

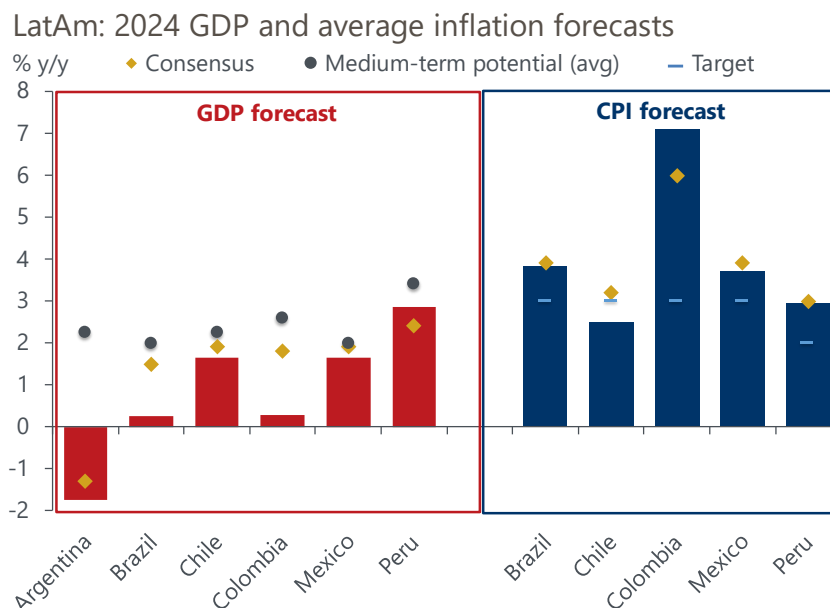
## Research Briefing | Latin America

# Key themes 2024 – Slower growth, but it’s not all bad news

- Overall, we think four key themes will dominate the outlook for Latin America in 2024.
- **Growth in most LatAm economies will be below consensus.** Economic momentum has surprised to the upside through most of 2023, but the full effects of record global and domestic monetary tightening are yet to be seen.
- **Inflation will continue to cool faster than markets expect, but most central banks will still miss their targets.** Fading distortions in core prices will take over from the initial disinflationary push caused by falling imported inflation. However, adverse weather conditions and geopolitical tensions in the middle east could revive non-core price pressures.
- **Central banks will cut rates faster than markets expect.** Markets will change their view of permanently-tight monetary policies once the Fed start to soften its tone.
- **Most countries plan to slow fiscal consolidation efforts with their 2024 budgets.** Mexico's fiscal position will worsen substantially as AMLO plans an electoral spending spree. Debt in the short term will be manageable for most, but soaring borrowing costs will add medium-term risks.
- **We are much more optimistic than markets on sovereign risk in four economies: Colombia, Mexico, Ecuador, and Dominican Republic.**

Our forecast for Latin America remains below consensus both on GDP and, to a lesser extent, inflation. We believe that the accumulated impact of record restrictive monetary policy warrant caution, especially as LatAm's commodity exporters also face headwinds from a [slowdown in China](#). Most countries also face idiosyncratic domestic risks from volatile political and social environments. This scenario is consistent with our baseline of additional monetary policy normalization in the region, but the trend will not be enough to compensate the accumulated effect of high rates debt accumulation. Our projections are based on our view that the post-pandemic boom won't be sustained. We expect the major economies, except Argentina, to continue growing in 2024, but base effects and lower statistical carry-overs will distort comparisons.

Chart 1: Below potential growth will allow inflation to cool



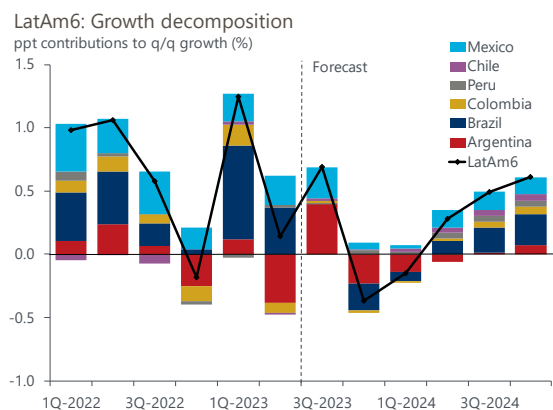
Source: Oxford Economics/Haver Analytics

# Key themes 2024 – Slower growth, but it's not all bad news

## Growth in most LatAm economies will be below consensus in 2024

Our baseline forecasts are for recessions starting this quarter in Brazil and Argentina, while Colombia could experience only a mild technical one. This will drag down the regional aggregate and will distort growth comparisons between countries (**Chart 2**).

### Chart 2: LatAm will start 2024 on a weak footing



Source: Oxford Economics

All countries face tight global monetary conditions, but domestic dynamics will vary. We expect Mexico to outperform most regional peers for the second consecutive year. The country continues to benefit from the [resilience of the US economy](#) and domestic fiscal support. We now believe that the country could avoid a recession, but GDP growth will slow to 1.7% from our estimate of 3.3% in 2023.

We expect Argentina to fare worse than regional peers in 2024 with a 1.7% GDP contraction. Rampant inflation and the necessary fiscal adjustment will drag on growth.

Brazil's technical recession will be mostly tied to fading support from the bumper harvest that boosted growth in H1. This will provide a negative carry-over for 2024 and will limit growth to just 0.2% growth.

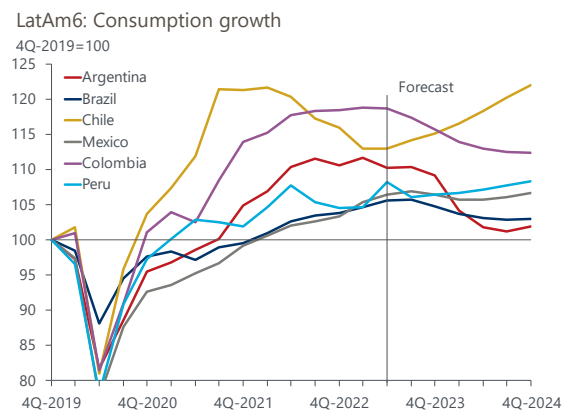
Growth in Colombia will continue to be meagre over 2024, as high inflation and interest rates stunt activity. The negative carry-over from a weak H2 2023 will limit growth to a meagre 0.3% GDP expansion next year.

Meanwhile, Peru and Chile will likely avoid recessions on the back of base effects and fading distortions. The correction in the Chilean economy is mostly over as the country was the first one to start cooling from the post-pandemic

surge in early 2022. Thus, we expect the economy to expand 1.6% next year. In Peru, fading shocks from adverse weather conditions and social unrest should allow growth to rebound 2.8% from our 0.1% estimate for 2023.

Across the region, we anticipate a rotation in the force of key drivers that will slow overall growth. The recovery in tourism, strong remittances, and real wage gains have supported a boom in consumption since the pandemic (**Chart 3**). However, the accumulated drag from record restrictive monetary policy and [cooling labor markets](#) will limit growth, especially as distortions in consumer patterns caused by the pandemic fade.

### Chart 3: Consumption growth is cooling after surprising to the upside in early 2023



Source: Oxford Economics/Haver Analytics

Upside risks materialized in 2023, but the tables could turn in 2024. Unexpected consumer resilience to tightening financial conditions lifted our 2023 growth outlook. This upside risk could also be a factor next year if tightness in the labor market supports consumer confidence.

On the other hand, downside risks are substantial. The slowdown in advanced economies and China could potentially offset the benefits of spikes in commodity prices caused by the intensification of geopolitical tensions in the middle east and the war in Ukraine.

In addition, adverse weather conditions caused by El Niño could impact regional exports of agricultural commodities – particularly relevant for Brazil and Argentina. The effects of the phenomenon will differ across crops and might hit countries at different times, but climate change has already caused severe distortions. In Argentina, a record drought crippled the country's large agricultural sector in Q1, but

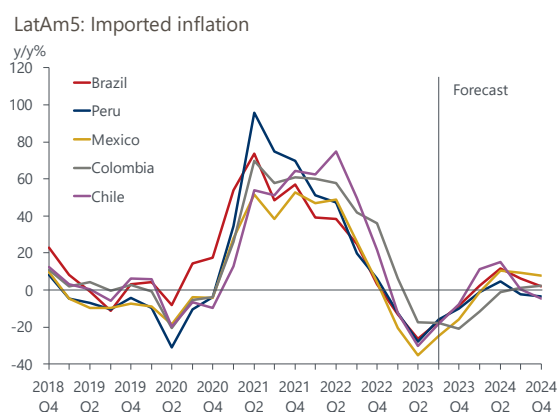
# Key themes 2024 – Slower growth, but it's not all bad news

Brazil's benign weather brought a bumper harvest in the same period.

## Inflation will cool faster than markets expect, but will remain above targets

Cooling growth should support disinflation momentum. The initial disinflationary drive from lower imported inflation and commodity prices has likely ended (**Chart 4**). Not only have international commodity prices stabilized, but currency gains have halted.

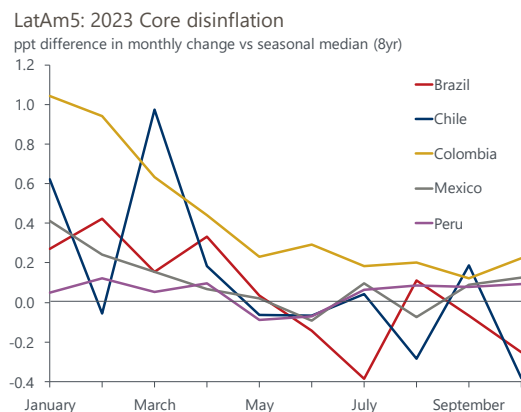
### Chart 4: Disinflationary support from falling imported inflation peaked in Q2



Source: Oxford Economics/Haver Analytics

Instead, we expect core inflation to continue to slow in line with cooling aggregate demand. Core dynamics seem to be stabilizing as supply-chain distortions fade and the accumulated impact of lower imported inflation continues to feed through. This allowed core inflation to return to its seasonal median and even undershot it in Brazil and Chile (**Chart 5**).

### Chart 5: Distortions in core prices are fading



Source: Oxford Economics/Haver Analytics

Inflation in most countries will only return to target ranges in late 2024, but all central banks

will miss their specific objectives. We expect Chile's inflation to undershoot the 3% target in Q4 2024, while inflation in Mexico, Brazil, and Peru will only fall to levels close to their upper bound limits (4% in Mexico and Brazil; 3% in Peru). In Colombia, we expect convergence to the target range to be delayed to H2 2025 due to structurally sticky inflation and the ongoing unwinding of fuel subsidies.

Geopolitical tensions and adverse weather conditions (mentioned above) also pose upside risks to inflation. But sharp swings in fresh food and energy prices are a norm in the region and we expect limited passthrough into core prices if shocks to commodity prices prove transitory.

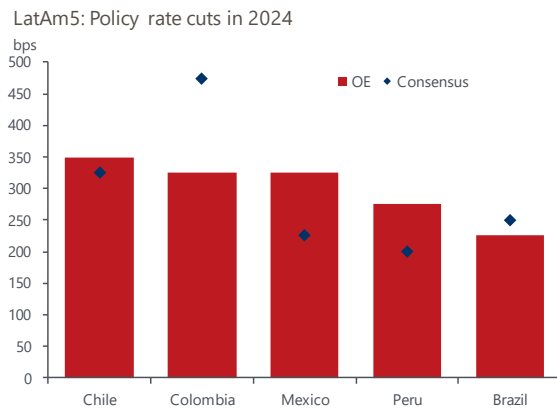
## Central banks could surprise markets with additional cuts

Our call last year on a broad start of policy normalization cycles in the region ahead of that in advanced economies was correct. Central banks in Chile, Brazil and Peru started to cut rates in mid-2023. Colombia's BanRep could join the club in December; Mexico's Banxico will be the only central bank to start in 2024.

Next year, we expect Chile's BCCh to cut another 350bps to 5% by December. Likewise, we expect BanRep to cut the policy rate by 325bps to 9.75%, and Peru's BCRP could implement cuts of 275bps to 4%. We forecast Brazil's BCB will cut the policy rate only 225bps to 9.5%.

Meanwhile, Banxico's traditional hawkish bias is more obvious than ever. Unlike its regional peers, economic momentum remains strong and market inflation expectations remain fixed above the target. Thus, we expect Banxico to be the last of the regional central banks to start the normalization cycle in February next year. We now forecast a cautious 325bp cycle to 8% by the end of next year, 100bps below consensus.

**Chart 6: We expect larger cuts than consensus in Mexico, Peru, and Chile**



Source: Oxford Economics/LatinFocus Consensus Forecast Nov. 2023

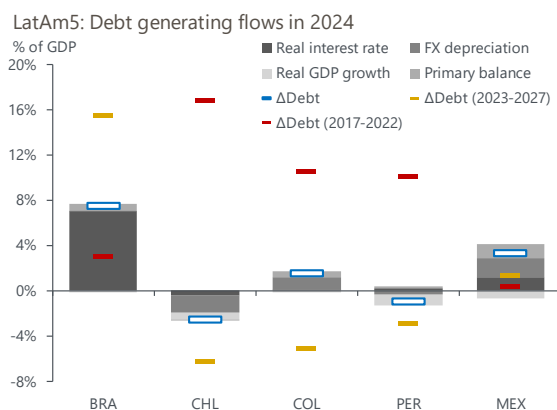
Our baseline is still consistent with restrictive real forward rates well into 2024 and early 2025. However, markets and consensus have not yet fully priced-in the extent of the easing cycles.

We acknowledge that persistent upside risks to inflation and the likelihood of renewed financial volatility will weigh on the speed of the normalization cycle. That said, slowing economic momentum should provide enough room for central banks to reduce their highly restrictive monetary policies.

## A high-rate environment will add to pressure on public finances.

Fiscal consolidation efforts since the pandemic have been offset by soaring borrowing costs. Moreover, 2024 budgets contemplate a relaxation in public finances. The effect of larger deficits and high borrowing costs will be more notable in Brazil, but it will also add a substantial burden to Mexico (Chart 7).

**Chart 7: Brazil will need the largest fiscal consolidation effort**



Source: Oxford Economics/Haver Analytics

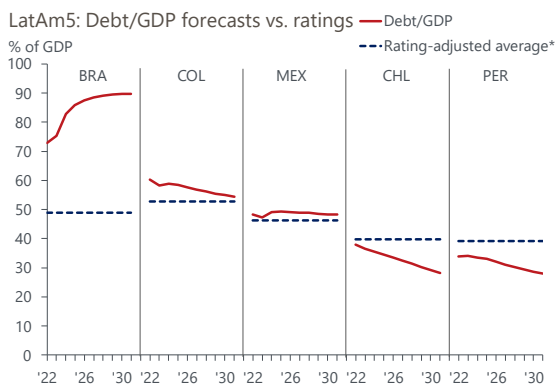
Brazil's fiscal position is becoming more lax in President Lula's third term. We expect the fiscal deficit to increase to 8.7% of GDP next year, larger than our 8% estimate for 2023. However, this is not solely attributable to wider primary deficits, but rather to an outsized burden of 6.9% of GDP from high real interest rates.

Meanwhile, Mexico's fiscal position will deteriorate markedly next year as President AMLO's electoral spending spree will cause the primary deficit to increase to 1.2%, a 20-year record. This, together with high borrowing costs and likely peso depreciation, will bring the largest debt-generating flow since 2016 (excluding the pandemic shock).

Still, we think the deterioration in Mexico's fiscal position could be transitory. GDP growth and inflation alone will not be enough to contain debt in the near term, but we expect the next administration to revert the primary balance back to surplus once AMLO's key infrastructure projects (0.6% of GDP) are finally paid off and direct support to Pemex (0.5%) reduced. However, it will require additional cuts to AMLO's social programs (2.2% of GDP), so incentives will be against the interest of the next administration.

Slow medium-term growth and slowing inflation will fuel the debt burden across the region. However, debt levels will remain manageable for most countries except Brazil, which will require substantial efforts to curb growing debt (Chart 8). We forecast Brazil's public debt-to-GDP ratio will increase by over 10ppts by 2026 in our baseline – before the end of the Lula's third term. By bootstrapping historical public debt drivers, we estimate a 34% probability that the debt-to-GDP ratio will exceed 90% by 2030.

**Chart 8: Debt levels remain consistent with credit rating averages**



\*Min-max debt/GDP bands for peers within the same rating grade in 2022

Source: Oxford Economics

## Markets are too pessimistic on sovereign risk in several economies

On credit, we favor Ecuador and Dominican Republic. Despite political fragmentation, President-elect Daniel Noboa's administration should be able to secure the official support needed to close financing gaps and lift bond prices. We think the most recent sell-off is unwarranted.

We've also been positive on Dominican Republic for a while given that our fair value model indicates spreads were high compared to sound external and fiscal fundamentals. The country's sovereign risk score has improved and is at historic lows. But that gap has shrank now, so we think upside is more limited.

In local-currency bonds, we like Colombia and Mexico. Colombia's inflation is more persistent than elsewhere, but market pricing implies unrealistically high real policy rates in the next year. In Mexico, markets underestimate the scope for disinflation and have overreacted to an expansionary 2024 budget. Despite FX overvaluation, we expect strong returns on Mexican bonds.

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