S&P Global
Ratings

Latin America Sector Roundup Q2 2024

Signs Of Slipping Credit Stability

May 15, 2024

This report does not constitute a rating action

Key Takeaways

- Latin America's (LatAm's) credit conditions will remain uneven during 2024, while many issuers will remain pressured by sluggish economic growth. Furthermore, unfavorable political dynamics could imperil the current credit stability.
- Risks for LatAm issuers remain substantial--we are monitoring closely the pace of interest-rate cuts in advanced economies; key elections; geopolitical developments especially with respect to ongoing conflicts; and China's economic growth path, as weaker growth could weigh on global trade.
- We project GDP growth in the region (excluding Argentina) to moderate to 2.0% in 2024 from 2.4% in 2023. Disinflation will continue; however, returning to central bank's inflation targets will be a long and slow process.

(Editor's Note: This report is an expansion of the "Sector Trends" section from our "Credit Conditions Emerging Markets Q2 2024: Unmet Expectations Could Heighten Risks" report, published March 27, 2024.)

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Adverse Political Dynamics Could Dampen Credit Stability

LatAm's credit conditions will remain choppy this year, while sluggish economic growth and unfavorable political dynamics will weigh on issuers. That said, we expect major economies in LatAm, except for Argentina, to keep growing in 2024 and the pace to slightly accelerate in 2025. This, along with falling inflation and interest rates, should support the rating performance in the region. However, lower-rated issuers will continue facing high refinancing risks and borrowing costs. The following risks for LatAm issuers remain sizable:

- The pace of interest-rate cuts in advanced economies, which could turn financing conditions more restrictive;
- Key election outcomes that could lessen policy predictability and undermine business confidence;
- Geopolitical tensions especially with respect to ongoing Israel-Hamas and Russia-Ukraine conflicts, that could erode investors' confidence and trigger sudden capital outflows; and
- China’s economic growth trajectory, as weaker growth could weigh on global trade.

Sustained growth in the U.S. economy should benefit many countries in LatAm. However, economic resilience and strong labor markets are slowing the path for rate-cuts. We have revised our forecast for fed funds rate cuts, which we now expect will start in December this year and last into late 2026. Consequently, we now expect a slower momentum for monetary policy normalization in most major economies in LatAm. Central banks that are in the latter stages of their monetary policy normalization cycle, such as those of Brazil, Chile, and Peru, will likely slow the tempo of interest-rate cuts in the coming months. Central banks that have just started reducing interest rates, such as that of Mexico, will likely pause for some time before resuming monetary policy normalization later this year.

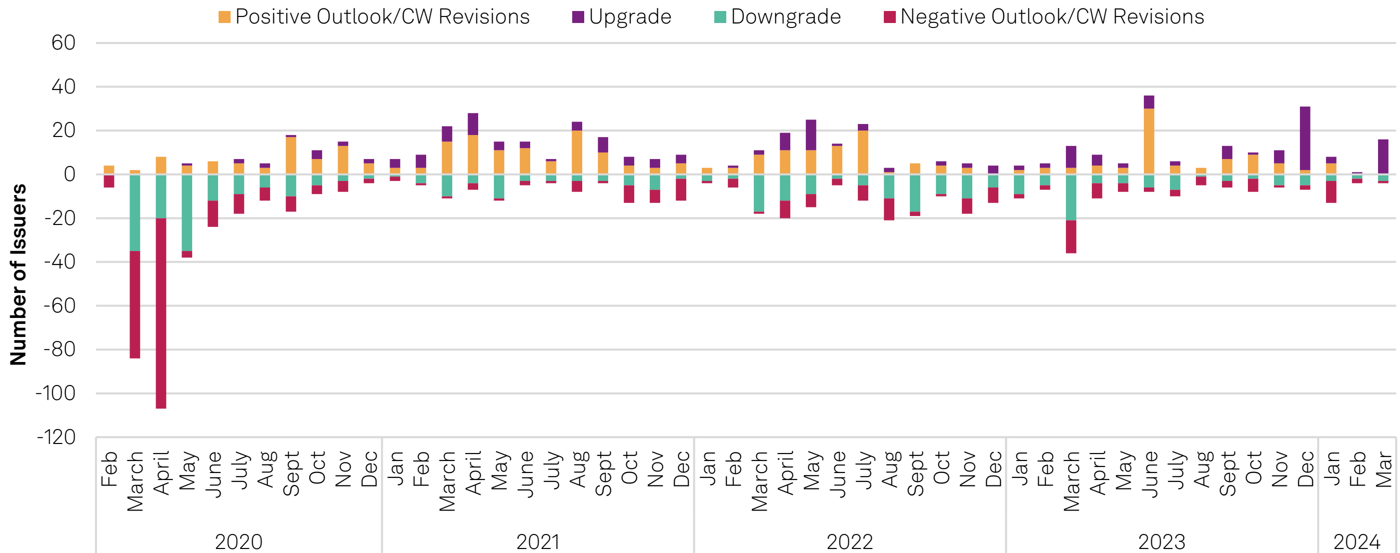
Unfavorable political dynamics have been a drag on growth in many economies in LatAm, and in some cases, this has resulted in fiscal slippage and weaker credit fundamentals. More sovereign downgrades in the next two years are possible if current administrations fail to put in place policies to boost growth and strengthen fiscal accounts. The latter could also be a drag on many corporations and banks in the region, not only because of poor economic activity, but given that sovereign ratings often act as a ceiling for the top-rated issuers.

We are watching closely developments in upcoming elections including those in the U.S. and Mexico. The outcome of U.S. presidential election could be highly consequential for key trade partners, as the new administration could consider more protectionists policies. Mexico's new administration will face a challenging fiscal panorama following this year’s extraordinary deficit.

Chart 1

Argentina's upgrade triggered most of positive rating actions in LatAm, sovereign downgrades could turn the balance negative.

Number of rating actions in LatAm



Data as of March 31, 2024. Source: S&P Global Ratings Research & Insights.

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Macroeconomic Outlook

Growth Paths Will Diverge Across The Region

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We project GDP growth in the region (excluding Argentina) to moderate to 2.0% in 2024 from 2.4% in 2023. Brazil and Mexico were the growth outperformers in 2023 – we expect activity to decelerate in 2024, but still remain relatively strong, keeping the GDP growth pace above potential in both economies. Conversely, Chile, Colombia, and Peru were growth underperformers last year – we expect an improvement in growth in those economies this year, although GDP expansion will remain below potential. The macroeconomic outlook for Argentina is highly uncertain as the new administration attempts to implement an aggressive fiscal adjustment, among other measures. We expect this will lead to a deep economic contraction this year, followed by a rebound in 2025.

Table 1

LatAm: GDP growth and S&P Global Ratings forecasts

	2021	2022	2023	2024f	2025f	2026f	2027f
Argentina	10.7	5.0	-1.6	-3.5	3.3	2.2	2.5
Brazil	5.1	3.1	2.9	1.8	2.0	2.1	2.2
Chile	11.9	2.5	0.2	2.0	2.7	2.9	3.0
Colombia	10.8	7.3	0.6	1.1	2.8	3.0	3.1
Mexico	6.0	3.9	3.2	2.5	1.8	2.2	2.3
Peru	13.6	2.7	-0.6	2.7	3.0	3.1	3.2
LatAm 6	7.4	4.0	1.8	1.2	2.3	2.3	2.4
LatAm excluding Argentina	6.9	3.8	2.4	2.0	2.1	2.3	2.4

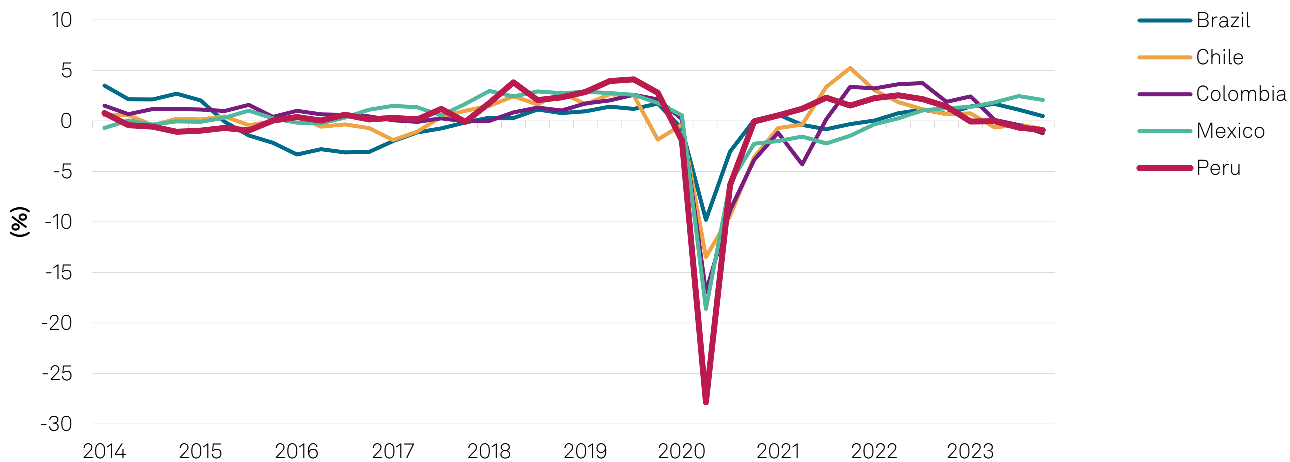
Note: The LatAm GDP aggregate forecasts are based on PPP GDP weights. f--S&P Global Ratings forecast. Source: S&P Global Ratings.

Disinflation will continue; however, returning to central bank targets will be a long and slow process. The median headline CPI in LatAm has more than halved from above 10% year over year in early from 2023 to 4% this year. However, bringing inflation down to 3%, which is the objective of most central banks in the region, will be difficult due to persistence in services sector inflation and the recent increase in oil prices. We expect inflation in most countries in the region will return to target ranges in 2025.

Shifting expectations over the Fed's policy could slow monetary policy normalization in the region. All the major central banks in the region have started lowering their benchmark interest rates. Brazil, Chile, and Peru are close to the end of their easing cycle, while Mexico and Colombia are at the beginning of it. We expect monetary policy normalization to broadly continue in the coming months across the region. However, uncertainty over the timing of the beginning of U.S. rate cuts, which have been pushed from the middle to the end of the year by analysts and markets, will influence the pace of interest-rate cuts in the region. Central banks may opt to pause their monetary policy normalization until there is more clarity over the Fed's policy to prevent disorderly capital outflows.

Chart 2

Output gap (% of GDP)



Note: We estimate output gaps using a Hodrick-Prescott filter. Sources: Haver Analytics and S&P Global Ratings.
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The lagged effects of high interest rates and an eventual slowdown in U.S. growth will dampen growth across most countries in the region. U.S. growth outperformance, vis-à-vis other advanced economies has benefited LatAm. However, we expect the U.S. economy shifting to below-trend growth in the second half of this year and into 2025. This will take place amid still-high benchmark interest rates, which will keep the cost of investment high.

Nearshoring in Mexico is advancing slowly, and there are significant obstacles to accelerate the process. The initial impact is most noticeable through an increase in private non-residential construction to expand production capacity among the traditional manufacturing hubs. The next stage of nearshoring will involve attracting more foreign manufacturers and increase production, which will face considerable impediments, including reliable supply of clean energy, water, and specialized labor availability, among other factors. In a scenario in which nearshoring were to boost Mexico's GDP growth to 3%, the manufacturing output growth pace would have to be double what it was in the decade before the pandemic.

Risks to our growth outlook: The potential for a further delay in the Fed's monetary policy normalization remains a key downside risk to growth in the region, as it could encourage rapid capital outflows. Uncertainty over the trajectory of the Chinese economy, amid subdued private-sector confidence and property-sector woes, could take a toll on key commodity prices that LatAm exports. Finally, a heavy electoral agenda, including the November general election in the U.S., could keep policy predictability lower than normal, which may restrain investment in some cases.

Country GDP Forecasts

Argentina: The economy will be subject to a high degree of uncertainty, as President Javier Milei attempts to push forward a series of ambitious policy adjustments, which are facing significant backlash from opposition parties. A substantial fiscal adjustment, which is already partly underway, will drive a decline in economic activity in the coming months. We expect GDP to contract in the first half of 2024, before returning to moderate sequential growth in the second half. Growth in 2025 will depend on the success, or lack thereof, of the policy adjustment in encouraging renewed investment. We project a GDP decline of 3.5% in 2024 and 3.3% growth in 2025.

Brazil: We project GDP growth of 1.8% in 2024, following the strong 2.9% expansion in 2023. Growth will be driven by continued--albeit diminishing--fiscal support. Lower domestic interest rates will encourage a recovery in investment. The benchmark SELIC rate has declined from 13.75% in early 2023 to 10.75% currently, and we expect it will fall further in the coming quarters. In our view, the terminal SELIC rate is likely to be around 9%. The main reason why growth is weaker in 2024 than in 2023 is that the large increase in agricultural output, boosted by a good harvest, won't be repeated. Agricultural output contributed 1.1 percentage points to GDP growth last year.

Chile: We forecast GDP growth to recover to 2.0% in 2024, after 0.2% in 2023. Both consumption and investment declined in 2023, and we expect that to be reversed this year. Data so far this year suggests consumption is already improving, as seen in strong retail sales and rising consumer confidence. However, the recovery in investment is lagging, with business confidence still subdued. The high degree of political fragmentation is likely to keep the rebound in investment subdued.

Colombia: We project a mild improvement in growth this year to 1.1% from 0.6% in 2023, both very low growth rates for Colombia's historical expansion pace. The economy is experiencing a steep decline in investment amid policy uncertainty over a series of reforms proposed by President Gustavo Petro, which are facing stiff opposition in Congress and resulting in political gridlock. Fixed investment declined 8.9% last year, and we expect it will contract again in 2024. Inflation is taking longer to slow in Colombia due to a series of upward adjustment to gasoline prices, and impending adjustments to diesel prices will likely keep inflation relatively high this year. Inflation is still above 7% year over year, compared to the central bank's 3.0% target.

Mexico: We forecast 2.5% growth this year, following the 3.2% expansion in 2023. Growth in Mexico will continue to be supported by a sharp uptick in public nonresidential investment in the run-up to the June general election. We expect growth will slow noticeably in the second half of 2024, once public investment slows and U.S. demand moderates. We anticipate broad policy continuity under the next government.

Peru: We project GDP to grow 2.7% this year, after declining 0.6% in 2023. Fixed investment declined nearly 6% in 2023, and we expect a slight improvement in 2024, mainly in the mining sector. A fragmented Congress and limited political capital of the administration will weigh on private-sector investment, and keep the overall recovery subdued. We expect inflation to be within the central bank's target range of 1%-3% by the end of this year, and anticipate monetary policy normalization to continue in the coming quarters. We expect growth beyond 2024 to average just above 3%.

Financing Conditions

Improving Investor Sentiment Bolstered Investment-Grade Issuance

Corporate spreads at three-year low, but risks loom ahead. LatAm corporate spreads dropped 60 basis points (bps) in the first quarter of 2024, as benchmarks slightly rose following the U.S. 10-year yield, which increased after the strong U.S. macro data prints. Corporate yields decreased, especially at the lower end of the rating spectrum (Chart 3) driven by market expectations of the achievement of a soft landing for the global economy. However, the level of borrowing costs remains 125 bps higher than the 10-year average, rendering market access still complicated for companies rated 'B' and lower. The outlook for financing conditions is sensitive to external risks such as market expectations of the Fed's policy stance (less rate cuts priced ahead could lead to delayed monetary policy normalization among regional central banks), climate related events, Chinese economic growth, and geopolitical tensions (heightening). This is confirmed by the recent increase in corporate yields for the region (up 30 bps since the end of March) and the dollar's appreciation, which could dampen international issuance in hard currency in Q2 2024.

Bond issuance rebounded in the quarter. Particularly for investment-grade issuance, which neared $9 billion, the highest level since Q2 2020 (Chart 4). Corporations exploited the yields' decrease to issue debt at longer tenor: issuance with tenor higher than 10 year jumped by 235% in the quarter, while short-term issuance decreased by 42%. The region's most active countries in the last quarter were Mexico, Chile, and Argentina; sector-wise banks, oil and gas, telecom, and mining. Refinancing risk remains contained for the rated companies, as the maturity wall is expected to hit its peak in 2027, with speculative-grade debt maturities at 39% in 2024-2025 mainly among oil and gas entities and financial institutions in Brazil (63% through 2028). The aforementioned dollar movements are important to monitor, as $36 billion out of $53 billion (68%) set to mature by 2025 is denominated in dollars.

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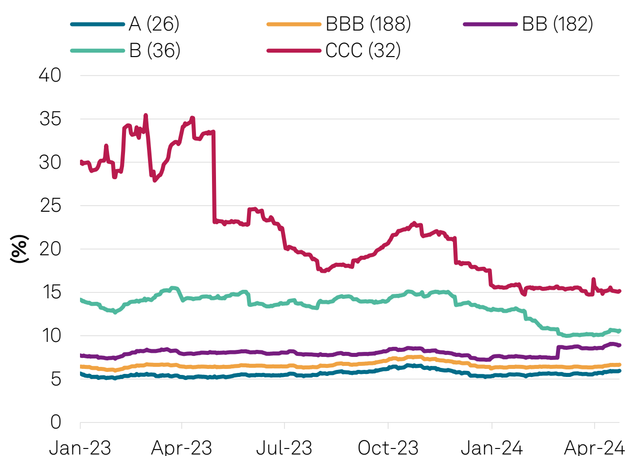
Chart 3

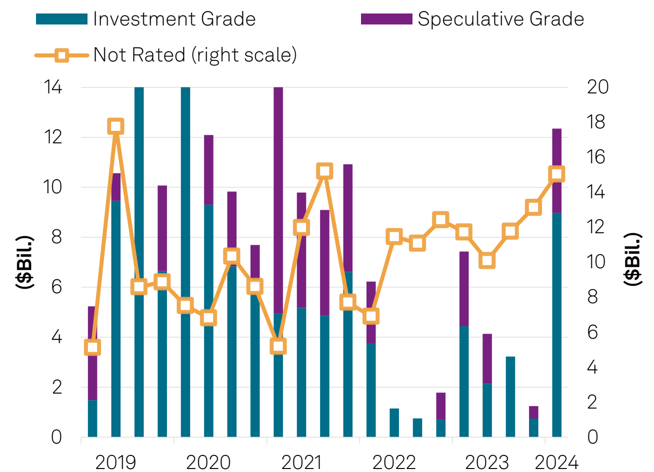
'B' and 'CCC' yields down more than 200 bps in Q1 2024



Note: The iBoxx USD Emerging Markets Corporates indices are designed to reflect the performance of USD denominated corporate debt issued by entities domiciled in the emerging markets. Number of Instruments in parenthesis. Data as of April 24, 2024. Sources: IHS Markit and S&P Global Credit Research & Insights.

Chart 4

IG issuance 12x higher than in Q4 2023

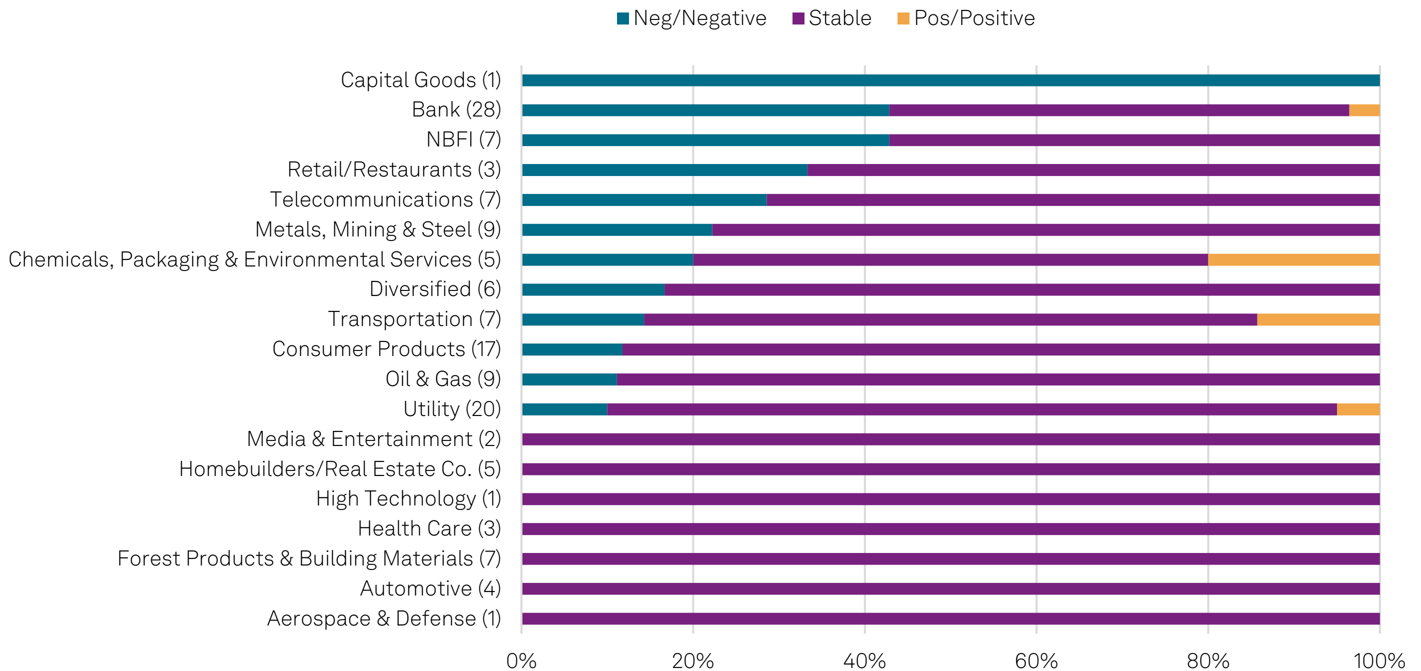


Credit Research & Insights and Refinitiv.Data including not rated. Data as of March 31, 2024.
Sources: S&P Global Ratings

Chart 5

Negative outlook bias is now at 22%, below five- and 10-year averages of 30%

Outlook distribution of LatAm issuers by sector



Data as of March 31, 2024. Source: S&P Global Ratings Research & Insights.
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Mexican elections

An upcoming change of government in Mexico in mid-2024 is not likely to materially change its fiscal, monetary, or trade policies. The country's new leadership will face the challenge of maintaining economic stability while meeting public expectations of better living standards and more public services. Although Mexico's economy grew more than 3% last year, it remains an underperformer compared to other EMs. Its public finances have remained stable in recent years, with moderate fiscal deficits helping to stabilize its general government debt burden, but its GDP has grown slower than those of its peers. Moreover, its fiscal deficit is slated to rise in 2024, an election year, before declining next year. Failure to adhere to moderate fiscal policy could, especially if GDP growth remains low, raise the debt burden and damage its creditworthiness. Conversely, greater success in attracting domestic and foreign direct investment (thanks to the opportunities offered by nearshoring) could set the stage for higher economic growth which, in turn, could improve economic resilience and sovereign creditworthiness.

Sovereigns

Challenging Political Landscape Could Weigh On Sovereign Ratings

What we expect for the next 12 months

- Rising rating pressure on Andean sovereigns, given their weak GDP growth and unfavorable political dynamics.
- The upcoming change of government in Mexico in mid-2024 is not likely to materially change its fiscal, monetary, or trade policies.
- A slower monetary policy normalization among local central banks will lower support to economic growth.

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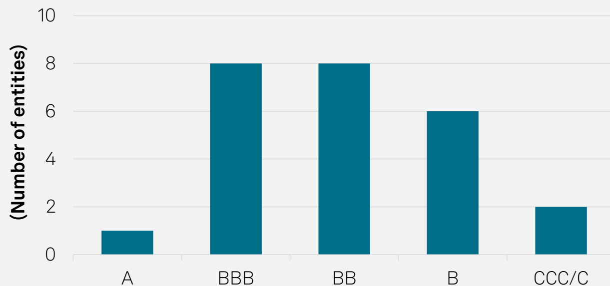
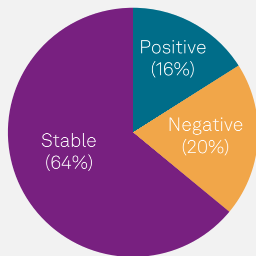
Rating distribution



Outlook distribution



Note: Includes public ratings only. As of April 26, 2024.

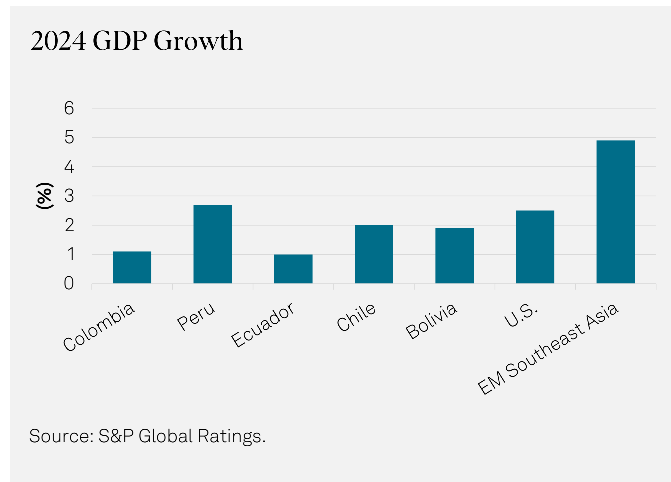
All the sovereigns in the Andean region currently have a negative outlook or were recently downgraded. Although the reasons for the negative outlooks and negative rating actions differ from country to country, there are common weaknesses pertaining to GDP growth and political factors that have contributed to poor economic performance and hurt creditworthiness.

We lowered our ratings on Peru in April 2024 because the enduring political standstill has limited the government's capacity to implement timely policies to boost the investment and economic growth outlook. Despite favorable commodity prices, economic growth remains subdued in Peru due in large part to political factors.

We assigned a negative outlook on Chile in October 2023 to reflect risks stemming from weakening political consensus on key parameters of its political and economic agenda, which might translate into weaker economic performance. Following the conclusion of an unsuccessful attempt to draft a new constitution, Chile's political impasse persists, preventing agreement on legislation to strengthen economic prospects and recover fiscal and external buffers.

In November 2023, we lowered our rating on Bolivia and assigned a negative outlook due to heightened external vulnerabilities (declining exports and limited liquid international reserves), high fiscal deficits, and poor transparency about central bank assets. Political stalemate and a divided Congress are constraining the government's room to maneuver, raising questions about its capacity to secure timely access to external funding.

In January 2024, we changed the outlook on Colombia to negative, reflecting concerns about the country's economic growth prospects. Private investment remains weak, partly due to a rift between the government and parts of the private sector.



Source: S&P Global Ratings.

We also assigned a negative outlook to Ecuador in January, reflecting deteriorated fiscal performance that has made it harder for the government to regain market access ahead of a challenging debt service profile starting in 2025.

We upgraded Brazil in 2023 and have a stable outlook on the rating. Further improvement to its credit quality would depend on addressing long-standing weaknesses that have limited the country's GDP growth rate. The obstacles to better growth are many, including weak public finances and low public investment in infrastructure. Economic reforms that strengthen public finances as well as directly target obstacles to growth could prompt us to raise the sovereign rating.

Most of our recent rating actions have been negative or neutral but **we also upgraded Paraguay** in February 2024. The upgrade was due to its track record of prudent macroeconomic policies, moderate fiscal deficits and general government debt, as well as a strong external position that have bolstered economic resiliency against external shocks and caused GDP per capita to rise consistently.

Corporations

Credit and business conditions mildly improving

What we expect for the next 12 months

- Business conditions to remain largely stable to slightly positive. Some sectors such as retail, chemicals, and telecoms will continue facing challenges.
- Some sectors that performed weakly in 2023 are showing good progress, such as protein producers, agribusiness, homebuilders, and airlines.
- Access to funding would continue improving both domestically and internationally as interest rates drop. International debt maturities will edge up in 2025 but they will remain manageable (roughly less than half of annual issuance).
- Investment trends should pick up as rates recede and after two years of relatively lower levels.

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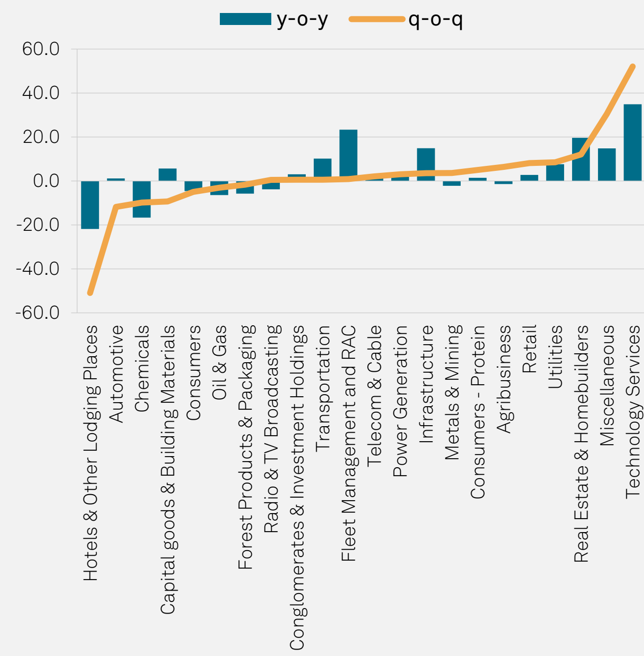
Revenue growth by sector



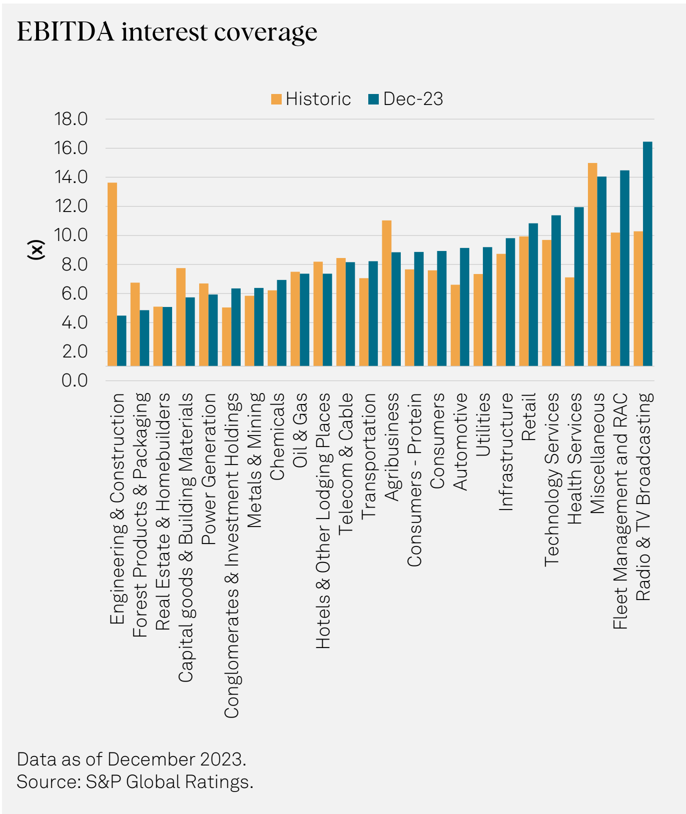
Business conditions are, for the most part, stable to mildly favorable. Although certain sectors like retail, chemicals, and telecoms will continue showing weakness due to secular negative trends. Competition among retailers remains fierce, evidenced by the recent default of Grupo Casas Bahia S.A. (not rated). Also, telecom and cable network operators are grappling with poor pricing power and margins while their debts remain a heavy burden--especially for small operators that invested aggressively to expand their networks.

We expect sectors like protein and agribusiness to improve as margins recover. The former due to lower corn prices (the main raw material) and the latter due to better ethanol prices. Although recent floods in the Brazil's southern state of Rio Grande do Sul may heighten operating risks, no material impacts have materialized so far.

Bond issuance should continue rising as domestic and international rates drop. With the caveat that trajectories are under ongoing debate. Domestic issuance remains buoyant in Brazil, Chile, and lately, Argentina. Argentine corporations may also benefit from declining risks premia as seen in recent issuances.

Debt maturities remain manageable in 2024 and will inch up in 2025, with international bond maturities of roughly $15 billion. We don't anticipate major issues in refinancing those maturities as they represent less than half of what the LatAm corporate sector issues annually.

We expect to see a pickup in corporate investments as interest rates drop. Investment levels had remained below historic levels for the past two years, even for some sectors with meaningful cash flow generation.



Data as of December 2023.
Source: S&P Global Ratings.

Financial Institutions

Solid Profits Should Support Ratings Stability

What we expect for the next 12 months

- Small and midsize enterprise (SME) and retail asset quality metrics could suffer from a slower interest-rate reduction pace in the region.
- Lending growth will remain at single digits as banks will continue to pursue conservative underwriting practices.
- Regional banks' solid profitability will enable them to withstand potential credit cycles and wider credit losses. This is thanks to a diversified business mix, sizable levels of high-yield government bonds, and healthy margins.

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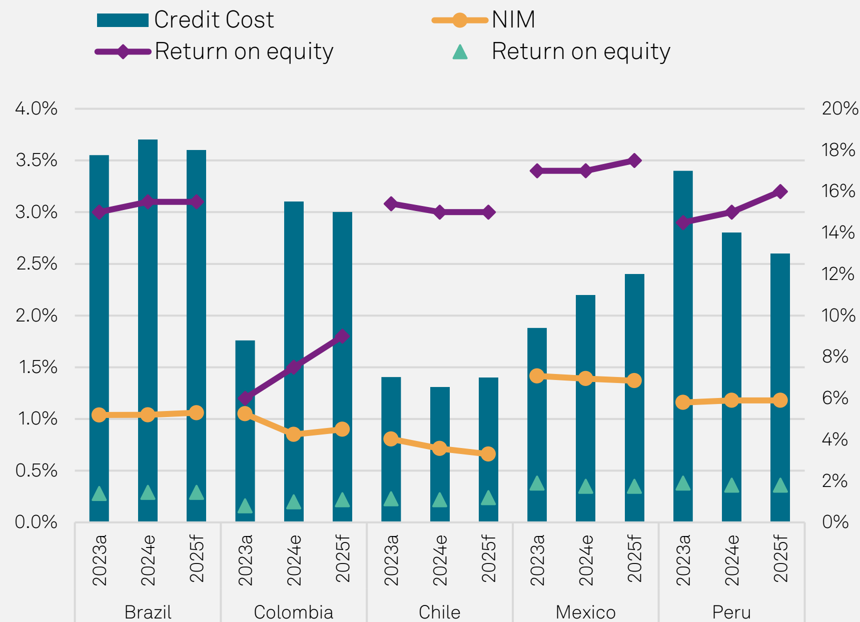
Credit growth, ROE, and NPAs*



*Simple average among major LatAm economies: Brazil, Mexico, Chile, Colombia, and Peru. ROE—return on equity. NPAs—nonperforming assets. e--estimate, f-- forecast. Source: S&P Global Ratings.

Asset quality metrics are starting to stabilize among most of financial institutions across LatAm. But the process is still fragile because economic growth remains subdued and the interest-rate drop pace among LatAm central banks, which has already started, may slow, as we expect that conditions for a monetary policy easing by the Federal Reserve won't be in place before autumn. As a result, there's a risk that asset quality metrics could suffer, especially in the SME lending and retail unsecured lending segments.

We expect lending growth to remain at single digits. We expect a pickup in credit demand in the corporate sector once interest rates fall to affordable levels, but banks will likely continue to pursue conservative underwriting practices, given the tepid pace of asset quality stabilization. SMEs' credit quality is strained as internal demand remains modest, given the persistently inadequate flow of credit to these entities and high interest rates, as they typically are charged a higher cost of borrowing than that for large companies. And during periods of asset quality deterioration, the access to credit is further restricted.

Regional banks' solid profitability, due to their diversified business mix and sizable levels of government bonds with high yields and margins, enable them to withstand credit cycles and wider credit losses. Banks continue to maintain high provisioning coverage ratios, which help mitigate the impact of weakening asset quality metrics. As central banks continue to lower their policy rates, we expect banks' margins to narrow but profitability should remain sound compared with those of international peers, thanks to still healthy margins and recovering asset quality metrics.

Insurance

A Balance Of Risks And Opportunities For Insurers

What we expect for the next 12 months

- We expect gross premiums written (GPW) growth to moderate this year to 5%-7% in real terms, with the pace in Mexico at the top of the range while that of Brazil and Colombia at the bottom. We forecast GPW in Argentina to contract in real terms this year.
- In our view, downside risks could stem from weaker-than-expected growth across the world's major economies--with potential significant repercussions for LatAm--along with a potential for further inflationary pressures that could extend the period of high interest rates.
- Our view of the LatAm insurance sector's credit quality remains steady, balancing its risks and opportunities.

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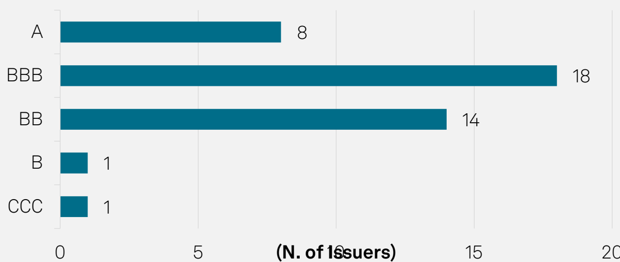
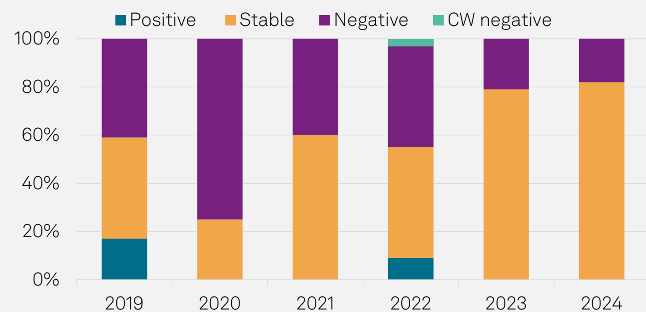
LatAm Insurance sector snapshot

LatAm insurer ratings distribution



LatAm Insurers' outlook distribution



Data as of May 6, 2024. Source: S&P Global Ratings.

Sluggish economy could weigh on insurers' growth prospects. However, opportunities from potential benefits of nearshoring, increasing awareness of the need for insurance protection, and insurers' digitalization and cost-efficiency strategies, could cushion the impact and allow them to posting profitable growth.

Weakening economies, high inflation, and climate events will pressure the sectors' operating performance. Nevertheless, we believe technical results will be supported by the prevalence of conservative underwriting policies. We expect insurers to keep increasing prices across certain business lines. Therefore, we expect steady levels of combined ratios in the region.

Cybersecurity risks and climate change are increasing and becoming more costly. As a result, reinsurance costs are rising, as are investments in technology, hurting insurers' margins.

The rating trajectory across the sector is stable. We expect the rated insurers will maintain conservative risk management and underwriting policies, along with sound capitalization and sufficient liquidity.

Strutured Finance

Falling Interest Rates Should Bolster Issuance

What we expect for the next 12 months

- We continue to expect market-wide issuance in LatAm to reach about $29 billion in 2024.
- Brazil will continue to be the most active market in the region, followed by the cross-border market.
- We observe interest in commercial mortgage-backed securities (CMBS) deals backed by industrial properties in Mexico and data centers in the region.

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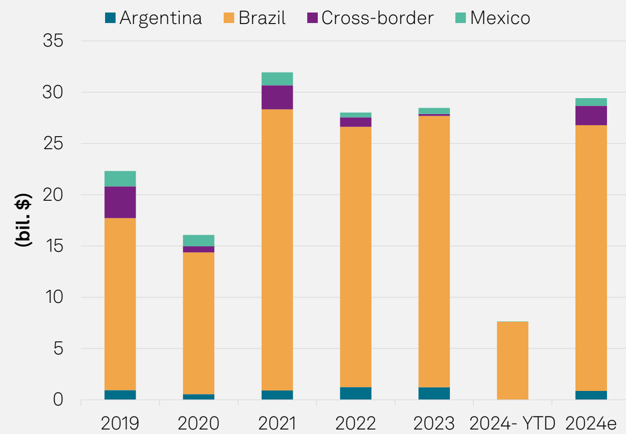
Structured finance market-wide new issuances



f - forecast. Source: S&P Global Ratings.

Brazil remains the most active market in the region. Some changes regarding the issuance of CRAs and CRIs may reduce issuance of these instruments, but we believe that larger issuances and other instruments will partially offset this. In addition to interest rates, there are significant refinancing needs in the corporate sector that should also drive issuance.

We continue to observe interest in future flows, repacks and diversified payment rights in the cross-border market.

Issuance volume remains subdued in Mexico. Investor sentiment toward nonbank financial institutions remains negative. However, interest rates are starting to come down, which should favor new issuance. We have also observed significant market interest in CMBS transactions backed by industrial real estate players across the country.

Conditions remain very challenging in Argentina. However, we have observed a drop in interest rates and some long-term assets are being originated. Both trends are positive for securitization.

Infrastructure

Extreme Weather And Oil Prices To Continue Driving Electricity-Price Volatility

What we expect for the next 12 months

- Hydro-based energy generation to continue experiencing volatility, with Brazil and Chile benefiting from lower prices, while spot-price hikes to pressure the industry in Colombia and Panama.
- Severity and increased frequency of climate-related events to impact other infrastructure operations, such as restrictions to cross the Panama Canal and the extreme flooding in the extreme south of Brazil. Still, we expect limited ratings impact at this point.
- Despite high interest rates and narrower margins, we don't expect worsening refinancing conditions to weigh on the rated issuers, given the absence of high debt maturities in the near term. In addition, except for Brazil, majority of LatAm infrastructure debt have fixed, or inflation-linked, rates, which should alleviate these entities' funds from operations.

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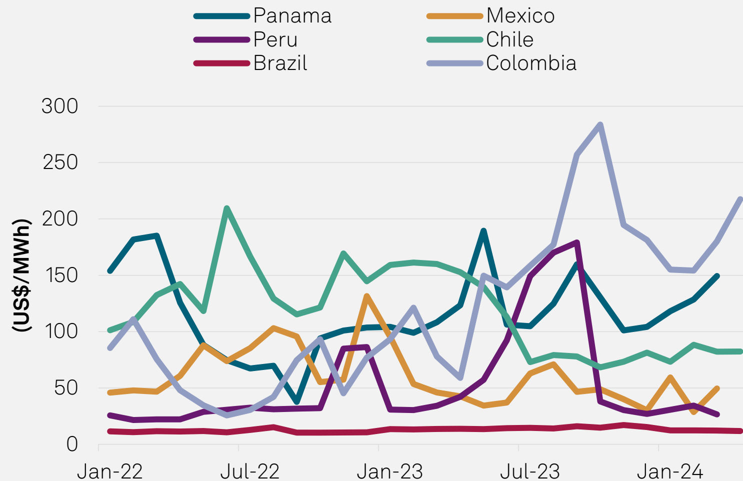
Climate events continue pressuring electricity prices

Spot electricity prices in LatAm



N Note: We estimate output gaps using a Hodrick-Prescott filter. Data as of May 10, 2024.
Source: Haver Analytics, S&P Global Ratings.

Adverse climate events to continue pressuring electricity prices. Whether or not influenced by El Niño phenomenon, we expect energy-price volatility to continue across LatAm in the next 12 months. In Colombia and Panama, energy price hikes will be significant in the short term, as hydro generation represents majority of installed capacity and severe drought has reduced reserve levels to critically low levels since El Niño began last year. Conversely, given favorable hydrology, Brazil, Chile, and Peru continue to benefit from low spot prices.

In Colombia, after reaching the peak of COP1.2 million per megawatt hour (MWh; about $310/MWh) in early April 2024, spot prices are subsiding due to the start of the wet season. But the government is working on to partially close the tariff balance to avoid a full pass-through of the energy price into consumers' energy bill. Despite low economic growth expected for 2024, the country will have to accelerate the construction of nonrenewable assets (concessions for which were granted in 2019) and transmission to reduce the share of hydro-based generation and meet the increasing demand.

Frequency and severity of climate events may continue to harm the operations of infrastructure assets, even though we don't anticipate the ratings impact at this point. Despite restrictions in daily transit in the Panama Canal due partly to the Gatún Lake water management, caused by severe drought that has reduced its water availability and daily transit by 30% in the past year, we don't anticipate a drop of cash flow. This is because Autoridad del Canal de Panama is offsetting lower traffic by raising prices to $10/ton from $6/ton under its "Value-Based Pricing" strategy in the near future. But we will closely monitor its ability to develop a permanent contingency plan to address similar risks in the future.

In Brazil, many infrastructure assets were damaged by the unprecedented floods in the state of Rio Grande do Sul. Although physical and financial impacts caused by the heavy rains in the state are still uncertain, given that the large share of infrastructure is submerged, we don't expect the rating impact on infrastructure entities. This is because the companies operating in Rio Grande do Sul are part of larger groups that benefit from relatively stable and predictable cash generation, as tariffs are usually adjusted to inflation while demand for infrastructure services is relatively steady. In our view, electricity distributors and water concessionaires will face modest impact, as we expect their essential services to be resumed once the flooding recedes and the companies to make investments for the reconstruction of damaged assets.

Gradual expansion of energy capacity to unlock nearshoring opportunities in Mexico, regardless who wins the presidential election in June 2024. Energy capacity and transmission constraints continue to hamper the expansion of manufacturing capacity. We expected the addition of 8 gigawatts in new renewable capacity by 2026, under slow and steady deployment by private investors, while state-owned Comisión Federal de Electricidad needs to invest to strengthen the transmission capacity, while adding new combined-cycle power plants, to mitigate already existing curtailment and energy spills.

Commercial Real Estate (CRE) In LatAm

The CRE segment remains a concern for banks across the globe. During the pandemic, hotels and retail properties have been hit especially hard. Currently, the stress comes from a longer-term structural shift in the sector, with many corporations implementing more flexible and hybrid working patterns. This has led to a decline in demand for office space, depressing asset valuations and cash flow. Given that banks in LatAm typically don't lend to this sector, because of the lack of access to long-term funding sources, their exposure to this segment is at single digits or negligible.

The only banking system in the region that has a more meaningful exposure to CRE is Chile's, but we believe it's manageable. Chilean banks have been reducing their exposure to the sector since the pandemic began and primarily lend to larger CRE players. So far, Chilean banks' asset quality remains strong despite the sector's downturn. We don't expect a major impact on Chilean banks from the property market because the exposure to construction companies and developers is about 12%. Of this percentage, the exposure to construction companies is only 3%, while the share of office loans is low, as most of the developments recently have been in the housing sector, but not in the multifamily segment. The multifamily property market is currently small in LatAm and is mainly funded by institutional investors and investment vehicles.

Historically, the issuance of CMBS has been low in LatAm. There are a few outstanding deals in Mexico and Brazil. However, we have observed increased market interest for potential deals backed by the industrial properties in Mexico and data centers across the region.

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