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Key takeaways

- *Global factors shaped financial conditions in Latin America in 2025, with exchange rate appreciations against the US dollar loosening conditions in most countries.*
- *Short-run monetary policy transmission in the region operates through financial conditions. In general, monetary easing leads to looser financial conditions and faster short-term output growth.*
- *Measurement of overall financial conditions depends on the methodologies and assumptions used to construct financial conditions indices (FCIs). Understanding these differences helps central banks to use FCIs as an input to monetary policy.*

Financial conditions tend to influence an economy's macroeconomic outcomes. A financial conditions index (FCI) aggregates a range of financial variables into a single metric to provide a concise snapshot of the cost and availability of financing to economic agents such as households, firms and the government. An FCI can be a valuable tool to monitor and assess the state of financial markets. For central banks, this is crucial for providing insights into how the monetary policy stance is transmitted through financial conditions, which serve as an intermediate step in the policy transmission process (see eg BIS (2025) and Lombardi et al (2025)). However, their measurement can vary depending on the source consulted, at times sending mixed messages. This happens as the construction of an FCI for the same country and period can differ among institutions, and their economic diagnoses do not always converge. Understanding these differences can be useful for central banks using FCIs.

This Bulletin examines the construction and use of FCIs in emerging market economies (EMEs), focusing on Latin America. First, it describes the main differences in the ways FCIs are constructed, highlighting how, for the same economy and period, conclusions drawn from FCIs by different institutions can diverge. Next, using a unified methodology, it analyses developments in financial conditions in five major Latin American countries between January and July 2025. Perhaps the most notable finding is that foreign and global factors such as exchange rate appreciation against the US dollar or a general weakening of the dollar loosen financial conditions in Latin America. Finally, it discusses the implications for monetary policy, showing that policy easing tends to loosen financial conditions, which positively affects output growth in Latin America in the short run.

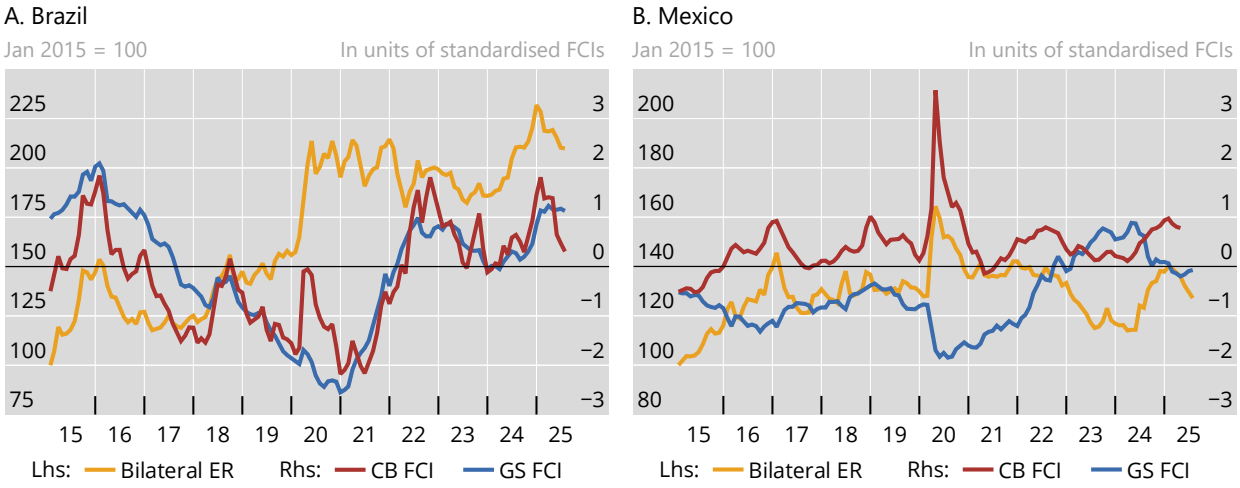
Construction of financial conditions indices

FCIs can be constructed to capture the impact of financial variables on output, but the methodologies vary across institutions such as central banks, international financial institutions and private sector financial institutions. The widely used Goldman Sachs (GS) FCIs feature domestic risk-free rates exerting a significant

influence on financial conditions and exchange rate depreciation against the US dollar generally easing financial conditions.[1, 2]

While these assumptions are well suited to major advanced economies (AEs), they may not align with the dynamics in EMEs.[3] In particular, FCIs developed by Latin American central banks indicate that local currency depreciation against the US dollar typically tightens financial conditions. For example, comparing the official FCIs published by the central banks of Brazil and Mexico with the corresponding GS FCIs during key episodes of financial stress – such as the Covid-19 pandemic – reveals stark differences. During this period characterised by sharp exchange rate depreciation, heightened risk premia and elevated volatility, the official FCIs indicated a tightening of financial conditions, whereas the GS FCIs suggested a loosening (Graphs 1.A and 1.B). For these two economies, the policy implications of such divergence could be significant, potentially sending mixed signals to the private sector.

Central bank and private sector FCIs can diverge for EMEs[1] Graph 1



[1] Bilateral ER = bilateral exchange rate against the US dollar; CB FCI = financial conditions index from central bank websites; GS FCI = Goldman Sachs financial conditions index. A higher value of an FCI means tightening financial conditions. A higher value of the bilateral exchange rate means a depreciation of the local currency against the US dollar.

Sources: Bloomberg; Goldman Sachs; national data; authors' calculations.

When we compare FCIs among four Latin American central banks, we find that most of the central banks make their index methodologies transparent and provide a decomposition of the FCI that explains its main drivers (Table 1). However, only two make the FCI data publicly available.

The publication frequency and methodology of FCIs vary across the central banks. The Central Bank of Brazil, Central Bank of Colombia and Bank of Mexico regularly publish FCIs, while the Central Reserve Bank of Peru publishes FCIs on an ad hoc basis.[4] In particular, the Central Bank of Brazil reports its FCI quarterly in its Monetary Policy Report, and the Central Bank of Colombia includes its FCI in the minutes of its monetary policy decisions, while the Bank of Mexico reports its FCI semiannually in its Financial Stability Report. In terms of methodologies, FCIs in three out of the four Latin American central banks are

[1] For details on the GS FCI, see Hatzius and Stehn (2012). This index is based on a modified version of the Federal Reserve's FRB/US Model (Reifschneider et al (1999)).

[2] Note that some papers (eg Arregui et al (2018)) do not include an exchange rate in FCIs since they argue that an exchange rate in and of itself does not measure the cost and availability of funding.

[3] Patelli et al (2023), Gelos et al (2024) and Hofmann et al (2025) show how EME currency depreciation against the dollar tightens financial conditions via capital flows or local currency bond yields in EMEs.

[4] The Central Reserve Bank of Peru regularly publishes a financial stress index instead of an FCI.

designed to assess the tightness of financial conditions relative to historical standards, while the Central Bank of Brazil measures the level of the tightness of financial conditions based on their impact on GDP growth.

Financial conditions indices in four Latin American central banks

Table 1

	Publishing frequency	Methodology	Breakdown provided? (Y/N)	Main purpose
BR	Quarterly. Reported in every Monetary Policy Report.	Considers seven blocks of variables: (1) domestic interest rates; (2) foreign interest rates; (3) risk; (4) currencies; (5) oil prices; (6) commodities; and (7) capital markets. Weights are based on principal component analysis.	Y	Impact of financial conditions on GDP growth
CO	Reported each time the minutes of monetary policy decisions are published.	Considers six variables: (1) interest rate spreads; (2) deviations in inflation expectations and uncertainty around those expectations; (3) GDP growth expectations; (4) confidence indices; (5) EMBI spreads; and (6) equity volatility. The methodology for aggregating weights is not specified.	N	Tightness of financial conditions by historical standards
MX	Semiannually. Reported in every Financial Stability Report.	Considers 18 variables covering eight blocks: (1) money market; (2) debt market (sovereign and corporate); (3) country risk; (4) equity market; (5) foreign exchange market; (6) others; (7) external financial conditions; and (8) macroeconomic variables. Weights are based on dynamic factor analysis.	Y	Tightness of financial conditions by historical standards
PE	No specific frequency. An FCI was proposed in the September 2024 Inflation Report.	Considers six variables for the local currency-denominated FCI: (1) three-month prime lending rate in local currency; (2) 10-year sovereign bond yield; and four spreads: (3) domestic interbank rate vs federal funds rate; (4) 10-year sovereign bond yield vs US Treasury yield; (5) three-month prime lending rate in local currency vs central bank securities rate; and (6) 10-year sovereign bond yield vs three-month central bank securities rate.[1] Weights are based on principal component analysis.	Y	Tightness of financial conditions by historical standards

[1] A foreign currency-denominated FCI is also proposed for the Peruvian economy. This index uses five variables: the interbank overnight rate in foreign currency, the three-month prime lending rate in US dollars, the 10-year yield of the Global Bond (the generic bond of the government of Peru denominated in US dollars), the spread between the three-month prime lending rate in US dollars and the interbank overnight rate in domestic currency, and the spread between the 10-year Global Bond yield and the 10-year US Treasury yield. It follows the same methodology as that for the local currency-denominated FCI.

Source: Central bank websites.

FCIs are an important tool for central banks, enabling them to assess complex financial developments in a clear way. Many central banks also provide a breakdown of their FCIs, along with an explanation of the factors driving financial conditions. For instance, the Bank of Mexico publishes detailed breakdowns, highlighting the main drivers. The Central Bank of Brazil also publishes the breakdown of its FCI into the broad domestic and foreign components and seven sub-components.

Financial conditions in Latin America in 2025

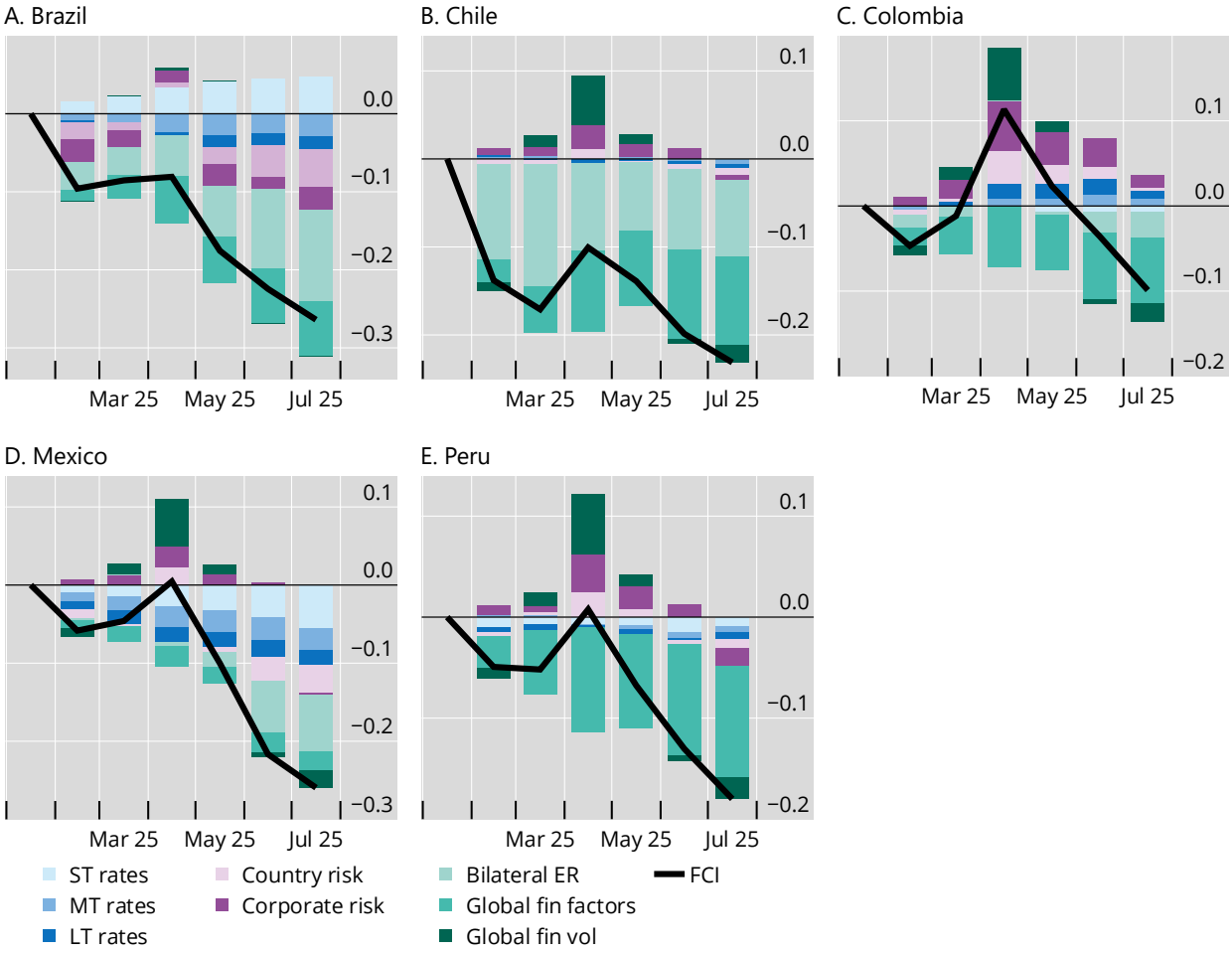
Constructing and monitoring FCIs can provide valuable insights into the economic outlook. We estimate an FCI considering both domestic and foreign/global factors to analyse key developments in Latin America during 2025.[5] Using the unified methodology for five economies – Brazil, Chile, Colombia, Mexico and

[5] Our FCI consists of three blocks of financial variables. The first focuses on domestic factors, specifically risk-free interest rates across short-, medium- and long-term maturities. The second also centres on domestic factors but incorporates risk premia, including the five-year sovereign CDS spread and the spread on US dollar-denominated corporate bonds. The third block is foreign/global factors, encompassing the bilateral exchange rate against the US dollar (as a foreign factor), the broad US dollar index and US long-term Treasury yields (as proxies for global financial conditions); and the Merrill Option Volatility Estimate

Peru – we find that foreign and global factors significantly influenced the region's FCIs during the first seven months of 2025 (Graph 2). In particular, the general weakening of the US dollar measured by the decline in the broad US dollar index (green bars) and the appreciation of local currencies against the US dollar (light green bars) generated a risk-on tone in financial markets and significantly contributed to easing financial conditions in all Latin American countries. The region experienced financial vulnerabilities from large swings in exchange rates and capital flows in the past, which partly explains the fact that regional currency appreciation tends to ease financial conditions. However, global financial volatility (dark green bars) acted in a countervailing manner, tightening financial conditions, particularly in April 2025.

Foreign and global factors have significantly eased FCIs in Latin America in 2025[1]

Index, January 2025 = 0 Graph 2



[1] ER = exchange rate; LT = long-term; MT = medium-term; ST = short-term. Global financial factors include the nominal broad US dollar index and long-term US Treasury yields, while global financial volatility is measured by the Merrill Option Volatility Estimate (MOVE) Index.

Source: Authors' calculations.

The heterogeneity in FCIs across the Latin American countries is largely driven by idiosyncratic developments in domestic factors. For instance, reductions in policy rates in Chile, Mexico and Peru lowered short-, medium- and long-term interest rates (light blue, blue and dark blue bars, respectively, in Graphs 2.B, 2.D and 2.E), which contributed to loosening financial conditions during the first seven months of 2025. In contrast, increases in the policy rate in Brazil were conducive to tighter financial conditions

(MOVE) index (as a proxy for global financial market volatility). The weights reflect the impact of financial conditions on GDP growth in one year.

during this period, but declines in its medium- and long-term rates helped loosen financial conditions (Graph 2.A). Similarly, rising medium- and long-term bond yields – primarily driven by higher risk premia – contributed to tighter financial conditions in Colombia (Graph 2.C). Finally, nearly all countries faced a tightening of financial conditions in April due to higher sovereign and corporate credit risks (pink and purple bars, respectively).

Implications for monetary policy

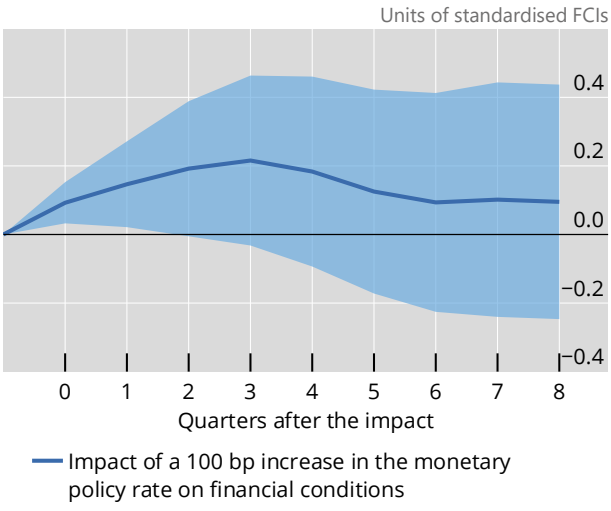
The analysis of FCIs in Latin America highlights important implications for monetary policy. First, FCIs can act as a specific yardstick for central banks to manage the pace of policy rate adjustments. They provide real-time information on financial market responses, helping central banks to better calibrate their policy stance. Empirical evidence suggests that monetary policy has generally been effective in influencing financial conditions in the short run in Latin America over the past decade (Graph 3.A). Therefore, if financial conditions tighten too rapidly, central banks may opt to moderate the speed of rate increases to keep from destabilising financial market dynamics or triggering sharper than expected economic fluctuations.

Second, FCIs can be useful when financial conditions move in the opposite direction to the one expected based on policy rate changes. For example, an EME central bank may reduce its policy rate to ease financial conditions through lower short- and long-term interest rates. However, higher risk premia – driven by factors such as increased uncertainty or credit risk – could simultaneously push up long-term yields, offsetting the overall loosening effect of lower short-term rates. In addition, a simultaneous strengthening of the US dollar could tighten financial conditions in the EME. These examples highlight potential challenges in the transmission of monetary policy.

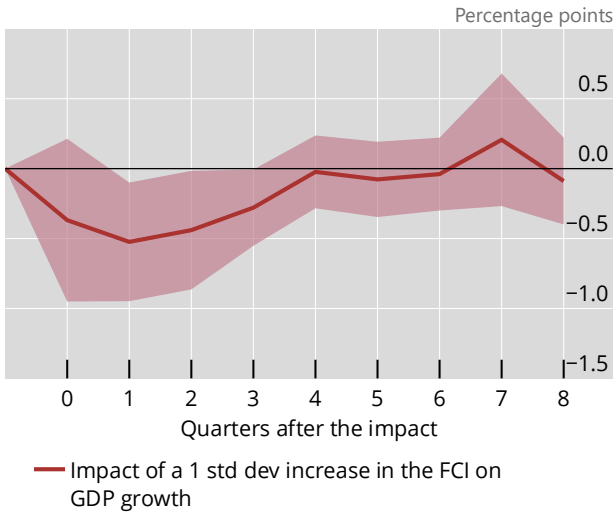
Third, FCIs are relevant for real economic activity, and as an input for monetary policy assessment process. A one standard deviation tightening of the FCI is associated with a 0.5 percentage point decline in the pace of GDP growth after one quarter (Graph 3.B). This implies that sharp movements in global factors – such as a significant strengthening of the US dollar – could tighten financial conditions in the

Monetary policy can influence output through financial conditions in Latin America[1] Graph 3

A. Monetary policy effectively influences financial conditions



B. Tightening FCI is associated with lower GDP growth



[1] Based on a panel local projection à la Jordà (2005) using data for Brazil, Chile, Colombia, Mexico and Peru, covering the period from Q1 2007 to Q2 2025, with 95% confidence intervals.

Source: Authors' calculations.

region, weighing on growth. These insights are particularly valuable to help EME central banks manage spillover risks from AEs.

Overall, FCIs are a useful analytical tool for central banks, offering insights into how the monetary policy stance is transmitted through financial conditions, which act as an intermediate step in the monetary policy transmission process. This is particularly important for assessing the extent to which domestic financial conditions are influenced by domestic monetary policy as opposed to foreign monetary policy.[6] At the same time, it should be acknowledged that FCIs do not necessarily identify whether supply or demand side factors drive changes in financial conditions, which is an important aspect for a central bank when it takes monetary policy decisions.

For central banks in Latin America, FCIs are especially valuable given the region's experience in assessing and preventing financial vulnerabilities from building up in response to large swings in exchange rates and capital flows (Tombini et al (2023)). By providing a comprehensive view of financial market developments, FCIs enable central banks to evaluate the implications of financial conditions for monetary policy and financial stability, facilitating informed decision-making in an increasingly complex and interconnected global environment.

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[6] See Rey (2015) and BIS (2025) for detailed discussions on this aspect.