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Challenges ahead for central banks in the Americas

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Introduction

Today, we gather at a crucial moment for the global economy. We face significant, perhaps unprecedented, policy uncertainties. A main driver of this uncertainty is trade tensions. Beyond tariffs, even some of the very foundations of the multilateral global trading system are being questioned and the risks of a broader trade war are rising. Against this backdrop, many companies have started to question the viability of their business models, such as supply chains integrated across borders and the nearshoring of production. Signs are emerging that these significant uncertainties are having an effect on growth prospects in major economies. Countries in the Americas must therefore navigate through turbulent waters. As I will argue below, the region must balance the need for resilience with the pursuit of growth and stability. Robust and adaptable policy frameworks will be essential in addressing these challenges and seizing the opportunities that lie ahead.

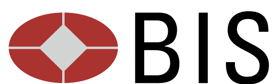
These events take place on top of significant shifts in the global economy after the Covid-19 pandemic. After a period of synchronised economic activity, inflation and monetary policy, economic developments have become more diverse and complex. Macroeconomic divergence has led to divergence in monetary policy, for instance between the United States and Europe, and within the Americas.

Over the next 20 minutes, I will discuss the implications of these policy shifts for financial markets and their impact on Latin America and the Caribbean. I will then conclude with some policy recommendations. While the challenges for policymakers and businesses are daunting, policymakers can build on the robust policy frameworks in much of the region.

A changing global outlook

The global outlook has changed significantly since the beginning of the year. The policy shifts announced by the US administration generated considerable uncertainty in the global economic environment. Shifts in trade are already occurring, contributing to heightened trade uncertainty (Graph 1.A). Changes in other policies like migration and fiscal policies, including tax reforms and government

[1] The views expressed are my own and not necessarily those of the BIS. I thank Ana Aguilar, Eduardo Amaral, Torsten Ehlers, Ilhyock Shim and Christian Upper for their input, and Berenice Martinez and Rafael Guerra for research support.



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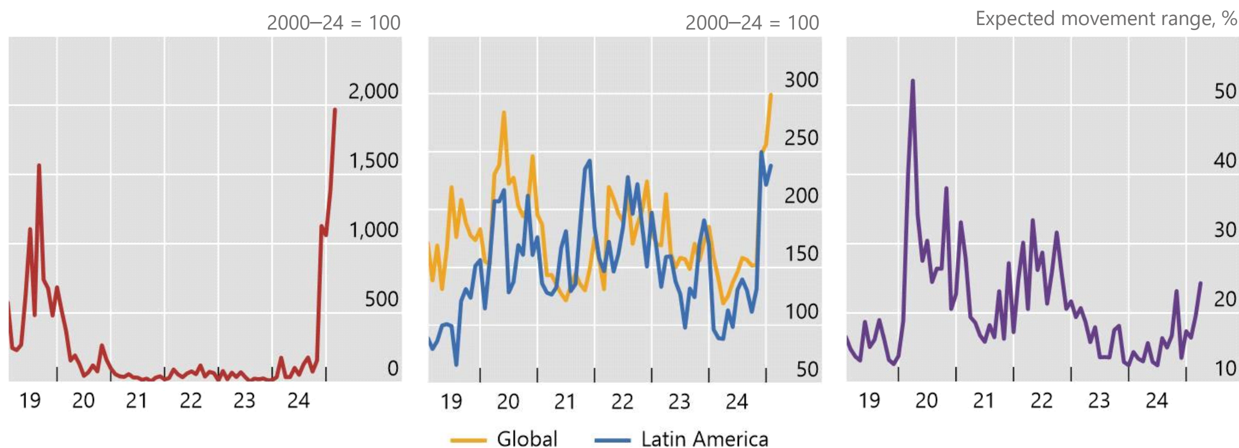
spending and operations, add to uncertainty. Indeed, policy uncertainty indicators have increased sharply (Graph 1.B). This was accompanied by significant market volatility, as illustrated by the sharp rise in the VIX (Graph 1.C).

Risks and uncertainty | Graph 1



[1] Latin America denotes the average figures of available data for the region: BR, CL and MX.

Sources: Baker et al (2016); Bloomberg; BIS.

To understand the effect of this uncertainty on the economy and financial markets, let me take a step back and look at the global backdrop. After the unusual synchronisation during and after the pandemic, the outlook for growth and inflation has grown more uneven across regions. Some economies are experiencing a robust expansion, while others see moderate or slow growth. Inflation has come down to target levels in some countries but remains persistently above target in others.

One of the drivers of the change in the global outlook has been the United States. In the fourth quarter of 2024, US growth moderated but remained resilient. Consumer spending continued to be a key driver of growth, even as investment declined. The February 2025 Consensus Economics report predicted an expansion of 2.2% in 2025 (Graph 2.A). Some expected policy changes, such as deregulation and tax cuts, supported expectations of robust growth and consumer optimism. These were also reflected in financial variables, as I will discuss later.

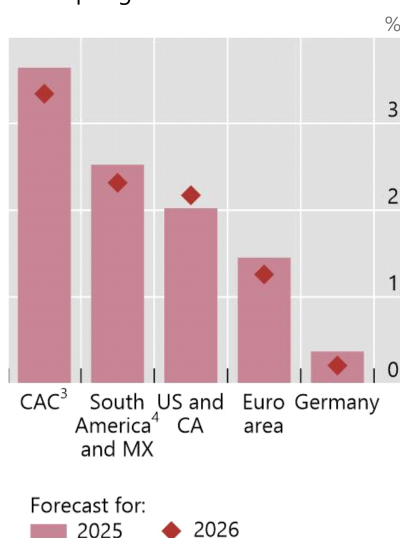
However, in recent weeks, several indicators were on the soft side, calling into question the previous solid outlook for the US economy. Consumer sentiment fell, while delinquency rates of consumer and credit card loans went up. Savings amassed by households during the pandemic were depleted. Future updates in growth projections will include some of the effects of tariffs and uncertainty and may show less resilience.

At the end of 2024, forecasters were less optimistic about the outlook for the euro area, expecting growth just above 1%. But recent announcements of additional fiscal spending on defence and

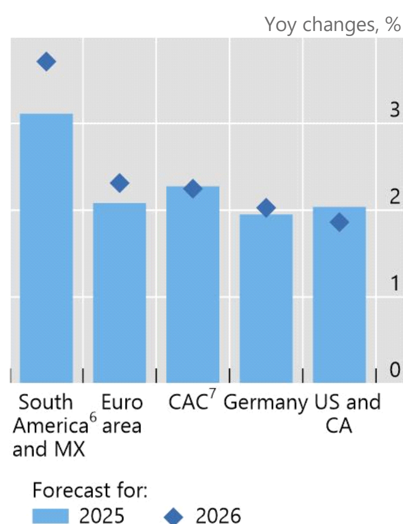
infrastructure in Europe, most prominently in Germany, boosted market sentiment. The Chinese economy achieved the official growth target of 5.0% in 2024, driven by strong growth in the fourth quarter on the back of various stimulus measures. But domestic headwinds and trade tensions also make it harder to achieve the unchanged growth target this year.

Outlook for growth and inflation has become more uneven across regions — Graph 2

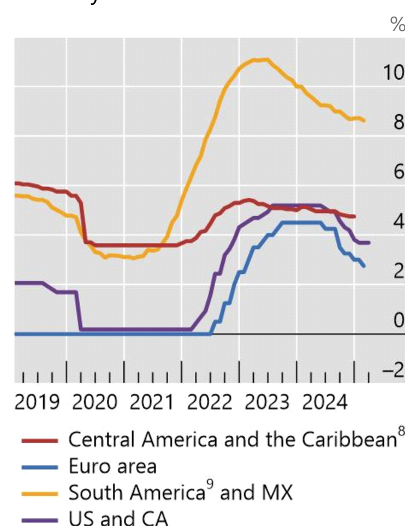
A. Output growth[1,2]



B. Headline inflation[1,5]



C. Policy rates[5]



[1] Forecasts from the IMF, *World Economic Outlook*, October 2024. [2] GDP weighted average for each region. [3] CAC = Central America and the Caribbean: AG, BB, BS, BZ, CR, DM, GD, GT, KN, LC, PA and VC. [4] AR, BO, BR, CL, CO, EC, PE and UY. [5] Mean across each region. [6] BO, BR, CL, CO, EC, PE and UY. [7] CAC = Central America and the Caribbean: AG, BB, BS, CR, DM, GD, GT, KN, LC, PA and VC. [8] BB, BS, BZ, CR, Eastern Caribbean Central Bank and GT. [9] BR, CL, CO, EC, PE and UY.

Sources: IMF; LSEG Datastream; national data; BIS.

Economic developments in other countries in the Americas were also uneven. In 2024, GDP growth was robust in countries such as Brazil, Chile and Peru and various countries in Central America (Graph 2.A). By contrast, growth remained subdued in Canada and Mexico. Economic performance within the Caribbean also varied.

Price trends showed that the last stage of the disinflation process was more difficult. Inflation returned to target in a few economies but remained above in most (Graph 2.B). A particular case is Brazil, where inflation declined until the beginning of the second quarter of 2024 and subsequently increased.

Looking ahead to 2025, economic activity in most major economies in the region is expected to decelerate, with inflation likely to remain above the midpoint of most central banks' target ranges.

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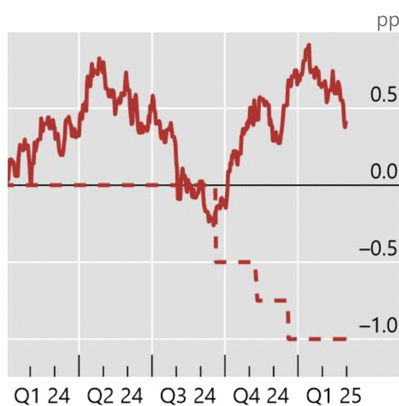
Diverging monetary policies, bond yields and international portfolio rebalancing

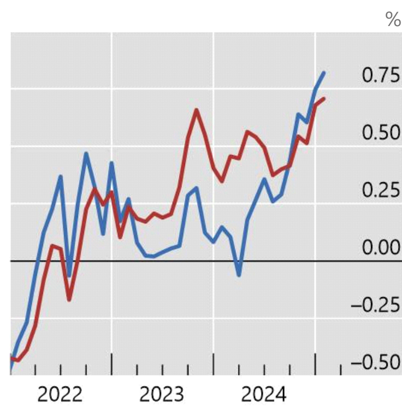
Reflecting these diverging output and inflation trends, central banks across the world's major economies entered 2025 at different stages of their monetary policy cycles (Graph 2.C). Analysts anticipated further rate cuts in several countries and a pause in others. For Brazil, they predicted further rate hikes despite already high real rates.

Long-term yields rose across advanced economies and later reversed — Graph 3

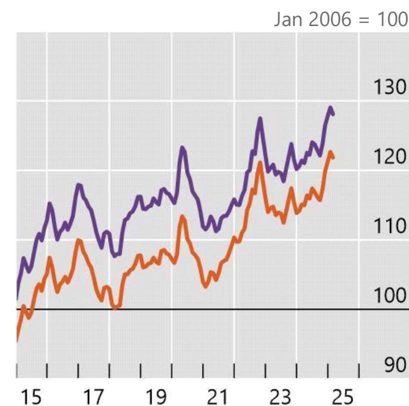
A. Long-term yields increased…



B. …with added pressure from term premia



C. US dollar indices[1]



[1] Monthly data of Federal Reserve board trade-weighted real/nominal US dollar index, based on trade in goods and services. An increase indicates appreciation of the US dollar.

Sources: Hördahl and Tristani (2014); Federal Reserve Bank of St Louis, FRED; Bloomberg; national data; BIS.

If we go back to 2024, long-term government bond yields rose across the board even though short-term interest rates declined as central banks cut policy rates (Graph 3.A). A yield decomposition exercise shows that the sharp rise in US yields around the turn of the year was mainly due to higher real term premia (Graph 3.B).[2] The increase in term premia could point to a reduced appetite by market participants for absorbing ever more public debt. Rising term premia are generally driven by higher uncertainty about future rates. This suggests that other factors also played a role. During this period

[2] BIS (2025).

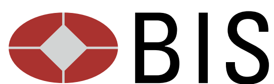
the US stock market and the dollar were still reflecting relatively strong US economic growth and expectations of continued resilience (Graph 3.C).

In mid-January, sentiment changed and expectations shifted. Treasury yields and stock prices started to decline and the dollar to depreciate. These developments accelerated in mid-February. While market participants and analysts initially saw tariff threats as a short-run negotiation tactic, they started to have doubts. Although analysts are still working out the implications of the announced policy shifts, it appears that they mostly expect higher tariffs to reduce economic growth in the United States and other countries. The effect on inflation is less clear since tariffs are inflationary in the short term but the disinflationary effect of lower growth may dominate in the medium term.

A rebalancing of global portfolios may be under way. The US stock market has taken a hit. Until January, stock prices had been supported by strong gains of the magnificent seven[3] AI-related and tech stocks, but this weakened in February. Price dynamics suggest that investors have shifted their portfolios not only towards US Treasuries, but also towards European, eg German, and Chinese equity markets (Graph 4.A). Bond yields in Germany rose significantly on the back of expectations of increased spending, particularly on defence and infrastructure.

The outlook for monetary policy also shifted. In the United States, markets had anticipated a halt in rate reductions. Instead, expectations for cuts throughout 2025 increased. Conversely, markets now expect fewer rate cuts in the euro area (Graph 4.B). The change in the monetary policy outlook is also reflected in volatility indicators for the US Treasury market (Graph 4.C). Taken together, these developments are consistent with the recent depreciation of the US dollar. Despite these adjustments, a significant gap remains between financial indicators and growth perspectives in the United States and Europe, although it may be narrowing.

[3] Refers to seven large US technology companies that have had significant influence on the stock market.



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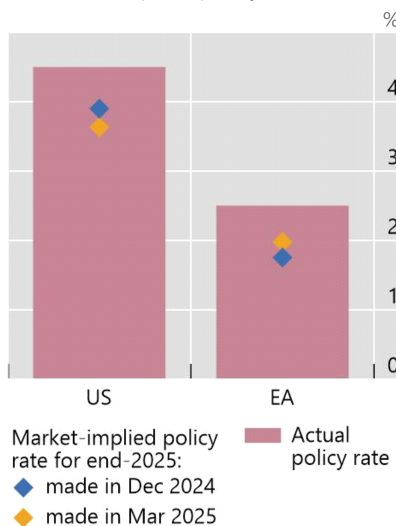
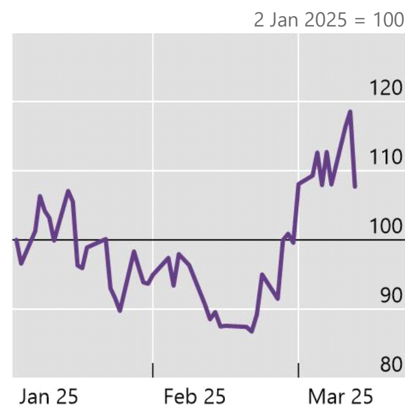
A rebalancing of the global portfolio may be under way Graph 4

A. Equity markets

B. Market implied policy rates



C. MOVE Index



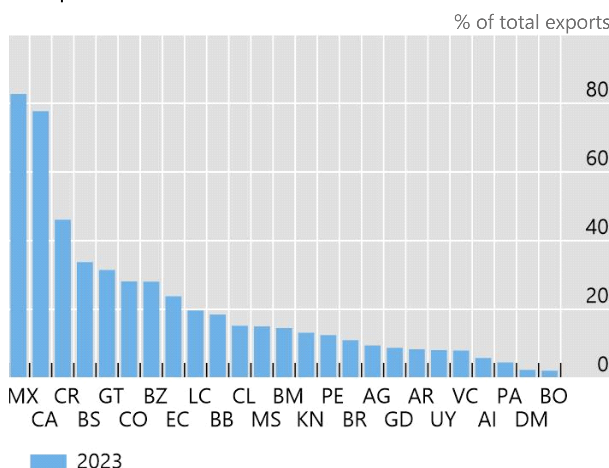
Sources: Bloomberg; BIS.

Latin America and the Caribbean in turbulent waters

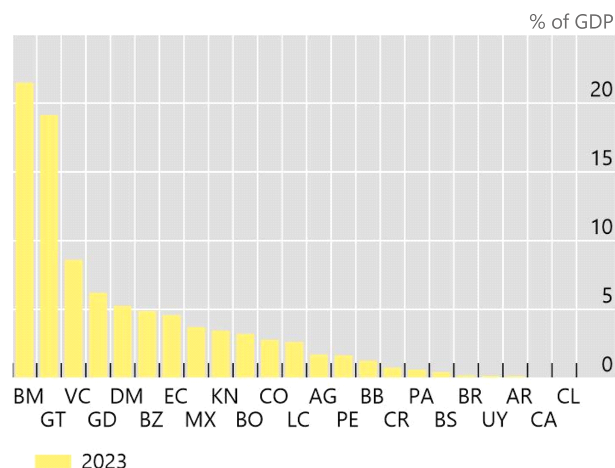
Let me now zoom in on Latin America and the Caribbean. This region is navigating through a period of significant uncertainty and potential realignment in its trading relationships. Indeed, the exposure of several economies to the United States via exports is high, above 20%. Mexico has the highest exposure with 80% of its exports to the United States (Graph 5.A).

High exposure of several economies to the United States — Graph 5

A. Exports to the United States



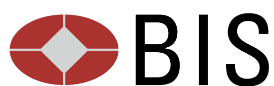
B. Personal remittances, received



Sources: IMF; World Bank.

Potential changes in US migration policies are another major challenge. It is not yet clear how policies will be implemented and with what impact. But it is clear that it may be difficult for countries to absorb a larger number of returning workers and integrate them into the labour market. Many economies in the region also depend on remittances, which may suffer from stricter migration policies. First of all, this is a social problem, as remittances are a vital source of income for many families. But it is also a macroeconomic problem, as they are a significant contributor to national economies. One economy in the region received over 20% of GDP in remittances in 2023. For many others, remittances are above 3% (Graph 5.B).

The impact of recent developments on commodity prices remains uncertain and could vary significantly across the region. Tariffs and other protectionist measures may lead to a major rerouting of commodity flows, resulting in price volatility. For example, tariffs on commodities like copper lead to price fluctuations and may force major exporters to find new markets. Weakening demand from China, a major consumer of commodities, could dampen prices further. This is particularly concerning for countries where commodity exports account for a larger part of their economic growth (Graph 6.C).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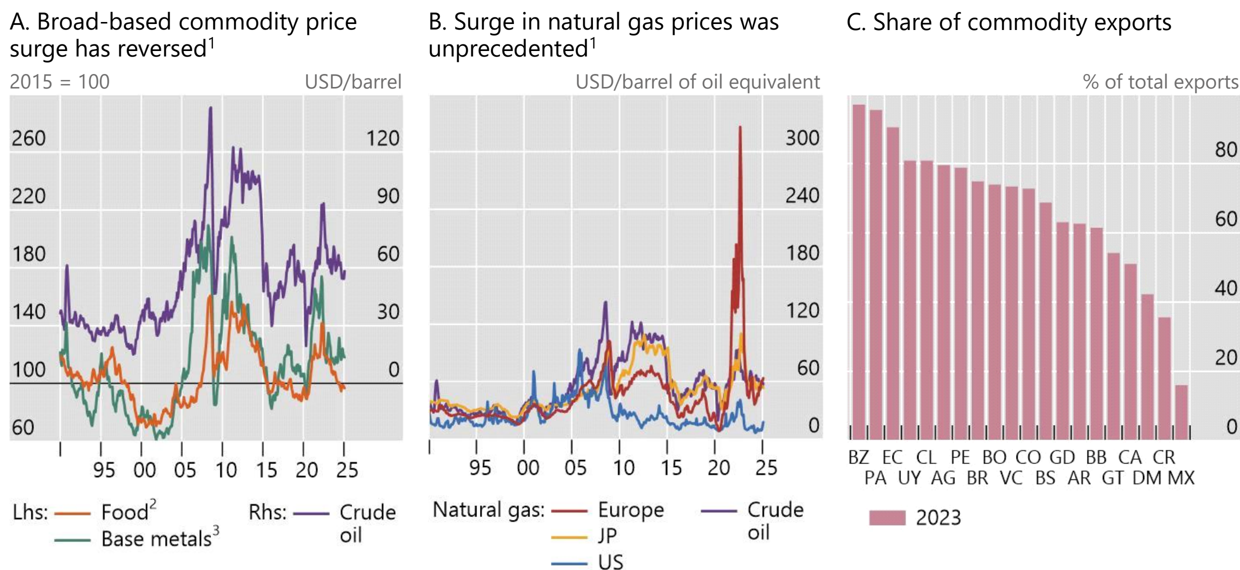
The impact of recent developments on commodity prices could affect the region Graph 6



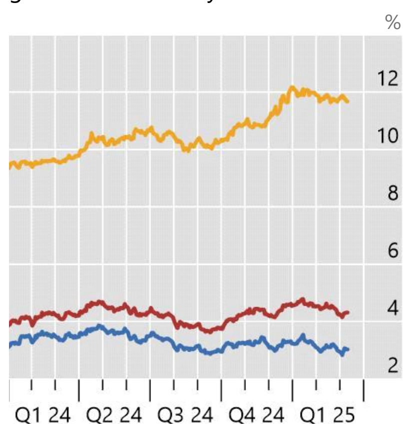
[1] Real prices (deflated with US CPI, 2015 = 100). [2] Weighted average prices of cereals, oils and other food items. [3] Weighted average price of aluminium, copper, iron ore, lead, nickel, tin and zinc.

Sources: World Bank; national data; BIS.

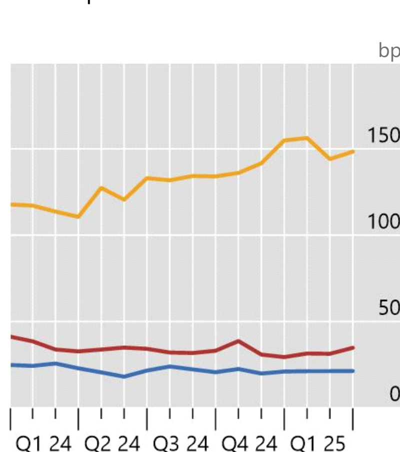
This global backdrop has implications for financial markets in Latin America and the Caribbean. In the last quarter of 2024, a strong US dollar and higher US Treasury yields led to more restrictive global financial conditions. Even though the US dollar and US Treasury yields receded in recent weeks, elevated uncertainty could weigh on capital flows, weaken domestic currencies and increase risk premia. Several financial indicators showed this evolution with a deterioration in the last quarter of 2024 and later a reversal. Five-year government bond yields rose in several economies of the region despite cuts in policy rates (Graph 7.A). The concurrent increase in the credit default swap premium indicates that this could reflect, in part, a rise in risk premia during the last quarter of 2024 (Graph 7.B). Exchange rates exhibited similar behaviour, with sharp depreciations of most currencies in the fourth quarter of 2024 (Graph 7.C).

Financial conditions tightened in 2024 and then reversed in Latin America — Graph 7

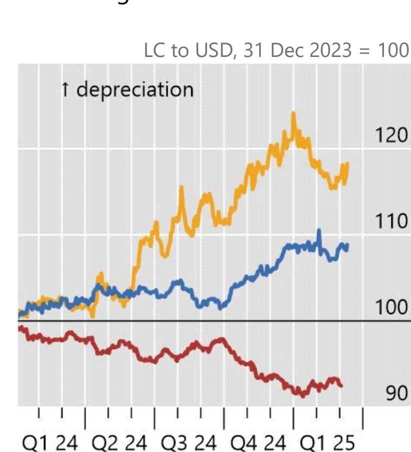
A. Ten-year local currency government bond yield



B. CDS premia[1]



C. Exchange rates[3]



US — CA — Latin America[2]

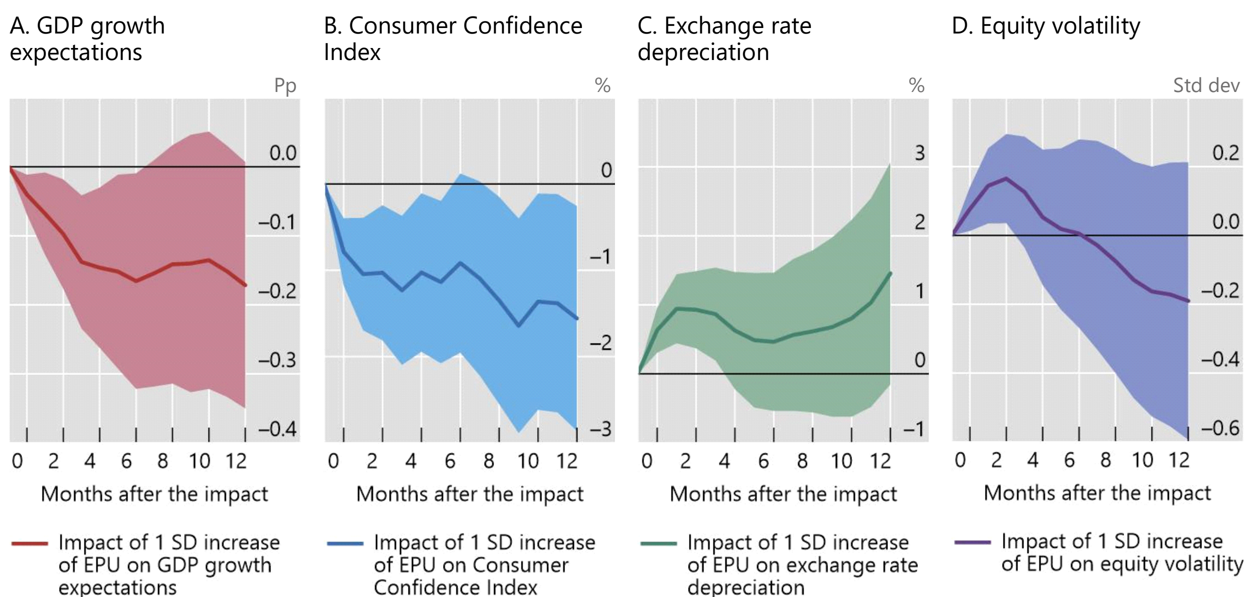
[1] Monthly average of daily five-year sovereign credit default swap (CDS) spreads. [2] GDP-PPP weighted average for BR, CL, CO, MX and PE. [3] For US, Federal Reserve trade-weighted nominal dollar index, broad, based on goods trade.

Sources: Federal Reserve Bank of St Louis, FRED; IMF; Bloomberg; Markit; BIS.

As is widely known, higher uncertainty affects financial asset prices, leading investors to demand greater compensation for holding assets. This can result in more frequent and pronounced market swings as investors react to new information or changing conditions. Research from the BIS Americas Office indicates that increased economic policy uncertainty is typically followed by a decline in GDP growth in Latin American countries, a deterioration in consumer confidence and currency depreciation, as shown in Graph 8.[4]

[4] Aguilar et al (forthcoming).

Economic policy uncertainty weighs on macroeconomic and financial outcomes[1] Graph 8



[1] SD= standard deviation; EPU = economic policy uncertainty. Panel local projections à la Jordà (2005) for Latin American countries with a monthly sample from 2003 to 2024. Confidence intervals at 90%.

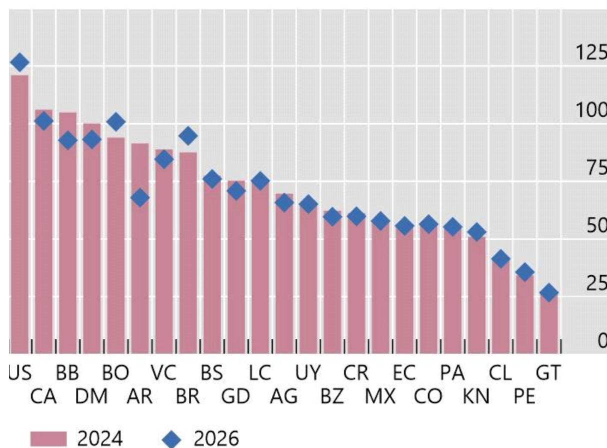
Source: Aguilar et al (forthcoming).

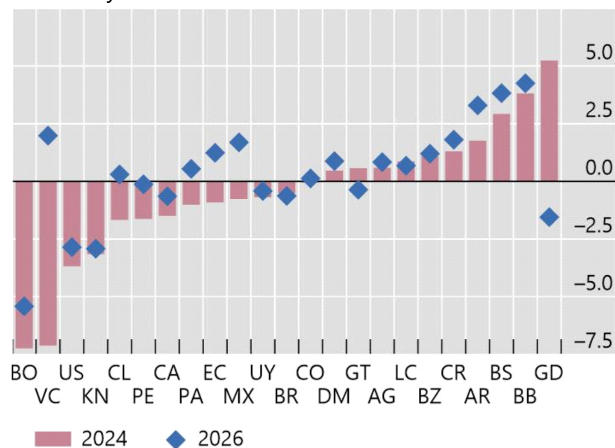
What can policy do to meet these challenges?

I am cautiously optimistic, while acknowledging the significant challenges. Unlike 30 to 40 years ago, Latin American and Caribbean economies have established solid macroeconomic frameworks. External accounts are less vulnerable than in the past. Flexible exchange rates provide a first line of defence, international reserves a second. Inflation rates are generally under control and long-term inflation expectations remain anchored despite the massive shocks experienced over the past five years. Another aspect of resilience is the management of public debt. Although public debt is elevated in most economies, higher expected primary fiscal balances suggest some effort to stabilise debt-to-GDP ratios (Graph 9).

Public finances

As a percentage of GDP Graph 9





[1] Diamonds denote forecast values.

Sources: IMF; BIS.

These strong foundations are something that countries can build on in navigating the current uncertain environment. Central banks in the region also have a track record in managing shocks. In reacting to the current global headwinds, countries in the region should balance the need to build up resilience to these shocks with a longer-term view on the pursuit of growth. This involves strengthening institutional frameworks, diversifying the economy and fostering competition. With all these factors, the adverse effects of global uncertainties can be mitigated.

Supporting long-term growth in the face of global shocks may also require fiscal space. But this space is more limited after the fiscal expansion during the pandemic. Creating more fiscal space will require a focus on consolidating public finances through prudent fiscal management. This includes implementing reforms to improve the efficiency of tax and expenditure systems. The aim should be to generate more sustainable revenue streams and reduce wasteful spending. This would allow governments to invest in the future.

In every crisis lies an opportunity, and countries must act flexibly to seize the chance to diversify and strengthen trade ties with other economies, both regionally and globally. Embarking on structural reforms is crucial for fostering long-term economic stability and growth. Amid the current turbulent environment, nations have a unique opportunity to implement these reforms, enhancing resilience, improving efficiency and better positioning their economies for future challenges.

Most of these steps are well outside the remit of central banks. But this does not mean that central banks should stand aside. They play a pivotal role in maintaining macroeconomic stability, which is a foundation for economic growth and social progress. One of their primary objectives should be to bring inflation back to target levels to avoid losing the credibility that has been built over years.

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Credibility is essential for maintaining investor confidence and ensuring stable economic growth. And once it is lost, it is very hard to rebuild.

Finally, effective communication and transparency are universally recognised as key components of central banks' strategies to deal with uncertainty. By clearly articulating their policy intentions, economic outlook and decision-making processes, central banks can help anchor expectations and reduce market volatility. Central banks must also safeguard financial stability. Ensuring that external shocks do not translate into domestic financial vulnerabilities is critical for maintaining overall economic stability.

Thank you very much for your attention.

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