

# Latin America's slowing economy shows improving signs of resilience

Atradius Economic Outlook – Latin America & Caribbean



## Atradius Economic Research

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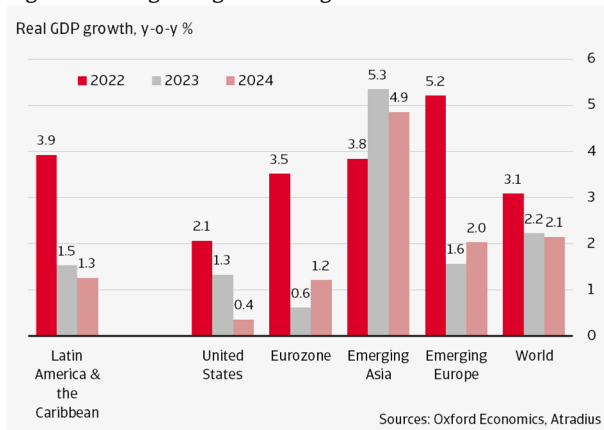
## Executive summary

- **Increased resilience.** The Latin American region is dealing remarkably well with the triple shocks of the pandemic, Russia's invasion of Ukraine and rising US interest rates. The region's GDP is now firmly above its pre-pandemic size. This underlines the region's much improved resilience since the financial crisis of the 1980s, on the back of stronger macroeconomic policy frameworks, improved banking supervision, and higher official reserves. Compared to other global regions, the Latin American region is more resilient to a downward global scenario of tightening global credit conditions. The main exception among the region's larger economies is Argentina.
- **Weak outlook.** Meanwhile, the region's outlook has worsened. This reflects global headwinds, tight financial conditions and political uncertainty in many countries. Growth will recover somewhat next year as these headwinds fade but will remain weak due to structural impediments. The recent arrival of El Niño adds to the region's challenges. As a result, Latin America and the Caribbean will once again lag the rest of the emerging market regions.
- **The region's largest economies** are facing particularly weak growth prospects. As these are mainly located in South America, this sub-region will show the poorest performance. The economies of Argentina, Chile and Colombia will contract in 2023 or 2024. Central America is expected to see steady growth. This is also the case for Dominican Republic, making it the exception among the region's larger economies. The smaller economies in the Caribbean will show the fastest growth, but most of their economies, particularly the tourism dependent countries, are still below their pre-pandemic levels.

# Improved robustness in the face of many challenges

Latin America and the Caribbean (LAC) is dealing remarkably well with the triple shocks of the pandemic, Russia's invasion of Ukraine and rising US interest rates. Real GDP grew 3.9% in 2022 and the region's GDP is now firmly above its pre-pandemic size. This underlines the region's much improved resilience on the back of stronger macroeconomic policy frameworks, improved banking supervision, and higher official reserves. Since the debt crisis in the 1980s – often referred to as the lost decade, which continued for some into the 1990s – many countries in Latin America moved towards flexible exchange rate systems. The latter allows the currency to be used as a shock absorber and enhances monetary policy autonomy. Furthermore, many have introduced fiscal rules and made their central banks independent. The fact that the region's central banks were among the first movers to hike interest rate in response to rising prices since 2021 is evidence of this improved policy framework.

Figure 1 Weak global growth drag on LAC outlook

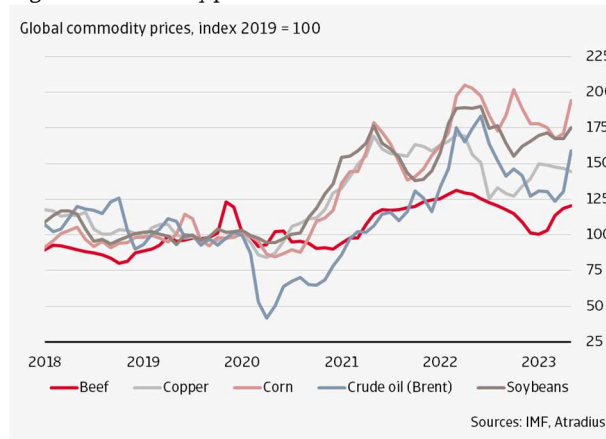


Meanwhile, the region's outlook has worsened. We forecast GDP growth to slow to 1.5% in 2023 and to remain sluggish at 1.3% in 2024, lagging other emerging market regions<sup>1</sup>. This slowdown mirrors the deterioration in the external environment, especially in key trade partners, the US and China. Skyrocketing inflation in the US and the Federal Reserve's monetary tightening response both pose headwinds to global economic activity. Although China's economy is recovering after the late lifting of that country's zero-Covid policy, its industrial production remains meagre and as such the demand for commodities. Lower demand for goods as well as travel from advanced economies and less production in China will keep Latin America's economic

growth below its pre-pandemic annual average of 2.5% over the coming years.

Commodity prices also pose an external drag on growth. The price of major commodities that Latin America and the Caribbean produce rose significantly from the pandemic through last year as global demand recovered. Russia's invasion of Ukraine and adverse weather conditions raised energy and food prices as well. While the impact of higher food prices on the major food exporting countries was muted as adverse weather conditions suppressed yields, higher energy prices provided some boost for oil exporters like Colombia, Ecuador, Guyana and Trinidad & Tobago that will fade in 2023 with prices more than one third lower around USD 75 per barrel Brent. Of course, the easing of oil prices does offer some relief, especially for those countries dependent on energy imports like in the Caribbean. Lower energy prices will help slow down inflation, easing pressure on consumers. But food prices are set to remain high with risks to the upside, especially associated with El Niño (see in focus box).

Figure 2 Commodity prices still elevated



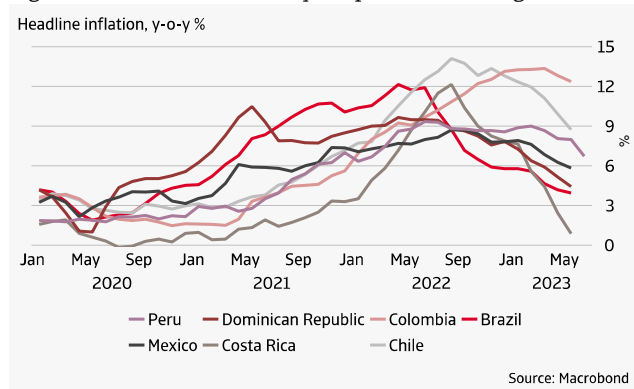
This brings us to internal factors explaining the meagre growth outlook for the region: still elevated inflation and the impact of tight financing conditions. To analyse the key regional trends here, we focus on the largest LAC economies with the addition of Costa Rica which recently joined Chile, Colombia and Mexico as an OECD member in the region.

Inflation appears to have peaked in most LAC countries but it's clear that we are not out of the woods yet (see figure 3). Inflation remains well above target in most markets – with the exception of Costa Rica – and risks remain to the upside,

<sup>1</sup> Data and forecasts as of 1 July 2023.

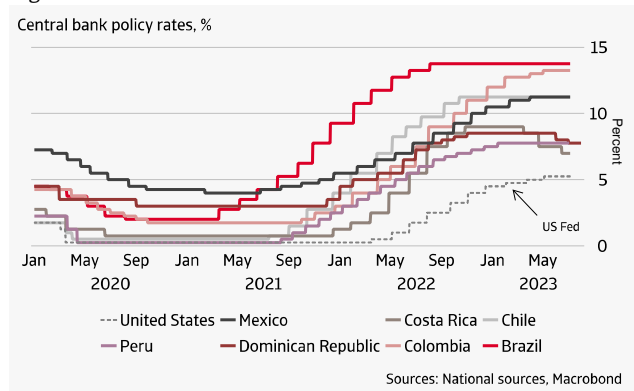
particularly for food prices. This will delay monetary policy easing.

**Figure 3 Disinflation underway but prices still too high**



As mentioned in this section's introduction, the region's central banks hiked interest rates earlier and more aggressively than the US Fed to fight inflation stemming from rising food and energy prices which was exacerbated by Russia's invasion of Ukraine (see figure 4). But core inflation, which excludes food and energy, remains stubbornly high above pre-pandemic levels and is only expected to decrease more sharply through the year given the lagged impact of monetary policy. On top of this, recent global financial volatility further deters a general monetary easing cycle. While the central banks of Costa Rica and the Dominican Republic felt confident enough about the disinflation process to start its monetary easing cycle in March and May of this year respectively, the region's other largest economies remain in wait-and-see mode. This will continue to drag on domestic demand, keeping growth prospects muted in 2023 and 2024.

**Figure 4 Most LAC central banks in wait-and-see mode**



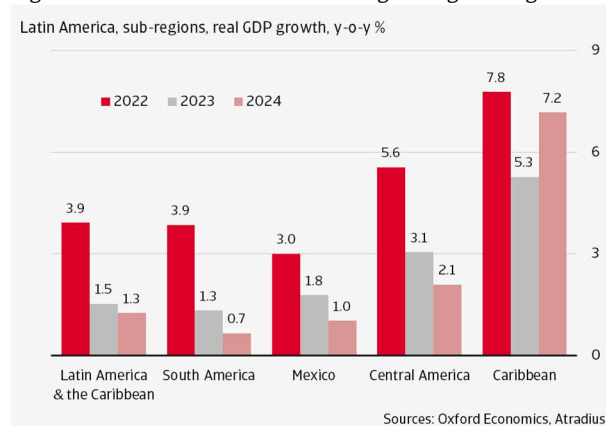
Next to the weaker external environment, elevated prices and tight financial conditions, the lacklustre economic outlook is due to policy uncertainty, limited room for fiscal support and most of all structural problems. Policy uncertainty is related to shifts in government in many countries over the past years. This reflected voters' discontent about drugs-related crime and violence and high inequality in income and access to healthcare and education,

<sup>2</sup> Atradius Economic Research, 'It's still all about inflation', 4 July 2023 [Economic Outlook - July 2023 | Atradius](#)

factors that also fuel social unrest. Policy uncertainty, social unrest combined with a challenging business environment constrain investments and the region's growth potential. These structural factors also explain the region's low global integration which makes it challenging for the region to benefit from nearshoring – a topic that we will explore more in depth in an upcoming research note.

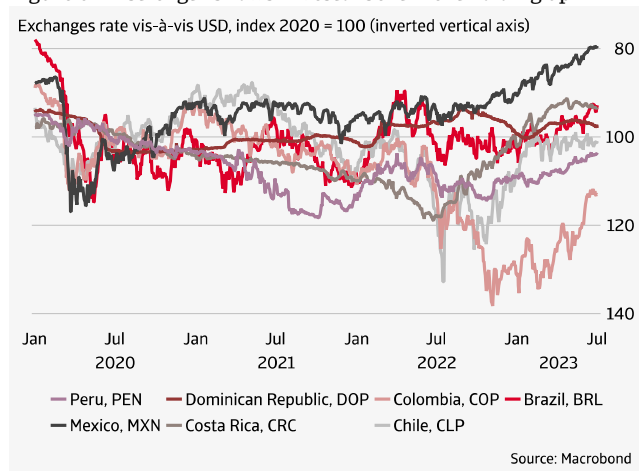
All-in-all, growth prospects are particularly weak in the region's largest economies. South America is the slowest growing sub-region (see figure 5) and Mexico is also facing meagre growth. Higher prices and the slowdown of the US economy are weighing on Central America's outlook as well. The Caribbean will keep its place as the fastest growing sub-region, with its largest economy, Dominican Republic, continuing with steady growth. Guyana will be the fastest growing economy in the western hemisphere over the forecast period as new oil production coming online ensures GDP growth above 35% per year.

**Figure 5 South America is the slowest growing sub-region**



To end on a positive note, much improved resilience will help most of the countries in the region to steer through this challenging environment. In fact, our modelling in the most recent Atradius Global Economic Outlook<sup>2</sup> shows that Latin America is the most resilient region to our downside global scenario of more persistent inflation and tighter credit conditions. This improved shock resistance is also what markets expect: the currencies of the region's largest countries among the world's strongest (see figure 6), despite a narrowing interest rate differential vis-à-vis the US. The most vulnerable countries are Argentina, Bolivia, Cuba, El Salvador and Venezuela – which have weak policy frameworks and low official reserves – and the smaller, less diversified islands in the Caribbean.

Figure 6 FX strength shows investor sentiment holding up



## South America: slow growth, high policy uncertainty

After a stronger than expected performance in 2022, we project economic growth in commodity-rich South America to fall from 3.9% in 2022 to 1.3% in 2023 and to ease further to 0.7% in 2024. This makes South America the weakest performing sub-region in Latin America. Next to a moderation of external demand and commodity prices and the lagged effects of high inflation and monetary policy tightening, country-specific factors weigh on South America's growth prospects. The region continues to deal with the effects of a wave of social unrest starting in late 2019, particularly in Bolivia, Ecuador, Chile, Colombia and Peru. Higher food and energy prices contributed to social pressures as well. This, combined with elevated policy uncertainty and governability challenges will undermine business sentiment and private investments in most of South America going forward.

Table 1 Real GDP growth, % - South America

	2021	2022	2023f	2024f
Argentina	10.7	5.0	-0.8	0.1
Bolivia	6.0	3.5	2.1	2.8
Brazil	5.3	3.0	2.5	0.4
Chile	11.9	2.5	-0.7	1.8
Colombia	11.0	7.3	0.2	-0.9
Ecuador	4.2	2.9	2.4	3.3
Paraguay	4.0	0.1	4.4	4.2
Peru	13.4	2.7	1.5	3.0
Uruguay	5.3	4.9	1.2	2.2
Venezuela	-4.1	12.3	0.8	0.0
<b>South America</b>	<b>7.5</b>	<b>3.9</b>	<b>1.3</b>	<b>0.7</b>

Sources: Oxford Economics, Atradius

### Box 1 Droughts contribute to social pressures

Periods of droughts are common in Latin America. They relate to the two opposing El Niño (warming) and La Niña (cooling) climate patterns in the Pacific Ocean that can affect weather worldwide causing heavy rainfall or droughts. But climate change also plays a role as it has increased the frequency, intensity and duration of heatwaves, reducing water availability and worsening the impact of droughts. Latin America is particularly vulnerable to such droughts, not just for its food production, but also for its electricity (mainly hydropower) and river transportation.

**Central Chile is since 2010 experiencing a 'mega drought' due to which over half of its population lives in an area suffering from "severe water scarcity". This puts Chile at the forefront of the region's water scarcity; Mexico is in second place.**

A three-year – unusually long - La Niña (2020-early 2023) resulted in a severe drought in **Northern Mexico** and **southern South America**, home to some of the world's largest producers of soy, corn and beef. Of these producers, Argentina was hit the most and to a lesser extent also Brazil (in 2020/21), Paraguay and Uruguay.

While La Niña has officially ended in March 2023, **El Niño has arrived and is likely to persist until 2024**, the US National Oceanic and Atmospheric Administration (NOAA) recently declared. This will bring – heavy - rainfall in South America's tropical west coast and Argentina, but droughts to the **north-eastern part of South America**, the **mid-centre of Brazil** (where over 70% of its electricity is generated) and to **Central America and the Caribbean**.

The upcoming drought would add to **food affordability challenges**. In most of the countries affected, food price inflation is already high between some 10%-17% in Central America (Panama being the exception) and some 14%-18% in Chile, Colombia and Peru in April 2023. Moreover, it could result in **food availability problems**. The most vulnerable countries are those with relatively low income and where drier-than-average weather conditions affect the entire crop cycle. This puts **lower middle-income countries in Central America and the Caribbean** at food security risk.

Finally, the upcoming drought could lift the region's **social pressures**. Water scarcity was an important factor driving protests in Chile and Northern Mexico. And research shows a correlation between droughts, food accessibility and availability, and urban conflict in the Central American Dry Corridor, an ecological zone stretching from Southern Mexico to Panama.

### Argentina: extreme drought adds to existing woes

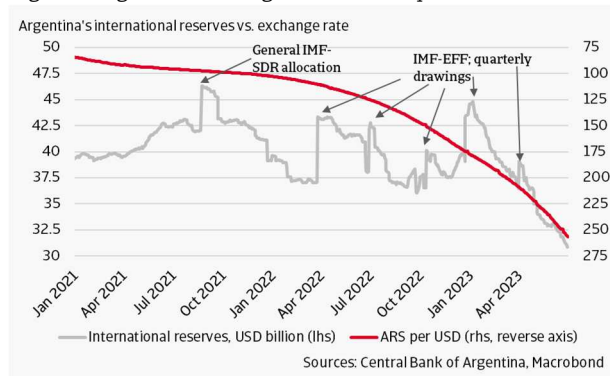
Following a stronger than expected expansion by 5.0% in 2022, driven by loose monetary and fiscal policies, Argentina's crises battered economy is facing a new crisis. The worst drought on record has severely darkened the outlook for its agriculture dependent economy, which is already struggling with spiralling inflation and a complicated web of price and currency controls. We project real GDP to contract by 0.8% in 2023 and to stagnate in 2024. The GDP contraction already started in the last quarter of 2022 due to some policy moderation under the current USD

44 billion IMF programme and will deepen in 2023 due to an estimated 36% drop in this season's corn and soybean output. This will have serious consequences for economic growth and external accounts: agriculture accounts for some 9% of GDP, a large part of the industrial sector consists of processing of agricultural goods, and over half of the export of goods consists of agricultural and food. Additionally, higher food prices due to the drought pushed annual inflation to 114% in May, despite price controls. More worrisome, core inflation, excluding food and energy prices, has accelerated and hit a new record high at 146% in May. This illustrates that recent policy setbacks have unanchored inflation expectations. In response, the central bank hiked the policy rate in several steps since March to 97% mid-May from 75% since October 2022. But this will do little as long as the root cause of high inflation, monetary financing of government spending, will not be addressed.

Stronger policies will be key to safeguard the IMF programme and restore macroeconomic stability. At the same time, the drought makes meeting the IMF targets all the more challenging, especially considering upcoming elections in October 2023. A shrinking economy and lower export receipts will make it difficult to meet the targets for the fiscal balance and official reserves. The latter are falling rapidly from already worrying low levels, despite suffocating and business unfriendly currency and capital controls (see figure 7). This reflects a run on the currency and a loss of confidence in policies.

In this environment, the risk of a disorderly devaluation of the Argentinian pesos (ARS) crawling peg to the USD is extremely high. The informal rate is at ARS 492.5 against the USD almost twice as high as the official rate of ARS 257. In our base scenario, we assume the government to increase the pace of the crawl to avoid a disorderly devaluation followed by a regime change, with the new government enacting more ambitious policy consolidation and business friendly policies. This, combined with a normalisation of the agricultural sector, will set the stage for a shallow economic recovery in 2024. But downside risks are extremely high.

**Figure 7 Argentina heading for a disorderly devaluation**



### Brazil: challenges delay monetary policy easing

After a surprisingly robust performance since the pandemic, we project Brazil's GDP growth to slow from 3.0% in 2022 to 2.5% in 2023 and to moderate further to 0.4% in 2024. As one of the first in the world, Brazil's central bank raised interest

rates sharply from 2% in March 2021 to 13.75% in August 2022, the highest in the region. This has reduced inflation from a peak of 12.1% in April 2022 to 3.9% in May 2023, and within the target band of the central bank (1.75%-4.75% in 2023). But it also slowed economic growth from 5.3% in 2021 to 3.0% in 2022. This slowdown will continue in 2023, despite a strong GDP expansion in the first quarter boosted by a record harvest. This is due to the lagged effects of high domestic interest rates, lower external demand and policy uncertainty. The latter keeps inflation expectations elevated and will delay the start of the monetary policy easing cycle (which we expect in the last quarter of 2023). Policy uncertainty stems from the change in government at the start of 2023 after the left-oriented former president Lula da Silva (2003-10) narrowly won the presidential election against the right-wing populist Bolsonaro. Economic policy will be more state-driven with higher social spending. This raised concerns about the credibility and future of the spending cap, an important anchor for public finances. Political pressure on the central bank to cut interest rates added to policy uncertainty.

We expect macroeconomic policy to stay broadly orthodox and the central bank to remain independent as pragmatism and a minority position in Congress will limit the risk of radical policies. Proposals for a new much-needed fiscal framework have just been passed by the lower house and are awaiting approval by the Senate. Additionally, the central bank has kept interest rates unchanged so far and although it acknowledged the proposals, it also indicated that an interest rate cut is not imminent. Both the proposals and central bank actions largely reassured investors. The sovereign CDS price has fallen from 250 bps at end-March to 174 bps by end-June. The real is among the world's strongest currencies this year and has appreciated by over 9% vis-a-vis the USD and illustrating Brazil's resilience.

Nevertheless, to put government debt (73% of GDP in April 2023) on a firm downward trajectory, the new rules need to be complemented with tax reforms to lift tax revenues - expected to be sent to Congress later this year. And as always, the proof of the pudding will be in the eating. As the effects of policy uncertainty and high interest rates will only slowly fade, we expect a further moderation of GDP growth in 2024. A normalisation of agricultural output and weak investment demand will outweigh positive effects from rising consumer demand on the back of falling inflation and improving global demand.

### Chile: dealing with aftereffects of overheating

Chile's economy was among the first to return to its pre-pandemic level, but we expect it to be among the poorest performers over the forecast period. We project real GDP to contract by 0.7% in 2023, before rebounding by 1.8% in 2024. Chile's strong recovery from the pandemic came at the cost of overheating and high inflation, exacerbated by Russia's invasion of Ukraine (CPI peaked at 14% in August 2022). Meanwhile, measures to address this - the withdrawal of fiscal support and raising interest rates from 0.5% in July 2021 to 11.25% in October 2022 - caused a sharp economic slowdown. Declining mining activity and policy uncertainty

due to the process of rewriting the constitution added to this. Real GDP started contracting in the course of 2022.

We expect this contraction to last well into in 2023 as still elevated inflation (CPI at 8.7% in May 2023), high interest rates and political uncertainty will continue to weigh negatively on consumption and investment. New mining projects and a more supportive global environment will bolster exports (particularly copper and lithium) and lead a tepid recovery. So will a gradual easing of monetary policy, which we expect to start in July 2023, assuming disinflation to continue and inflation expectations to fall within the central bank's 2%-4% target range. Upside surprises to the outlook come from stronger than expected demand from China (Chile's largest trading partner) and a smooth constitutional reform process. A more radical process or more state intervention in the lithium sector than we currently assume following the president's recently unveiled plans pose downside risks to the outlook.

**Table 2 CPI inflation, % - South America**

	2021	2022	2023f	2024f
Argentina	48.4	72.4	119.6	97.4
Bolivia	0.7	1.7	3.0	3.5
Brazil	8.3	9.3	5.0	4.2
Chile	4.5	11.6	7.9	3.2
Colombia	3.5	10.2	11.5	5.4
Ecuador	0.1	3.5	2.6	2.2
Paraguay	4.8	9.8	4.9	2.4
Peru	4.0	7.9	6.9	3.6
Uruguay	7.7	9.1	7.3	6.5
Venezuela	1588.5	147.1	45.6	38.0
<b>South America</b>	<b>42.6</b>	<b>22.8</b>	<b>17.8</b>	<b>13.9</b>

Sources: Oxford Economics, Atradius

### Colombia: Economy heading for a hard landing

After one of the fastest GDP-growth rates among emerging markets at 7.3% in 2022, Colombia's real GDP growth will decelerate to 0.2% in 2023 and contract by 0.9% in 2024. The combination of high inflation, high domestic interest rates, policy uncertainty, fiscal consolidation and slowing external demand, will drive the sharp slowdown. With the US being its main trading partner, Colombia is more exposed to a US slowdown than other countries in South America. Colombia's economy was the first country in the LAC region to recover from the pandemic. But the domestic demand-led expansion, supported by fiscal measures and several pension withdrawal bills, resulted in overheating. Consumer prices jumped from less than 2% in 2021 to 13.3% in March 2023, exacerbated by rising food and energy prices after Russia's invasion of Ukraine. In response, the central bank tightened interest rates from 1.75% in September 2021 to 13.25% in April 2023. We expect the central bank to remain on hold in 2023, as unlike in most other countries in the region, disinflation has just started. Annual consumer prices fell to 12.4% in May, still significantly above the central bank's 3% official target.

Elevated inflation, high interest rates and state-intervention in the energy sector under current president Gustavo Petro, Colombia's first left-wing president, will subdue private consumption and investments in 2023 and push the

economy in recession in the second half of this year. We expect this recession to last well into 2024. Next to a necessary correction of consumer demand from overheating, this has to do with the arrival of El Niño at the end of 2023. This will slow Colombia's disinflation process through its impact on food prices and delay the start of monetary policy easing.

### Peru: Political crisis, resilient economy

Amidst its deepest political and social turmoil in decades, economic growth in Peru will slow from 2.7% in 2022 to 1.5% in 2023, before rebounding to 3.0% in 2024. In December 2022, former president Pedro Castillo (2021-22) was ousted and replaced by his vice president Dina Boluarte. She is the sixth president in six years, illustrating rising political instability in the past years. Violent pro-Castillo protests followed, with mine closures and protesters demanding for Boluarte's resignation and new elections. Protests have eased since March 2023, but social unrest will stay high at least until the elections, which we expect to take place early 2024.

Social unrest and the lagged effects of tight monetary policy will reduce investments. Combined with a bad 2022-2023 harvest following a severe drought and fertiliser shortages this will weaken GDP growth in 2023. The main growth drivers are exports, albeit at a slower pace due to the global slowdown, and private consumption, supported by early pension withdrawals and government stimulus measures. These are necessary to maintain consumers spending power, considering sticky inflation resulting from protest induced supply chain disruptions and higher food prices following the bad harvest (CPI 7.9% in May from a peak of 8.8% in June 2022).

We expect the central bank to start an easing cycle in October 2023, provided that inflation expectations will converge towards its 1-3% target range. This and the expected fading of social unrest following 2024 early elections and expanding mining output and exports will drive the 2024 economic recovery. At an expected 30% in 2024, the GDP growth rate will be in line with its potential growth rate. Key downside risks are more persistent inflation due to the arrival of the El Niño phenomenon and new bouts of social unrest. El Niño brings heavy rain and floods in Peru's northern agricultural coastal areas, which could result in crop failures, transport problems, higher food prices and a delay in monetary policy easing. Upside surprises to the outlook might come from stronger than expected demand from China (Peru's largest trading partner).

### Smaller markets dealing with governability and weather challenges

Of the regions smaller markets, a political crisis in **Ecuador** clouds the economic outlook after president Lasso dissolved the National Assembly, bringing forward general elections. This followed a second impeachment attempt against the president in one year amid frustration about a sharp rise in homicides in the past two years and rising food prices.



Meanwhile, in **Bolivia**, worries about a disorderly devaluation of its currency peg dampen its growth prospects. Due to unorthodox policies, its official reserves continue to fall, despite higher energy prices. A severe drought and weaker growth in Argentina and Brazil will slow down **Uruguay's** GDP growth in 2023. With consumer prices falling from 10% in October 2022 to 7.1% in May 2023 and core inflation under control, the central bank felt confident enough to start its easing cycle. In April, it cut rates by 25 base points to 11.25%. With rainfall returning in **Paraguay**, boosting agriculture and – hydro - energy production, this country will be the region's star performer over the outlook period. El Niño however is a major downside risk to the 2024 outlook as flooding could damage harvests and raise transportation costs. Finally, despite a strong 2022 outcome, **Venezuela's** oil-dependent economy was still only a quarter of its size prior to its long depression, from 2014 to 2020. This reflects years of economic mismanagement, a lack of financing, sanctions and on declining oil production. Oil production is rising since 2021, but still below its pre-pandemic level. Meanwhile, the outlook is poor as capacity constraints limit future oil production, while unorthodox policies have fuelled inflation and undermined the business climate.

## Mexico and Central America: exposure to US slowdown

After a reasonably strong performance in 2022, we expect growth in Central America to moderate from 5.6% in 2022 to 3.1% in 2023 and 2.1% in 2024, around the region's modest pre-pandemic growth rate. The region has strong trade and investment linkages with the US, through the Dominican Republic-Central America free trade agreement with the US (CAFTA-DR), among others. The US is also home to over 7 million immigrants from Central America. The money they sent back home – remittances – offered a lifeline during the pandemic and also mitigated the impact of higher energy and food prices in the past years. As a net importer of energy and food, importing some 60% of the cereal it consumes, the region is highly vulnerable to these higher prices. In particular in El Salvador, Guatemala, Honduras and Nicaragua remittances grew strongly since 2020 (see figure 8). This reflects altruism and improved labour conditions in the US, and for Nicaragua mass emigration to the US due to increased repression. However, going forward, weaker growth in the US will weigh on remittances, exports and foreign direct investments.

Meanwhile, annual food price inflation in most countries in the region remains elevated, trending between 10.1% (Costa Rica) and 15% (Honduras) in April 2023, with Panama (4.8%) being the exception. This will slow the disinflation process in most countries, particularly in the region's poorest countries Honduras and Nicaragua, and also weigh on the growth outlook. We expect El Salvador and Nicaragua to be the regions weakest performers. Country specific factors also explain their subdued growth outlook. Poor access to international financial markets, due to sanctions (Nicaragua) or high risk of debt distress (El Salvador), a weak rule of law

(both countries) and increasingly unorthodox policies (El Salvador) curtail private investments in these countries. We expect Panama to be the region's strongest performing country, underpinned by mining and public investment.

Figure 8 Strong remittances mitigated impact of global headwinds, but will this last?

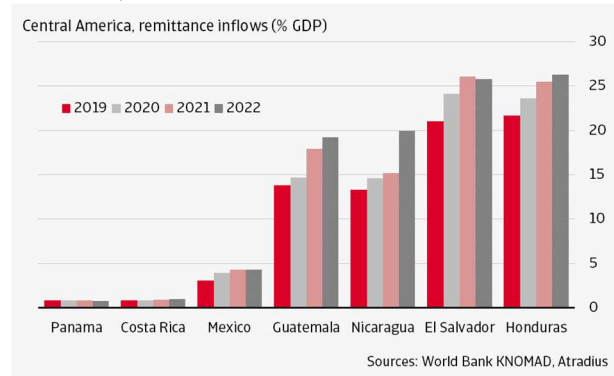


Table 3 Real GDP growth, % - Central America & Mexico

	2021	2022	2023f	2024f
Costa Rica	7.8	4.3	3.0	2.0
El Salvador	11.2	2.6	1.6	0.7
Guatemala	8.0	4.1	1.9	2.1
Honduras	12.5	4.0	2.5	2.6
Nicaragua	10.4	3.8	0.7	0.2
Panama	15.8	10.8	5.7	2.9
<b>Central America</b>	<b>10.5</b>	<b>5.6</b>	<b>3.1</b>	<b>2.1</b>
<b>Mexico</b>	<b>4.9</b>	<b>3.0</b>	<b>1.8</b>	<b>1.0</b>

Sources: Oxford Economics, Atradius

### Mexico: stuck in low gear

After one of the slowest and still incomplete recoveries from the pandemic, we project Mexico's real GDP growth to weaken from 3.0% in 2022 to 1.8% in 2023 and 1.0% in 2024. As the most open and US-dependent economy among the region's largest markets, Mexico is highly exposed to the US economic slowdown. This will curtail exports and inward remittances. Moreover, the lack of fiscal support during the pandemic will leave lasting scars on Mexico's economy like permanent business closures and lower quality jobs. Furthermore, business unfriendly policies under President López Obrador, in power since December 2018, will continue to curtail domestic private investments. Finally, still elevated inflation and the lagged effects of monetary policy tightening will restrain domestic consumer demand and business investment. Consumer prices rose from slightly over 2% prior to the pandemic to a peak of 8.7% in August and September 2022; Russia's invasion of Ukraine and a severe drought in Northern Mexico lifted food and energy prices even higher.

In response, the central bank lifted interest rates from 4% in June 2021 to 11.25% in March 2023. Although inflationary pressures have eased to 5.8% in May, consumer prices remain above the 2-4% target range of the central bank. Also, core inflation (excluding food and energy), remains elevated at 7.4% in May 2023. And with wage increases in the manufacturing sector being relatively high as well, we expect the central bank to remain very cautious. It also may take up to the last quarter of 2023 before it starts an easing

cycle. Combined with ongoing state intervention in the energy sector, this will slow the economy in 2024 as well. That said, strong foreign direct investment inflows could result in upside surprises to the near growth outlook. These flows came primarily from multinationals already operating in Mexico and illustrate that the president's business unfriendly policies have so far not scared them off.

**Table 4 CPI inflation, % – Central America & Mexico**

	2021	2022	2023f	2024f
Costa Rica	1.7	8.3	3.9	3.1
El Salvador	3.5	7.2	2.6	0.3
Guatemala	4.3	6.9	6.9	4.3
Honduras	4.5	9.1	7.4	4.8
Nicaragua	4.9	10.5	8.1	4.8
Panama	1.6	2.9	2.6	2.0
<b>Central America</b>	<b>3.4</b>	<b>7.4</b>	<b>5.2</b>	<b>3.2</b>
<b>Mexico</b>	<b>5.7</b>	<b>7.9</b>	<b>5.6</b>	<b>3.9</b>

Sources: Oxford Economics, Atradius

### Costa Rica: fiscal consolidation slows growth

After a strong rebound from the pandemic, driven by the exports of medical supplies, Costa Rica's recovery lost momentum due to global headwinds. We expect real GDP growth to moderate further from 4.3% in 2022 to 3.0% in 2023 and 2.0% in 2024. Slowing global demand and ongoing fiscal consolidation under the IMF-programme (2021-24) will outweigh the positive impact of significant disinflation on economic growth. Annual consumer price inflation fell from a peak of 12.1% in August 2022 to 0.9% in May 2023, below the lower bound of the central bank's 2% to 4% target range. This reflects a cooling of domestic demand and enabled the central bank to begin monetary policy easing.

In March 2023, Costa Rica's central bank became the first in Latin America to cut interest rates; two more cuts followed in April and June. These steps have brought the policy rate down from 8.5% to 7.0%. However, at this level, financial conditions are still tight. And we do not expect this to change anytime soon. The central bank will be cautious about lowering interest rates. In June, it slowed the pace of rate cuts, stating that risks were tilted towards higher inflation. This has to do with the arrival of El Niño. Tight financial conditions will for some time constrain private investments and weigh on next year's GDP growth. That said, the outlook for private investments is overall positive, considering Costa Rica's attractive business climate, market-friendly and orthodox economic policies and its OECD accession in 2021.

### Caribbean: highest but most fragile growth outlook

The Caribbean is the fastest growing sub-region in LAC but – with the Dominican Republic a notable exception – this growth is more vulnerable to external shocks than that in Central and South America due to lack of diversification and limited policy room. We expect aggregate GDP growth in the region to slow to 6.9% in 2023, from a strong 11.2% expansion last year, dragged down by higher inflation. Economic growth is likely to pick up to 9.7% in 2024 but this figure headline figure masks wide disparities in growth. The

Caribbean is generally characterised by two types of economies: tourism-dependent like the Bahamas and Jamaica, and commodity exporters like Guyana and Trinidad & Tobago. The latter group are expected to grow 12.8% this year and 15.8% next, led by Guyana's rapidly expanding energy sector. Prospects for tourism-dependent countries are much more subdued on the other hand with 3.1% and 2.5% expansions expected.

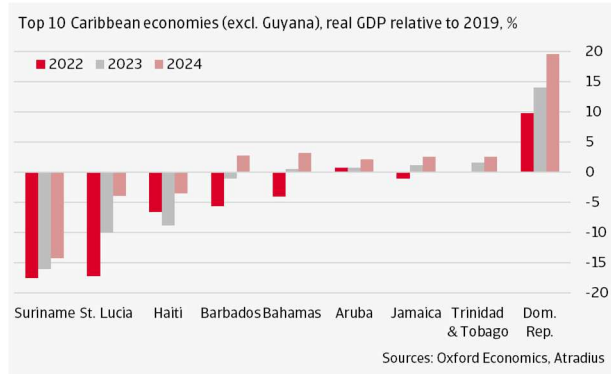
**Table 5 Real GDP growth, % - Caribbean**

	2021	2022	2023f	2024f
Tourism dependent	5.6	6.1	3.1	2.5
Commodity exporters	3.0	20.9	12.8	15.8
<b>Caribbean</b>	<b>3.1</b>	<b>11.2</b>	<b>6.9</b>	<b>9.7</b>

Sources: Oxford Economics, Atradius

As primarily small, island economies, the Caribbean has been one of the hardest hit by the challenging global developments underway. Supply chain disruptions and dependence on food and energy imports has pushed regional inflation into double digits since 2022. High regional GDP growth in 2022 was driven by an ongoing recovery in the tourism sector from its deep contraction in the pandemic while rallying global commodity prices contributed to strong growth in commodity exporters as well. But still, region-wide tourism only reached 84% of its pre-pandemic levels and most economies' output levels remained below pre-crisis levels.

**Figure 9 Caribbean economies still recovering pandemic losses**



Of the Caribbean's 10 largest economies, only three have recovered to their 2019 levels. Guyana's economy, not included in the figure, already nearly doubled its pre-crisis size in 2022 as its emerging energy sector continued to propel its GDP growth at the highest global rate. Trinidad & Tobago, the region's other largest commodity exporter saw its economic activity just match 2019 levels thanks to higher global prices for hydrocarbons but production remains well below pre-crisis levels. The Dominican Republic has already grown some 10% since the pandemic and is set to continue growing steadily. Most other economies are only expected to barely recover to pre-pandemic levels over the forecast period. This is especially the case for tourism-based economies struggling with both higher domestic prices and lower demand from tourism source markets, especially the US.

While the Caribbean leads Latin American growth rates, the past few years highlight the intensifying need for many island economies to diversify, but progress here is slow. The

list of countries around the world most dependent on tourism for GDP, exports and employment is dominated by Caribbean countries (half the top 20 of the Tourism Dependency Index). Public debt levels are at historical highs – Suriname, Barbados and Dominica have government debt above 100% of GDP while Antigua & Barbuda, Bahamas and St. Lucia have debt surpassing 90% of GDP. Fiscal space is limited by narrow revenue bases and higher recent spending to counter pandemic losses and the cost of living crisis. Several countries operate under fiscal responsibility frameworks and IMF programmes to help improve fiscal discipline and improve shock resilience but progress is slow. Overall, the Caribbean’s outlook is moderately positive, but vulnerability to global inflation as well as food security pose significant downside risks.

**Table 6 CPI inflation, % - Caribbean**

	2021	2022	2023f	2024f
Tourism dependent	2.2	6.5	5.0	2.8
Commodity exporters	19.5	19.6	17.4	12.0
<b>Caribbean</b>	<b>6.7</b>	<b>11.0</b>	<b>9.8</b>	<b>5.6</b>

Sources: Oxford Economics, Atradius

### **Dominican Republic: bright spot in LAC shines due to sound policy framework**

The Dominican Republic, the Caribbean’s largest economy, is also losing some steam this year, with real GDP growth slowing to 3.8% from 4.9% in 2022. But its growth prospects in H2 and 2024 are improving and we expect an acceleration to 4.9% in 2024, bucking the regional deceleration trend. The IMF flags the Dominican Republic as “one of the most dynamic and resilient in the Western Hemisphere over the last two decades” in its 2023 Article IV consultation,

underpinned by strong macroeconomic policies and institutions. The short-term slowdown is in part due to slowing tourism as the sector accounts for 17% of GDP and 16.7% of employment. While workers’ remittances inflows (8% of GDP) have surpassed pre-pandemic levels, they’re also faltering as the US economy slows. With income strained by easing tourism and remittances, soaring inflation – especially fuel price – has further strained purchasing power. But the prospects for the Dominican Republic are improving.

The most central promising development is that price pressures are beginning to ease. The central bank (BCRD) raised its policy rate by a cumulative 550 bps since November 2021 to 8.5% which has helped contain price pressures by peso appreciation and kept inflation expectations anchored. Sound policy management has helped ease the burden of the cost-of-living shock on consumers and the fiscal risks have remained contained. Both headline and core inflation have shown a sustained decline since Q2 2022 and headline inflation at 4.4% in May, is back within the central bank’s 3% to 5% target range. This has allowed the BCRD to begin easing its monetary policy in May this year, cutting rates twice already to 7.75%. Furthermore, strong institutions are underpinning the Dominican Republic’s status as an attractive investment destination. The tourism sector’s outlook is improving thanks to USD 3.6 billion in private investment secured to improve hotels and open new flights to and from Europe.

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