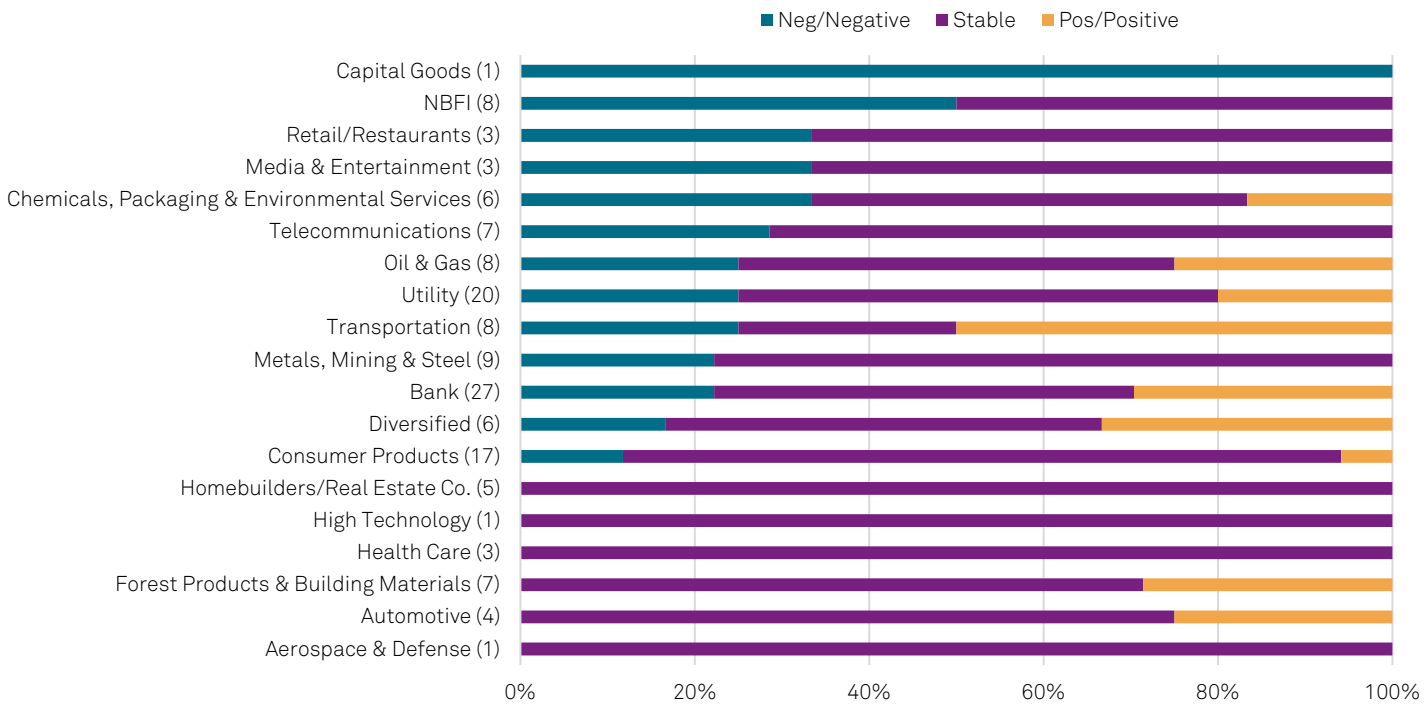
#### Issuance remains subdued year to date



Data as of Sept. 30, 2023. Data including NR (not rated).  
Sources: S&P Global Ratings Credit Research & Insights and Refinitiv.

Chart 5

The negative outlook bias rose to 22%, still below five- and 10-year averages of 30%  
Outlook distribution of LatAm issuers by sector



Data as of Sept. 30, 2023. Source: S&P Global Ratings Research & Insights.  
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## Sovereigns

### Difficulties In Delivering Solid Growth

#### What we expect for the next 12 months

- Boosting long-term economic growth remains the key challenge for the region.
- LatAm central banks should be able to ease monetary policy to support economic growth, which could strengthen future economic resilience.
- Appropriate economic policies, along with leadership that focuses on long-term, pro-growth policies, can make a difference



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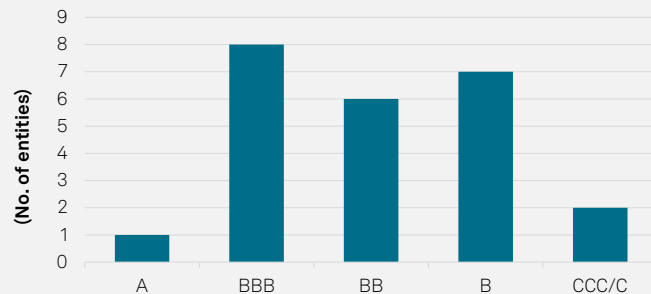
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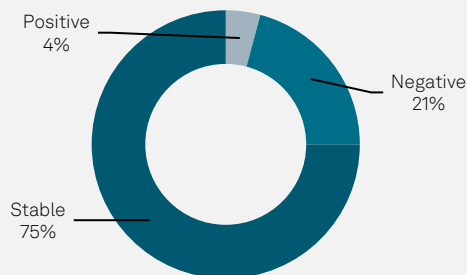
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#### Rating distribution



#### Outlook distribution



Note: As of Oct. 5, 2023. Includes public ratings only.  
Source: S&P Global Ratings.

#### All sovereigns in the region now carry a higher burden of debt than during pre-pandemic years.

However, LatAm economies have expanded above their pre-pandemic peak level of GDP, and the poverty rate is likely to have stabilized, if not fallen, after the recent rise. Moreover, there appears to be little long-lasting harm to the credibility of monetary policy from the recent inflationary upsurge, nor a change in policy orientation among those countries that pursue inflation-targeting monetary policy. This hard-won pillar of economic stability, which emerged during periods of high inflation across the region's many countries during the last few decades of the previous century, has endured, auguring well for future economic resilience.

**The key hurdle now is bolstering long-term GDP growth.** Economic growth has picked up modestly this year in large countries, like Mexico and Brazil, and in some smaller countries, like Costa Rica. Moreover, the unemployment rate has dropped towards pre-pandemic levels in many countries, helping ease social problems. However, the region's long-term growth prospects remain weak.

**Global population growth and a shift towards renewable energy could provide an opportunity for much of LatAm, especially South America.** These factors could strengthen the region's economic growth prospects thanks to favorable long-term demand for foodstuffs and key minerals like lithium, copper, and silver. LatAm's agricultural sector can meet growing demand for food as it's more resilient than that of much of the world, thanks to abundant fertile land and water sources.

**The number of LatAm countries, which has maintained a healthy GDP growth rate over many years, is low. Nevertheless, their success shows that appropriate economic policies, along with leadership that focuses on long-term, pro-growth policies, can make a difference.**

## Corporations

### Credit And Business Conditions Are Improving Mildly

#### What we expect for the next 12 months

- Credit market access has widened for domestic and international issuers since early September.
- Business conditions remain stable for the most part, although persistently high interest rates continue to depress capital allocation and demand for durables. Nevertheless, key sectors of the region remain healthy such as metals and mining, consumer products, oil and gas, automotive, agribusiness, and transportation.
- Some sectors continue to exhibit weak fundamentals such as telecom and cable, retail, homebuilders, protein, and chemicals.
- Inflation remains a factor to monitor, along with the policy-rate trajectory, the latter especially in Brazil.



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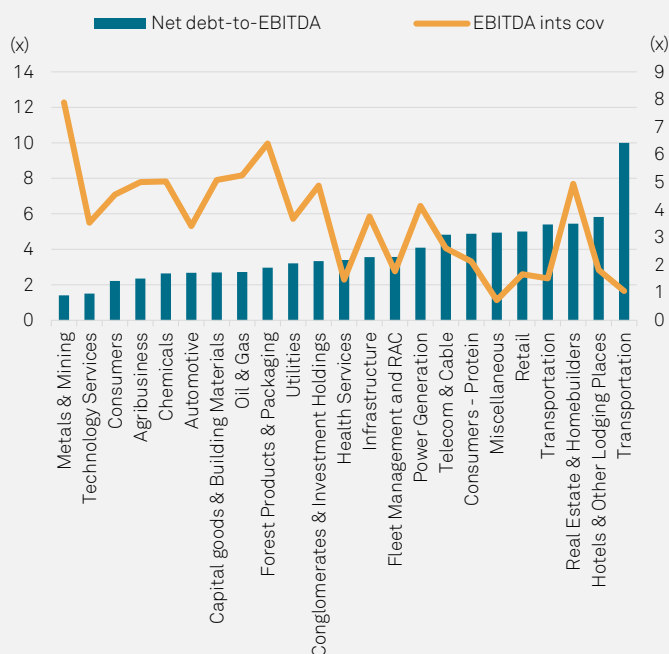
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#### Leverage trends



Source: S&P Global Ratings. Data as of March 2023 (last 12 months).

**Debt issuances have picked up in September and October.** A slight decline in spreads propelled international and domestic bond issuances. Slightly better business conditions, along with the decline of Brazil's policy rates, prompt us to believe access to market is likely to continue recovering.

**Business fundamentals are stabilizing, and visibility for 2024 is improving as inflation levels subside and socio-political factors stabilize.** Although macroeconomic conditions will remain subdued for the largest economies in the region, commodity prices are likely to remain supportive, particularly for copper, iron ore, oil, sugar, ethanol, soybeans, and pulp, and probably less so for steel and proteins.

Bond maturities remain manageable for the rest of 2023 and for 2024, **but value creation and free cash flow generation remain impaired across most sectors** as pre-tax returns on capital are mostly below borrowing costs. We expect that to ease gradually as policy rates fall. Still, growth and capital allocation decisions are very much influenced by such factors.

**We closely monitor leverage and operating performances in the retail, telecom, and cable sectors in Brazil and Chile.** Several retailers are suffering from poor growth and weak competitiveness particularly in online segments, which hurt margins and leverage. Also, some telecom and cable operators are struggling to pass through inflation-fueled costs, as rates are pressured by stiff competition while investment needs remain high to keep up with demand.

**Upcoming presidential election in Argentina may trigger significant policy changes.** Conditions may turn more favorable for exporters, particularly for energy and oil and gas entities, as the country needs to strengthen its external front.



## Financial Institutions

### Asset Quality Remains Under Pressure As Economy Struggles And High Interest Rates Linger

#### What we expect for the next 12 months

- Asset quality metrics remain strained because of high interest rates, disappointing economic performance, and increased household leverage.
- Credit growth remains soft given conservative underwriting standards and low credit demand.
- Major banks' balance sheets remain robust with high provisioning buffers and adequate capitalization, but bottom-line profits are stagnating.



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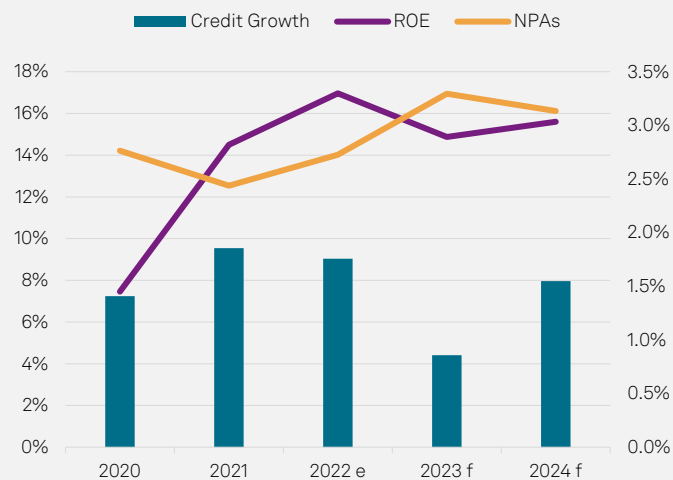
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#### Credit growth, ROE, and NPAs\*



**Profitability will continue to soften because of deteriorating asset quality that will require banks to continue strengthening their provision levels.** LatAm banks' operating performance will continue to sag in 2023 and slightly improved in 2024 but to remain solid compared with those of international peers.

**Credit demand from corporations remains low owing to lackluster economy.** Banks continue focusing on entities with stronger credit quality, such as large and midsize entities, while having less appetite for middle market, small companies, and microcredit.

**Loan growth in the retail unsecured segment will remain sluggish because of recent asset quality deterioration.** We expect lending to slightly increase in 2024 from low levels, as economic activity remains subdued.

**LatAm banks' asset quality will likely keep deteriorating in 2023 and stabilize in 2024, although credit costs should remain manageable.** Furthermore, banks in the region have adequate profitability and provision levels, which should help weather a temporary setback.

\*Simple average among major LatAm economies: Brazil, Mexico, Chile, Colombia, Peru. e-- estimate, f-- forecast. Source: S&P Global Ratings.

## Insurance

### Economic Risks And Climate Change Will Test Insurers' Performance

#### What we expect for the next 12 months

- Cooling economy and potentially greater inflationary pressures will weigh on premiums growth and operating performance of LatAm insurers.
- However, we expect insurers' credit quality to remain resilient thanks to their healthy balance sheets, sound capitalization, and sufficient liquidity.
- Stable credit trends prevail among LatAm insurers, although amid increasing risks during prolonged economic doldrums.



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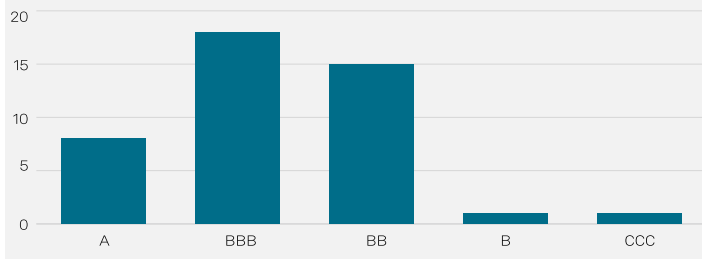


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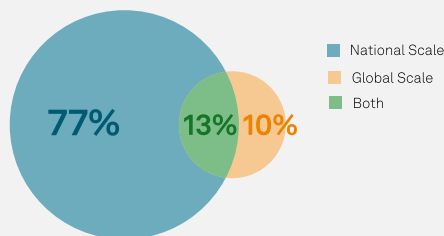
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#### Latina American insurers' ratings distribution

As of October 10, 2023



Global and national scale rating distribution of Latin American insurers



Source: S&P Global Ratings

**Weakening economic conditions will constrain insurers' premiums growth.** Slowing domestic demand, rising unemployment, and narrowing corporate margins could sap demand for insurance products and increase lapse rates in the coming quarters. Non-life premiums real growth mostly stems from higher prices, rather than from new business or clients.

**Pressure on non-life insurers' technical results could intensify.** Unemployment, social tensions, crime, and fraud could increase amid weakening economic conditions, which could raise claims for insurers. Moreover, the Fed's monetary tightening could weaken local currencies, which could compound strains.

**Persistently high interest rates could hamper the credit quality of insurers' investments.** This situation could be unsustainable for highly indebted companies, leading to defaults and bankruptcies, and could depress insurers' capitalization levels and liquidity positions.

**Cybersecurity risks and climate change are increasing and becoming more costly.** As a result, reinsurance costs are rising, as are investments in technology, hurting insurers' margins.

**Conservative underwriting and investment policies will prevail amid economic strains.** This will ease pressure on insurers' capitalization and liquidity levels. High interest rates will keep supporting life insurers' investment incomes and overall profitability.

## Strutred Finance

### Issuance Volumes Jumped

#### What we expect for the next 12 months

- We expect cross-border market new issuances to fuel an approximately 11% growth in total issuances across the region this year, while Brazil will remain the most active market in LatAm.
- Improved GDP growth expectations should favor collateral performance in Brazil and Mexico.
- Ratings performance remains stable due to cushions in credit enhancement and deleveraging.



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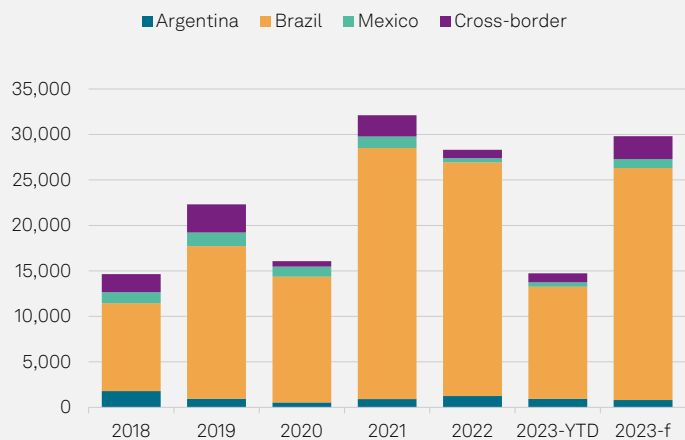
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Structured finance market-wide new issuances (bil. \$)



f--forecast. Source: S&P Global Ratings.

**Issuance volumes soared across the region since June.** Therefore, our new issuance forecast is unchanged.

**We expect the Brazilian economy to expand 2.9% this year thanks to strong agricultural production and higher household spending, given fiscal stimulus measures.** This should favor ratings and collateral performance of trade receivables, consumer credit, and residential financings. Issuances in Brazil should continue to fuel overall issuance growth in the region.

**Issuances remain subdued in Mexico across all asset classes.** We continue to believe that activity could pick up in the coming months, as companies plan to secure funding ahead of the next year's elections. In addition, investments associated to nearshoring could also be funded via capital markets, particularly equipment and real estate. Ratings performance remains solid amid stable collateral performance.

**In Argentina, we continue to see new issuances in the ABS consumer sector. Issuance has remained steady amid the electoral season.**

## Infrastructure

### Uneven El Niño Effects Across The Region

#### What we expect for the next 12 months

- Prospects of a stronger El Niño in the next two years alleviate spot prices in Brazil and Chile, while elevating them in Colombia and Panama.
- Elevated refinancing costs to continue to pressure free cash flow generation, while banks and capital markets' appetite for infrastructure assets remains strong, boosted by the historical execution of inflation-fueled cost pass-through to rates.



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**Better hydrology as well as an improvement in the cash collection cycle will strengthen liquidity of the rated Chilean generation companies (gencos).** The final monetization of accumulated balances from the Precio Estabilizado al Cliente Regulado receivables (the mechanism to recover differences between the regulated contract power prices and stabilized prices), combined with low average spot prices thanks to better hydrology prospects for 2024, should be a credit positive for the rated gencos in Chile. This is because most of them need to buy energy in the spot market to honor contracts. Underlying risks remain, in light of regulatory developments to mitigate the volatility caused by transmission curtailment. New regulation could include an updated framework for energy auctions, including pricing per zone and batteries.

**Brazilian infrastructure issuers continued to access capital markets, and we forecast leverage to peak in 2023.** After a dry spell in domestic capital markets during the first half of the year, infrastructure companies have begun tapping financing afterwards, and we expect them to continue attracting funding from debt and equity investors not only for their sizeable capex but also for debt refinancing. The expected slow decline in interest rates to 9% by the end of 2024, from 12.25% currently, should help ease debt servicing and improve leverage metrics, although debt burden remains high, more than 50% of which has floating-interest rates. We expect toll roads and ports handling agricultural commodities to continue presenting stronger elasticity to the country's forecasted GDP growth of 1.2%, as favorable hydrology bolsters harvest yields, while agricultural exports are somewhat inelastic to the global macroeconomic weaknesses. Amid low electricity demand and spot prices, we continue to expect deployment of about 3 gigawatts of new solar capacity, mainly in the distribution generation.

**Mexico's regulatory turmoil will likely continue until the end of the current administration.** Leading presidential candidates haven't announced their plans for changes in the transportation infrastructure sector and for energy transition. However, we may see additional attempts or measures to make regulatory changes, particularly for those sectors that haven't been targeted by the current administration, such as the recent attempt to modify the tariff scheme for private airport operators. Nonetheless, we expect courts or Congress to provide some protection against these measures, as was the case in the energy sector. Finally, we believe that there are some policies, like the 2014 energy bill, that are unlikely to be changed, as the current administration failed to implement modifications in the last five years. Still, we see a slower-than-expected deployment of new investments in the energy grid to support the expansion of nearshoring. Domestic toll roads continue posting strong performance with close to a 10% traffic growth, as the regions where they are located maintain high levels of economic activity.

**El Niño will crimp transportation demand in Peru.** Despite our view of a more stable political and social environment in Peru recently, we anticipate significant short- and medium-term challenges due to the emergence of reportedly the strongest El Niño phenomenon of the past 25 years in Peru, which is expected to end by mid-2024 and which will take a toll on agricultural and fishing industries. At the same time, the ongoing arbitration over the early termination of the toll road Rutas de Lima concession brightens prospects for the country's rule of law, which could spur new investments, namely in wind, solar, and ports.

**Colombia's distribution companies are facing higher working capital pressures because of El Niño.** The hike in spot prices stemming from a drier season in the country could crimp liquidity and profitability of the Colombian distribution companies, which must comply with a rate ceiling since the implementation of the “opción tarifaria” in 2020. The government is currently working on measures to alleviate the accrued receivables of these entities, while they're incurring higher costs. We view the delays in the execution of non-conventional renewable projects and transmission lines as a medium-term risk for the system's capacity. We expect a slow implementation of the 5G program, to be launched in the first half of 2024, while most of the 4G projects are finalizing their construction.

## Related Research

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- [Emerging Markets Real Estate Issuers Stand Their Ground, Sept. 20, 2023](#)

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