Comité Latino Americano de Asuntos Financieros
Latin American Committee on Macroeconomic and Financial Issues
Comitê Latino Americano de Assuntos Financeiros

Statement No. 47

Washington, D.C., December 3rd, 2025

Latin America: Adapting to the New Global Financial Environment

I. The New Global Financial Outlook: Challenges and opportunities

After a surge in uncertainty driven largely by the announcement of sweeping country-specific import tariffs by the new U.S, administration, the global financial outlook has improved. Although indicators of US trade policy uncertainty remain elevated, they have declined substantially from their peak in April. Widespread retaliation has not followed the U.S. tariff announcements, and the administration has reached several trade agreements with key trading partners. Early warnings of a U.S. recession have so far proven premature.

Indicators of volatility in equity markets —such as the VIX index— and in the US Treasuries market —such as the MOVE index— have also declined relative to previous peaks. At the same time, commodity prices —measured by the CRB index— have risen to historically high levels, albeit with moderate energy prices. Although significant risks remain, as discussed below, recent developments support a more positive outlook, especially for emerging markets and developing economies.

Accordingly, risk spreads in emerging markets, both in the high-yield and in the investment-grade segments, have compressed significantly. Similarly, after three consecutive years of capital outflows, emerging markets are seeing inflows again, both in equities and bonds. Renewed inflows to EMs have concentrated in domestic bond markets, reflecting a search-for-

yield and expectations of continued strengthening of exchange rates relative to the US dollar (USD).

Consistent with these positive developments, the latest IMF World Economic Outlook has revised upwards —compared to July— its 2025 global growth rate projection to 3.2%, reflecting improved prospects in both advanced economies and emerging markets. An increasingly important driver of economic activity, especially in the US, is investment linked to artificial intelligence (AI).

The Committee believes that Latin America can benefit from this global macroeconomic environment. Regional 2025 GDP growth should be near 2.4%. The region's modest current account deficit (1% of GDP) can be readily financed in countries with market access, given the strong foreign demand for emerging market securities. In large part reflecting the USD depreciation relative to major currencies (since January this year), currencies have appreciated in the larger Latin America countries. The combination of fiscal adjustment programs in some countries and currency appreciation contributed to lowering inflation.

The impact of US import tariffs on the region has been limited so far. Although the reciprocal tariff announcements were very high for some countries, their actual impact depends on two factors: (a) the *effective tariff* rate (defined as the announced tariff rate adjusted for exemptions and sector-specific tariffs, such as those on steel, aluminum and copper) and (b) the extent of each country's reliance on the US market, measured by the share of its exports destined for the US. When these factors are taken into account, most Latin American countries face a tariff burden that is smaller than the headline figures suggest. Even in Mexico —where a reciprocal tariff of 25% was announced and a large share of exports is directed to the US— the effective tariff rate remains much lower due to extensive exemptions under the USMCA treaty, which remains in force.

The main exception is Brazil, for which a 50% tariff has been announced. Despite the recently announced exemptions for select agricultural products, which reduced Brazil's effective tariff rate, Brazil's effective tariff rate in the US remains among the highest in the world. The durability of tariffs imposed by the US administration remains uncertain, however, not just because of frequent reversals arising in the context of bilateral negotiations, but also due to a pending decision by the US Supreme Court on the matter.

Beyond the better-than-expected juncture, the Committee believes that Latin America faces a complex combination of risks and opportunities for the coming years. The policy shifts by the new US administration may lead to a durable dislocation of the multilateral trade and financial architecture established after World War II. Structural changes are likely to occur if the US uses import tariffs not just to gain political leverage in foreign policy, but also to repatriate manufacturing activity, redirect supply chains back to the US, attract FDI, secure access to crucial materials (e.g., rare earths), and promote the development of new technologies.

Significant changes in global finance could also occur if debt dynamics in the US place the role of the US dollar as the dominant reserve currency under pressure. This could lead to higher volatility in risk aversion, equity prices, interest rates, and currency valuations. Moreover, if

fiscal deficits and ballooning debt trajectories persist, a consequent rise in long-term interest rate may be a harbinger of higher inflation and an erosion of confidence in US Treasuries.

While the Committee believes it is premature to foresee a secular decline in the dominant position of the US dollar, current high asset valuations, combined with rising debt burdens and heightened geopolitical tensions, may induce dynamics that pose risks to global financial stability. In addition to the broad rise in valuations across asset classes, speculative behavior in precious metals and cryptocurrencies and signs of stress in parts of the financial system all warrant caution. The recent rally in asset prices may be a manifestation of speculative excess and asset bubbles, particularly in the Artificial Intelligence sector. These, together with a significant migration of financial contracting towards the shadowy and highly leveraged private credit industry, suggest a nontrivial vulnerability of markets. A correction would trigger de-risking and capital outflows from emerging markets.

Early warning signals emerged in October from the less regulated, highly leveraged segments of the financial system—specifically Business Development Companies (BDCs), Non-Depository Financial Institutions (NDFIs), private credit, and commercial real estate. In the third quarter of 2025, large Global Systemically Important Banks (G-SIBs) sharply increased provisions for potential losses, partly due to their direct or indirect exposure to leveraged segments of private credit markets.

In sum, major policy shifts in trade, fiscal, and monetary domains—against a backdrop of stretched valuations and fragilities in private credit—could threaten financial stability. This is particularly concerning given that advanced economies today are constrained by fiscal weaknesses and already expanded central bank balance sheets and, therefore, have limited capacity for countercyclical responses. **The Committee believes that Latin American countries should therefore take advantage of the current market environment to reinforce their external, fiscal, and financial buffers in anticipation of potential global shocks.**

Moreover, the region should view structural transformations in trade and finance not only as risks but also as opportunities. **The Committee believes that proactive policy initiatives will be essential to position Latin America favorably within the evolving global system and geopolitical realities.**

II. Recommended policy actions for Latin American policymakers in the current international environment.

In considering policy recommendations for Latin America at the current juncture, **the Committee identified three major areas of focus: 1) the region´s prospects for enhanced trade relations; 2) the opportunity to strengthen regional supply chains and deepen regional integration, as well as enhance the region´s role as a supplier of natural resources, particularly rare earth and critical minerals, and 3) strategies to improve liability management and reserve composition.**

1. Trade relations

In the face of changing geopolitical responsibilities and objectives within the US and its Nato allies, the European Union (EU) is redesigning its global trade architecture to strengthen its own economic security and the resilience of its supply chains by intensifying the expansion and modernization of its network of free trade agreements (FTAs). The EU has stepped up the expansion of its global network of free trade agreements (FTAs), including recent agreements with New Zealand and the upgrading of existing agreements with key partners, as well as ongoing negotiations with India, Australia and several South-East Asian economies.

The Committee believes that the Latin America and Caribbean (LAC) region stands out as a reliable and like-minded partner for the EU. The regions are also economically complementary: LAC offers precisely what the EU needs most, critical raw minerals such as lithium and copper, and abundant renewable energy sources essential for the green and digital transition. The EU, in turn, has the capital, technology and know-how to promote the development of high value-added bi-regional production chains.

The Committee believes that the reconfiguration of global trade and the economic complementarity of the two blocs offer a formidable strategic opportunity. Once the EU-Mercosur agreement is ratified —hopefully before year end— the EU's network of trade agreements with LAC will cover 97% of regional GDP, well above the coverage of the US (44%) and China (14%).

However, this network is not yet fully interconnected: the fragmentation of the current regimes of rules-of-origin makes the combination of inputs from different countries very costly –even if they have bilateral agreements with the EU and with each other– to benefit from tariff preferences limiting the creation of bi-regional value chains.

To overcome the current fragmentation and interconnect the EU-LAC FTA network, Cornejo, Estevadeordal and Talvi (2025)[1] have proposed a 'flexible diagonal cumulation' mechanism as a pragmatic, legally viable, and high-impact solution, taking advantage of existing bilateral agreements. It would allow inputs from countries that have bilateral agreements with the EU and with each other to be considered as 'originating', without the need to modify the specific rules of origin of each treaty.

The Committee supports this proposal and believes that the adoption of a 'common protocol' would constitute the regulatory basis for implementing this system of 'flexible diagonal cumulation'. The common protocol would be incorporated into existing agreements between the EU and LAC countries or blocs of countries, without the need to renegotiate them.

The Committee believes that this proposal would be the steppingstone for the creation of an integrated EU-LAC bi-regional economic area, which would encompass 1.1 billion people

[1] Cornejo, Estevadeordal and Talvi. 2025. Towards an Integrated EU-Latin America Economic Area. Real Instituto Elcano

and a GDP comparable to that of the US. Such bi-regional economic area would allow for an increase of up to 70% in bi-regional trade and 40% in intra-regional trade, and would facilitate the articulation of bi-regional industrial chains, with great potential in high value-added decarbonized sectors spanning from data centers and cloud computing to electric vehicles.

This strategy also contributes to strengthening a global and rules-based trading system and offers a replicable and expandable model for integration with other partners with whom the EU and LAC have bilateral agreements and who wish to connect to this network of agreements.

A closer trade relation between Latin America and the EU should not be seen as alternative but rather complementary to better trade relations between the region and the US. To date the US administration has announced joint statements on frameworks for trade agreements with several countries in Latin America: Argentina, Ecuador, El Salvador, and Guatemala, while maintaining existing trade agreements such as UMSCA (US-Mexico-Canada), the CAFTA (Central America-US), the US-Colombia FTA Agreement, the US-Peru and US-Panama Trade Promotion Agreements, and the Caribbean Basin Initiative.

2. Strengthening regional integration and the region's role as a supplier of natural resources

Strengthening regional integration has been a long-standing area of interest in CLAAF´s previous statements. In particular, the Committee has recommended focusing efforts on coordinating regional logistics, and optimizing the infrastructure networks of ports, railroad, road, and energy. It recommended advancing a process of harmonization and coordination of customs requirements, particularly those related to transport logistics (e.g. establishing a single passport for trucking logistics), and standardization of the regulatory environment to facilitate, for instance, the transfer of energy across countries in Latin America.

The Committee believes that the current changes promoted by the US administration, favoring nearshoring to the Western Hemisphere and the development of safer and more reliable supply chains, opens a new opportunity for strengthening the region´s integration, especially in infrastructure. The Committee believes regional development multilaterals such as the IDB and CAF could play a central role in mobilizing financing and knowledge resources to meet this ambitious goal.

An area where several countries in Latin America should join forces is mining, in particular the exploration, extraction, and processing of rare earth minerals and more traditional minerals such as copper and lithium that are essential for addressing climate change concerns and are also important in areas such as defense and national security and, more generally, in the advancement of technical progress. Mining requires large foreign direct investment and —given the extended time span of its production cycle— it also requires stability and predictability in terms of rule of law and fiscal treatment. **The Committee recommends exploring ways to harmonize legislation and regulatory environments to promote large-scale foreign direct investment in this area.**

3. Improving liability management and reserve composition

Changes in the global trade and financial architecture will likely alter terms of trade, interest rates, and exchange rates. Under these conditions, international financial management principles underscore the importance of sound asset and liability management by sovereigns.

The Committee believes that adoption of policies to better manage financial risks is particularly important at a time when the region faces a favorable external environment, although with significant potential risks. As we have discussed earlier, in the context of elevated valuations, risks to the current global outlook mostly relate to the unsustainable fiscal dynamics observed in several advanced economies, and to the rapid growth of private credit, non-depositary financial companies, and commercial real estate lending.

On the asset side, Latin American governments face key decisions regarding the composition of international reserves. The USD remains overvalued on a real effective trade-weighted basis by roughly 10%, implying downside risks to long USD positions.

While the Committee does not take a view regarding the future of the USD as the dominant world currency, it believes that the risks from significant USD movements can be mitigated in several ways. First, central banks can diversify their reserves by increasing holdings of gold and other convertible currencies from advanced economies— such as the Euro, Yen, Pound Sterling, Canadian and Australian dollars, and Swiss Franc. Second, they can develop active programs of currency and interest rate hedging through swaps. Thirdly, they should actively manage the duration and composition of their bond holdings issued by advanced economies between fixed and floating-rate instruments**.**

The Committee believes that, on the liability side, sovereigns must optimize the currency and legal structure of external debt. Potential benefits exist in issuing debt under jurisdictions other than New York, including Great Britain, the Euro Area, Switzerland and Japan. Governments should also monitor the direction of US interest rates to adjust the duration and rate composition (fixed versus floating) of their external debt. In reconstructing yield curves, they should consider tender offers to retire legacy bonds and issue new instruments. A number of countries in the region, including Colombia, Mexico and El Salvador have successfully completed such tender offers.

The Latin American Committee on Macroeconomic and Financial Issues (CLAAF) gratefully acknowledges financial support from the Center for Global Development and FLAR for funding its activities during 2025. The Committee thanks Kate Barnes for her support in the production of this statement. The Committee is fully independent and autonomous in drafting its statements.

This statement was jointly produced by:

José De Gregorio, Dean of the School of Economics and Business, Universidad de Chile. Former Minister of Economy, Energy, and Mining, and former Governor of the Central Bank of Chile.

Augusto De La Torre, former Chief Economist for Latin America and the Caribbean, World Bank. Former Governor, Central Bank of Ecuador.

Pablo Guidotti, Professor of the Government School, University of Torcuato di Tella. Former Vice Minister of Economy, Argentina.

Paulo Leme, Chairman of the Global Asset Allocation Committee, XP Securities. Former CEO and Chairman of Goldman Sachs of Brazil

Enrique Mendoza, Presidential Professor of Economics, University of Pennsylvania.

Ernesto Talvi, Senior Fellow, Real Instituto Elcano, Madrid. Former Executive Director, CERES. Former Minister of Foreign Relations, Uruguay.

Liliana Rojas-Suarez, president, CLAAF; Senior Fellow and Director of the Latin American Initiative, Center for Global Development. Former Chief Economist for Latin America, Deutsche Bank.

Andrés Velasco, Dean of the School of Public Policy, London School of Economics. Former Finance Minister, Chile.