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Introduction

• Over the last decades, countries in Latin America have reduced the risk of domestically driven financial crises and enhanced their resilience to external shocks.
• In turn, financial institutions in Latin American economies have exhibited a strong resilience to both domestic and external shocks.
• Nevertheless, recent developments in the global economy as well as domestic factors pose challenges in terms of the risks and vulnerabilities for financial stability in several countries.
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The international environment has been characterized by weakness in global economic activity and the stagnation of world trade.
The Chinese economy has slowed and commodity prices remain at low levels

China Real GDP Growth

Commodity Prices

Source: IMF, World Economic Outlook
Source: Bloomberg
Monetary policy remains highly accommodative in advanced economies, although in the U.S. the normalization process is gradually underway.


Source: Bloomberg
Financial Stability in Latin America

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Latin America has experienced an economic slowdown and fiscal deficits have widened.

GDP Growth %

- Average growth rate 2010-2012
- Average growth rate 2013-2015

Fiscal Balance % GDP

Source: IMF, World Economic Outlook
Public debt levels have shown an upward trend in the region

Gross Public Debt

% GDP

2010 2015

Source: IMF, World Economic Outlook

Gross Public Debt

Weighted average by GDP*

*Weighted average by GDP. Countries included: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Jamaica, Mexico, Panama, Peru and Uruguay.
Domestic credit increased over the last years, although it has recently slowed in line with economic activity.
Domestic credit has grown faster than economic activity

Domestic Credit to Private Sector
and GDP growth*
Average 2010-2015

- Average economic growth 2010-2015
- Average growth of domestic credit to private sector 2010-2015

Source: World Bank and IMF World Economic Outlook
*On average, credit growth has been 2.7 times GDP growth.
External debt of non-financial corporations has exhibited an upward trend in the region.

[Graph showing external debt of non-financial corporations as a percentage of GDP for various countries, with data from 2010 and 2015.]

Source: BIS
*International debt securities

*Weighted average by GDP. Countries included: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Guatemala, Jamaica, Mexico, and Peru.
Scenarios for deleveraging in LATAM Firms and Default Rates

LATAM corporate debt to EBITDA

Multiples

Share of corporate debt by interest coverage ratio bucket

2016

% 

Brazil

Colombia

Argentina

Mexico

Chile

Peru

Dollar Bond Default Rates in Latin America

Source: Global Stability Report, IMF Oct 16

Source: Global Stability Report, IMF Oct 16

Source: Global Stability Report, IMF Oct 16
Macrofinancial Risks and Vulnerabilities

• After having slowed during the last few years, capital flows to Latin America have recently picked up.
  • Given accommodative monetary conditions in major advanced and the moderate recovery in commodity prices, capital flows to the region have started to recover.
  • However, Latin American economies still face the risk of reversals in capital flows, disorderly increases in domestic interest rates and additional foreign exchange pressures.
  • This scenario represents an important challenge for domestic financial systems.
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Banks in EMEs appear well-capitalized and have been able to maintain adequate levels of profitability.

**Regulatory Capital to Risk-Weighted Assets**

- **Emerging Asia**
- **Emerging Europe**
- **Latin America**
- **Other EMEs**

- **2010**
- **2015**

**Return on Assets**

- **Emerging Asia**
- **Emerging Europe**
- **Latin America**
- **Other EMEs**

- **2010**
- **2015**

Weighted average based on total assets of banking systems in Emerging Asia (China, India, Indonesia, Malaysia, Philippines, Singapore and Thailand), Emerging Europe (Czech Republic, Hungary, Poland, Russia, Turkey), Latin America (Argentina, Brazil, Chile, Colombia, Mexico and Peru) and other emerging countries (Israel, Saudi Arabia, South Africa, United Arab Emirates).

Loan performance in EMEs shows some deterioration. Actions must be taken to maintain high asset quality.

Weighted average based on total assets of banking systems in Emerging Asia (China, India, Indonesia, Malaysia, Philippines, Singapore and Thailand), Emerging Europe (Czech Republic, Hungary, Poland, Russia, Turkey), Latin America (Argentina, Brazil, Chile, Colombia, Mexico and Peru) and other emerging countries (Israel, Saudi Arabia, South Africa, United Arab Emirates).

Banks funding structure has become more dependent on wholesale funding

Customer Deposits to Total Loans

%  

Emerging Asia  Emerging Europe  Latin America  Other EMEs

2010  2015

Wholesale funding

%  

Emerging Asia  Emerging Europe  Latin America  Other EMEs

2010  2015

Weighted average based on total assets of banking systems in Emerging Asia (China, India, Indonesia, Malaysia, Philippines, Singapore and Thailand), Emerging Europe (Czech Republic, Hungary, Poland, Russia, Turkey), Latin America (Argentina, Brazil, Chile, Colombia, Mexico and Peru) and other emerging countries (Israel, Saudi Arabia, South Africa, United Arab Emirates).

Regulation and supervision of the banking sector

• Considerable progress has been achieved in the region to enhance financial stability by improving regulation and supervisory practices.

• However, progress has been heterogeneous and important shortcomings still remain. Areas which deserve attention are:
  • Quality and quantity of capital.
  • Implementation of liquidity standards.
  • Supervisors’ operational and resources independence.
  • Supervisory frameworks over banks’ risk management policies.
  • Forward looking estimation of credit losses and provisioning practices.
  • Internal controls, audit and Know-your-customer (AML-CFT)
  • Consolidated supervision.
  • Macroprudential policy frameworks. Clear mandate and scope of systemic stability; macroprudential toolkit, and; effective coordination, execution and accountability mechanisms.
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- Given the complex external environment and the domestic vulnerabilities prevailing in several cases, Latin America economies need to:
  - Design and adopt growth enhancing reforms and diversify their economies.
  - Implement sound macroeconomic policies and improve their economic fundamentals.
  - In some cases, further strengthening the supervisory and regulatory framework may be needed to prevent the development of financial imbalances.
  - Authorities must be prepared to intervene in key financial markets in order to preserve their orderly functioning.