

SECTOR IN-DEPTH

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Contacts

Gersan R Zurita +55.11.3043.6097

Senior Vice President/CSR
gersan.zurita@moodys.com

Jaime Reusche +1.212.553.0358

VP-Sr Credit Officer
jaime.reusche@moodys.com

Aneliza Crnugelj +55.11.3043.6063

AVP-Analyst
aneliza.crnugelj@moodys.com

Lucas Viegas +55.11.3956.8717

VP-Senior Analyst
lucas.viegas@moodys.com

Sandra Beltran +52.55.1253.5718

VP-Senior Analyst
sandra.beltran@moodys.com

Ceres Lisboa +55.11.3043.7317

Associate Managing Director
ceres.lisboa@moodys.com

Marcos Schmidt +55.11.3043.7310

Associate Managing Director
marcos.schmidt@moodys.com

Cristiane Spercel +55.11.3043.7333

Senior Vice President/Manager
cristiane.spercel@moodys.com

Marianna Waltz, CFA +55.11.3043.7309

MD-Corporate Finance
marianna.waltz@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

Financial Stability – Latin America & Caribbean

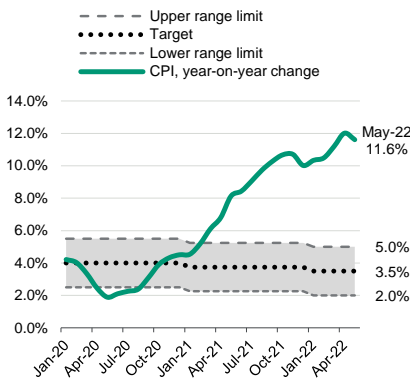
Frequently asked questions on inflation and interest rate rises in Latin America

- » **Inflation will remain above monetary authorities' target ranges in Latin America's five largest economies in 2022.** While we still expect inflation rates across the region to slow in 2023, the difference between actual and target inflation has widened relentlessly this year. Food and energy continue to be the leading components of higher headline inflation. Monetary policy in Latin America shifted toward tightening earlier than in other emerging economies and much earlier than in advanced economies.
- » **Inflation that reduces real wages risks curtailing consumption and weighing on economic activity in Latin America, disproportionately affecting lower-income households and risking social discontent.** Inflation has helped boost revenue for Latin American governments, which have increased spending on subsidies and existing social programs. But public finances face higher financing costs as central banks raise interest rates and implement monetary tightening, especially for countries with high ratios of interest payments to government revenue.
- » **Persistent high inflation and higher social demands increase the risk of political interference for regulated infrastructure issuers and utilities.** Government initiatives across the region in 2022 to alleviate customer affordability concerns are complicating cash-flow protection mechanisms for infrastructure companies' contracts. While most companies can still generate enough cash to cover mandatory cash obligations and maintain short-term capital spending on existing assets, they also face higher debt costs and working capital needs with rising energy costs.
- » **Latin American banks began the current inflation cycle highly provisioned and with low levels of problem loans, offering some protection from rising asset risk as inflation and higher interest rates reduce household income.** But credit growth, profitability and asset quality vary by country, depending on the stage of the credit cycle. Delinquencies have already returned to pre-pandemic levels in Brazil and will likely rise further because of weak forecast GDP, while business conditions will be more benign for bank margins in the Andean region and in Mexico.
- » **Latin America's consumer-dependent sectors in particular face tighter margins as their costs rise.** Most rated Latin American consumer-facing companies have sustained profitability so far, and can generally withstand a period of higher inflation. But rising costs will become more visible to retailers as pandemic-induced distortions fade, and persistent high inflation will strain profitability in consumer-related sectors such as protein producers, auto suppliers and airlines.

Will inflation continue to rise in Latin America and will interest rates respond accordingly?

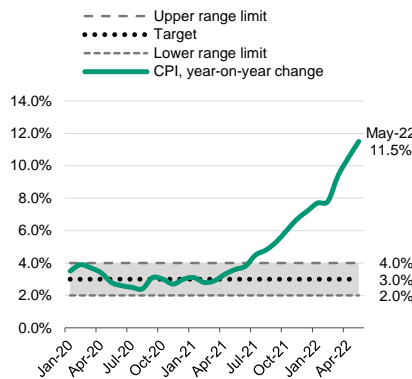
We maintain [our view](#) from February that inflation will remain above monetary authorities' target ranges in most of Latin America. Inflation rates are now far above targets in the region's five largest economies – Brazil, Chile, Colombia, Mexico and Peru – and remains chronically high in Argentina (see Exhibits 1-6). In Brazil and Chile, inflation rates are 2.5x to 2.9x higher than the upper limit of the tolerance range set by the central banks. Despite rapid and substantial increases in reference rates intended to quell the reflation momentum that began with the recovery in economic activity from pandemic lockdowns, the difference between actual and target inflation has widened relentlessly this year. However, we continue to expect inflation rates across the region to slow in 2023.

Exhibit 1
Brazil consumer price inflation
 Year-over-year change, Jan 2020-May 2022



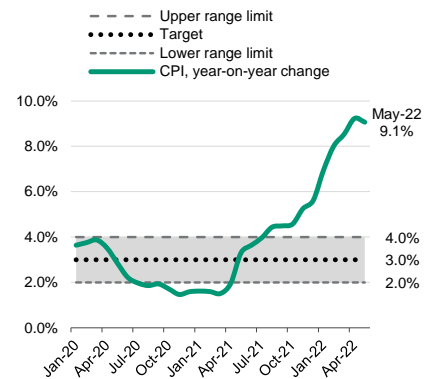
Sources: Instituto Brasileiro de Geografia e Estatística (CPI), Banco Central do Brasil (target and ranges)

Exhibit 2
Chile consumer price inflation
 Year-over-year change, Jan. 2020-May 2022



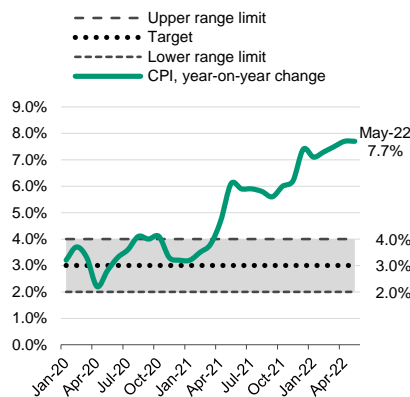
Sources: Instituto Nacional de Estadísticas (CPI), Banco Central de Chile (target and ranges)

Exhibit 3
Colombia consumer price inflation
 Year-over-year change, Jan. 2020-May 2022



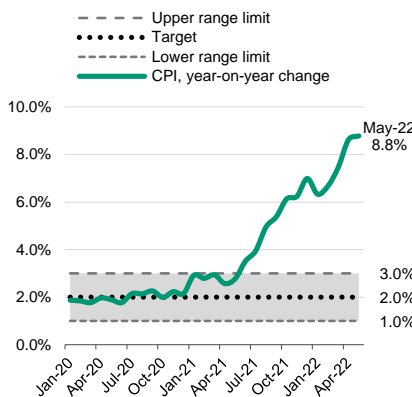
Sources: Departamento Administrativo Nacional de Estadística (DANE), Haver Analytics (CPI); Banco de la República (target and ranges)

Exhibit 4
Mexico consumer price inflation
 Year-over-year change, Jan. 2020-May 2022



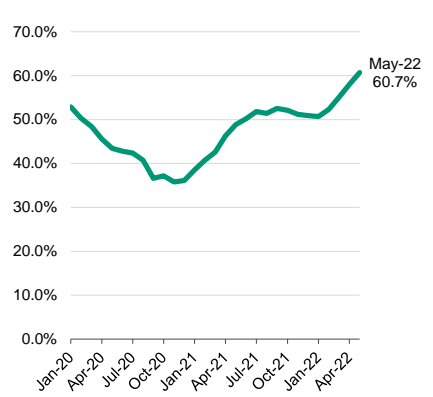
Sources: Instituto Nacional de Estadística, Geografía y Informática (INEGI), Banco de México (target and ranges)

Exhibit 5
Peru consumer price inflation
 Year-over-year change, Jan. 2020-May 2022



Sources: Instituto Nacional de Estadística e Informática (CPI), Banco Central de Reserva del Perú (target and ranges)

Exhibit 6
Argentina consumer price inflation
 Monthly change, Jan. 2020-May 2022



Data are not seasonally adjusted
 Source: Instituto Nacional de Estadística y Censos (CPI)

Food and energy continue to be the leading components of higher headline inflation. Food prices are correlated with oil prices, which remain elevated and will likely persist at high levels for the duration of the Russia-Ukraine military conflict. Oil prices are twice the average in the five years preceding the COVID-19 pandemic. Fertilizer prices are also up sharply, which is negative for Latin American farmers because they import large quantities of fertilizer from Russia. Some fertilizers such as ammonia and urea are derived from

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natural gas, which is in high global demand for electric power, chemicals and other uses; gas prices are therefore 3x higher than the five-year pre-pandemic price and, along with oil, has contributed to higher food costs. One mitigant to rising fertilizer prices is that, even before the outbreak of the Russia-Ukraine conflict, Latin American farmers had been searching for alternative suppliers or looking to shift toward less fertilizer-intensive crops as prices had been rising.

Although Latin America does not import Ukrainian wheat, the supply of which has been severely disrupted, food inflation is very high in most countries in the region and around the world. In Colombia, for example, food price inflation surged to 26.2% in April from the same month a year earlier, 2.9x higher than total consumer-level inflation and 3.4x higher than the core (less volatile) component of the consumer price index. Likewise, energy prices in Peru were up 22.3% in May from a year earlier, which is 5x higher than the core segments of the index, which rose 4.3%.

Supply bottlenecks and raw materials prices remain among the key drivers of inflation globally. The cost of transporting goods by sea vessels in key routes is around 7x their long-term cost (\$100 for a 40-foot container), down from 12x in the fall of 2021. It is therefore doubtful that aggressive policy rate increases alone will effectively reduce inflation to the target ranges, but these increases will likely succeed in removing some of the excess money supply that was added to financial systems in 2020 to counteract the liquidity crisis during the COVID-19 crisis. Brazil and Chile, in particular, lowered interest rates to historic lows in 2020 following large output gaps, a sudden stop in non-food consumption and rising unemployment. Chile's central bank also expanded liquidity through unconventional measures, including quantitative easing. The combined effects of excess money supply and strong demand for consumer goods that resulted from stimulative measures with stable (at best) or diminished productive and import capacity in the aftermath of the pandemic, will likely maintain inflation above the levels targeted by central banks through 2023.

Monetary policy in Latin America shifted course toward tightening earlier than in other emerging economies and much earlier than in advanced economies. For example, Brazil's interest rates have jumped by 1,175 basis points since February 2021 to 13.75% currently, the highest level since 2016. Policy rates have also risen in Chile, Mexico, Colombia and Peru. In these Latin American countries, the sole or top mandate of central banks is to safeguard price stability. We therefore expect reference rates to continue to rise until inflation convincingly begins to descend toward the target ranges, although the increase in rates will perhaps not be as rapid as it was at the start of the reflation cycle.

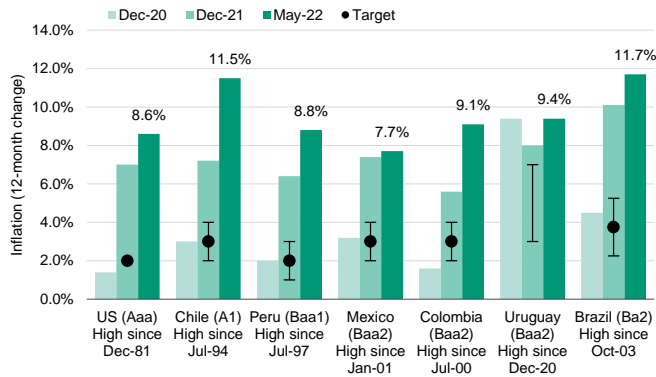
What are the main risks from the persistent inflationary environment for the region's sovereigns?

The overall macroeconomic impact of the current spike in inflation is negative because it brings about two direct challenges. The first is a reduction in real wages that will likely curtail private consumption and weigh on economic activity, further moderating growth throughout the region in 2022-23. The second is the intensification of social unrest as the cost of basic necessities increase for the general population. The rise in inflation for most Latin American economies is due in part to the strong increase in energy and food prices. These have an outsized negative effect on households' well-being, disproportionately affecting lower-income households and prompting the boiling over of social discontent. Moreover, vulnerable households that spend a greater proportion of their income on food and energy risk falling into poverty.

In response to these pressures, governments in the region have enacted spending measures that include subsidies, transfers and expanding existing social programs, in some cases complimenting these with tax relief measures. The fiscal costs from these measures are partly offset by the fact that inflation has helped boost government revenues in nominal terms and that the tax intake has benefited from the post-pandemic rebound in economic activity. However, the rapid rise in prices necessitated a swift response by governments, and because of the small window for implementing these measures, most are untargeted and regressive, resulting in a larger than warranted fiscal cost.

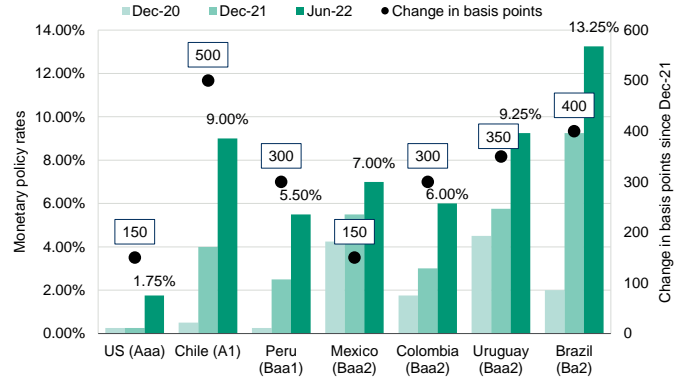
Despite these inefficiencies, the main risk to the region's public finances comes from the increase in financing costs as central banks, both global and domestic, raise interest rates and implement monetary tightening measures to tackle higher inflation. Globally, we find a high degree of synchronization on inflation rates, especially among advanced economies, that is feeding price pressures and driving inflation to its highest levels in almost 40 years (see Exhibits 7-8). Central banks in advanced economies are tightening monetary policy at a relatively quick pace, which will result in further increases to global interest rates, and due to the high degree of synchronization, Latin American central banks are also rapidly adjusting their policy rates.

Exhibit 7
Inflation reaches highest levels in decades...
 Consumer price inflation, current targets and target ranges



Vertical lines indicate target ranges
 Sources: Central Reserve Bank of Peru, Haver Analytics, Moody's Investors Service

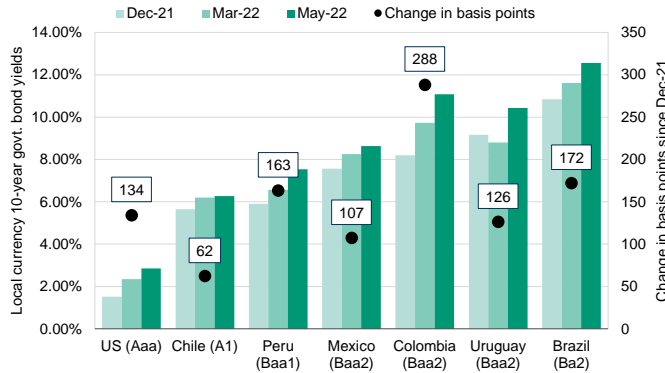
Exhibit 8
...prompting significant monetary tightening
 Central bank policy rates



Sources: Central Reserve Bank of Peru, Haver Analytics, Moody's Investors Service

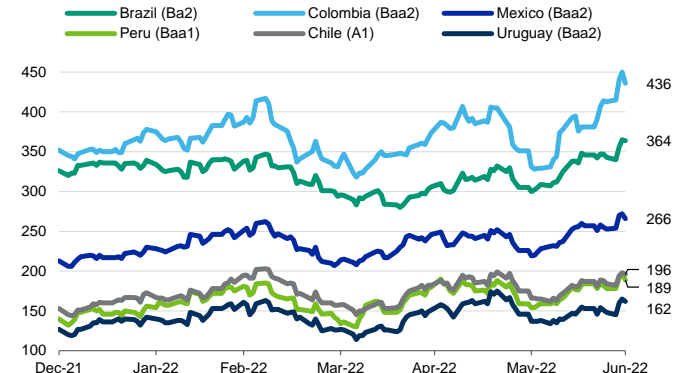
This tightening has led to invariably higher funding costs in local and foreign currencies for the region's sovereigns (see Exhibits 9-10). Those with relatively large financing needs will be most exposed to increased global and domestic interest rates. Because financing needs are a function of fiscal deficits and debt coming due, sovereigns that front-loaded fiscal consolidation efforts or will have relatively lower fiscal deficits from 2022 onward, such as [Mexico](#) (Baa2 stable, 3.4% of GDP), [Peru](#) (Baa1 stable, 1.8% of GDP) and [Uruguay](#) (Baa2 stable, 3.8% of GDP), will be on a relatively stronger footing to absorb higher funding costs. Similarly, sovereigns with a lengthy average maturity of their debt like Peru (13.2 years) and Uruguay (12.3 years) will face lower rollover requirements and refinancing rates.

Exhibit 9
Cost of funding on the rise in local currency...
 Local currency 10-year government bond yields



Sources: Haver Analytics, Moody's Investors Service

Exhibit 10
...and on foreign-currency issuance
 EMBI+ sovereign spread (basis points)*



*EMBIG for Chile and Uruguay
 Sources: Haver Analytics, Moody's Investors Service

Conversely, sovereigns that already face debt affordability challenges with a high ratio of interest payments to government revenue, such as [Brazil](#) (Ba2 stable, 22.5%), [Costa Rica](#) (B2 stable, 31.2%) and [Dominican Republic](#) (Ba3 stable, 21.5%), will be most vulnerable to the higher funding costs brought about as central banks fight to tame inflation.

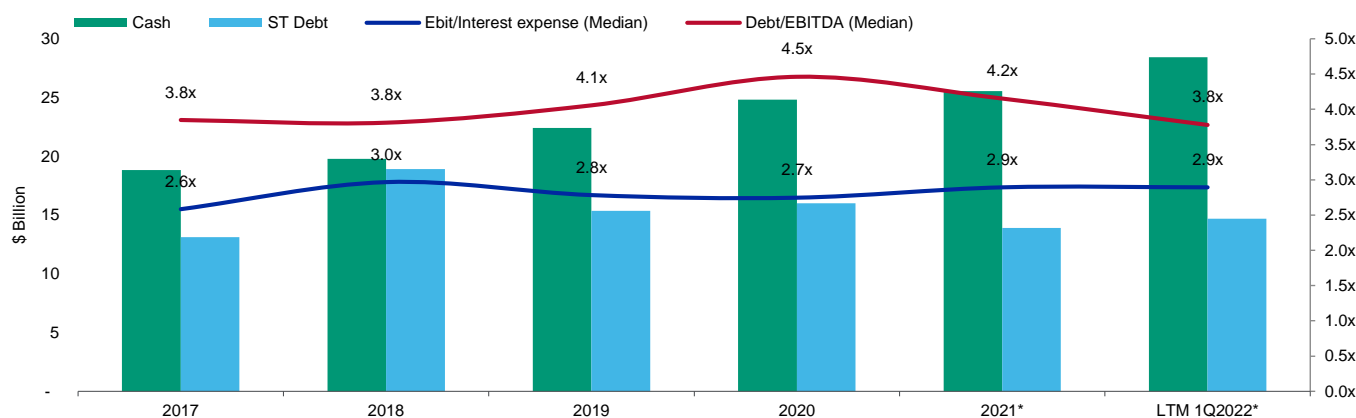
How will the policy response to high inflation influence institutional frameworks for infrastructure issuers and utilities?

Persistent high inflation and higher social demands increase the risk of political interference for regulated infrastructure issuers and utilities. Latin American regulators have begun delaying approvals for tariff adjustments and imposing price caps, increasing the need for government subsidies and tax changes in response to political pressure on customer's affordability concerns. Political, regulatory and legal uncertainties make long-life, capital-intensive infrastructure projects more exposed, because they depend on their asset bases' remuneration and cost-recovery mechanisms to meet future debt payments.

While rising energy costs and interest rates increase working capital needs and debt burdens, most companies within the infrastructure and utility sectors can still generate enough cash to cover mandatory cash obligations and maintain maintenance capital spending on existing assets at a healthy rate. Cost-saving efforts and gradually improving demand are easing some of the stress on their operating cash flows. Additionally, better hydrological conditions favor electricity generation and distribution operating margins in 2022.

Exhibit 11

Inflationary and rising interest rate pressures are somewhat mitigated by the portfolio's liquidity



* considering data availability for the respective companies within the portfolio

Source: Moody's Financial Metrics™

Government initiatives across Latin America in 2022 have set out to alleviate customer affordability concerns, complicating cash-flow protection mechanisms for infrastructure companies' contracts. Difficulties in passing through costs to consumers through tariff adjustments will strain operating margins in most jurisdictions. Electric utilities and power companies have especially more exposure to working capital needs, with a lag between their incurring costs and collecting higher revenue under their regulatory allowances and power-purchase agreements. Nonetheless, we expect the institutional frameworks' checks and balances to ease the credit strain by allowing companies to pursue courts to enforce contractual provisions if necessary.

Brazil's relatively benign regulation has allowed regulated companies to pass through their higher costs, but with an election in October 2022, companies face some political risk of deferrals that increase regulatory lag and working capital constraints. One bill under discussion in the lower house of Brazil's congress would cap tariffs' pass-through and even revert tariff adjustments that the federal regulator ANEEL has already approved. Sao Paulo state regulator ARTESP has temporarily suspended for six months the annual tariff review that toll roads had expected in July 2022, but with an alternative compensation for lost revenues with transfers from the state [Government of Sao Paulo](#) (Ba2 stable). Meanwhile, congress has capped collection of the state ICMS tax, to address price increases for such essential services such as fuel, electricity, natural gas, telecom and public transportation. The government will use about \$6.4 billion in privatization funds from [Centrais Eletricas Brasileiras SA-Eletrobras](#) (Ba2 stable) to subsidize electricity tariffs.

Mexico's federal energy regulator CRE will likely extend its 2021 price cap on liquefied petroleum gas, originally set to expire in August 2022, to help protect consumers from high energy prices for longer. The government will also maintain highway tolls without adjustments, reduce taxation and import tariffs for some items. In 2019, the government had capped inflation-related readjustments

of electricity tariffs for [Comision Federal de Electricidad's](#) (Baa2 stable) domestic and agriculture customers, limiting the utility's full recovery of its fuel costs.

A renewed push for further price intervention in **Chile**, particularly for residential consumers, would hurt credit quality for the country's regulated utilities. Chile in 2019 implemented PEC, a somewhat credit-neutral, market-based price-stabilization mechanism, but PEC has proven insufficient to withstand prolonged high inflation and fuel prices. Chile's congress is now reviewing a proposal to implement a PEC-like mechanism to allow an emergency government fund to help power generation companies recover their higher costs, rather than passing them on to end customers. Inflation adjustments of regulated tariffs will likely continue.

In **Colombia**, meanwhile, regulatory delays in tariff adjustments and proposals to eliminate passing through the costs of currency volatility raise credit risks for gas utilities such as [Promigas](#) (Baa3 stable) and [Transportadora de Gas Internacional](#) (Baa3 stable), on top of lower returns on their asset bases.

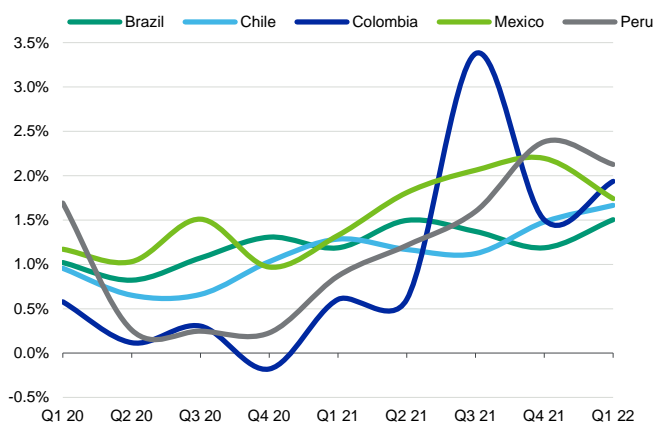
Argentina's political interference in the tariff-setting process has been erratic for most of the last 20 years, on top of utilities' ability to pass through their increased but heavily subsidized power costs to end consumers. Argentina's power production relies heavily on gas-fired thermal power, but the country lacks sufficient natural gas to meet its demand, particularly in the winter, so it must import more expensive gas and fuel oil, increasing generation costs significantly. Rather than customers, the government pays these additional costs, straining its fiscal accounts and exacerbating Argentina's inflation risks. The lack of a tariff-adjustment mechanism leads to declining margins for regulated electric distribution companies such as [Edenor](#) (Caa3 negative), which cannot fully pay for its power purchases and must take on commercial debt with Cammesa, Argentina's wholesale energy market clearing operator.

How will Latin American banks navigate prolonged inflation and any further interest rate hikes? What are the implications for growth, asset quality and profitability?

Latin American banks have navigated through previous periods of high inflation and interest rates and have proven their ability to pass on higher rates to customers, manage asset risks and absorb increasing expenses (see Exhibit 12). The banks in the region entered this cycle supported by high provisioning levels and with low levels of problem loans, conditions that will help shield their balance sheets from rising asset risks as inflation and higher interest rates reduce household income (see Exhibit 13). However, countries in the region are at different stages of the credit cycle, with varying growth prospects and disparate responses to the COVID-19 crisis, leading to diverse scenarios for credit growth, profitability and asset quality.

Exhibit 12

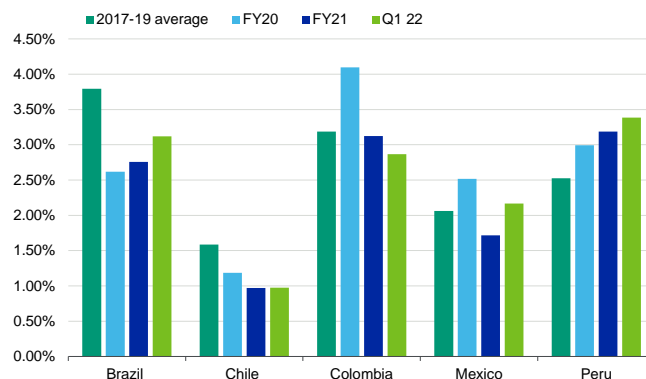
Latin American banks are passing higher rates to borrowers, helping profitability
Net income to tangible assets



Sources: Banks' financial reports, Moody's Investors Service

Exhibit 13

Problem loans will converge to higher pre-pandemic levels in most countries, following government aid packages, pressured by economic challenges
90+ non-performing loans as percentage of gross loans as of Q1 2022



Sources: Banks' financial reports, Moody's Investors Service

Country ratio calculated as the average from a sample of large banks in each system. **Brazil** - Itaú Unibanco S.A. (Ba2 stable, ba2¹), Banco Bradesco S.A. (Ba2 stable, ba2), Banco Santander (Brasil) S.A. (Ba1 stable, ba2), Banco do Brasil S.A. (Ba2 stable, ba2); **Mexico** - Banco Nacional de México, S.A. (Baa1, under review, baa2), Banco Santander México, S.A. (Baa1 stable, baa2),

BBVA Mexico, S.A. (Baa1 stable, baa2), Banco Mercantil del Norte, S.A. (Baa2 stable, baa2); **Chile** - Banco Santander-Chile (A1 negative, baa1), Banco de Chile (A1 negative, baa1), Banco de Credito e Inversiones (A2 positive, baa1); **Peru** - Banco de Credito del Peru (Baa1 stable, baa2), Banco BBVA Peru S.A. (Baa1 stable, baa2); **Colombia** - Bancolombia S.A. (Baa2 Stable, ba1), Banco Davivienda (Baa3 stable, ba1)

In Brazil, loan delinquencies are already converging to pre-pandemic levels of 3%-4% of gross loans for the industry at the end of 2019. The rapid monetary policy tightening cycle in response to persistent inflation has increased benchmark rates by 1,125 basis points since April 2021, which has constricted borrowers' cash flow, particularly since the end of 2021. Meanwhile, elevated [household indebtedness](#) (52.6% in December 2021) and weak economic activity will continue to raise provisioning costs in the second half of 2022 and beyond, and will also keep credit demand low. These factors will likely depress banks' profitability, despite higher lending rates, as banks focus new loan origination on secured and lower yield products, such as payroll loans (11% of industry credit in February 2022). At the same time, mortgages that grew strongly in times of low interest rates will be less attractive at current rate levels, with individuals postponing long-term investment decisions. Mortgages in Brazil are largely fixed rate and accounted for 18% of total loans in February 2022, which limits asset risk pressure. Nonetheless, there could be strain on some banks' profitability, particularly those more focused on housing products, such as federally owned social housing lender [Caixa Economica Federal](#) (Ba2 stable, ba3), with 64% of its loan book in housing as of March 2022.

Mexican banks resumed credit expansion later than most of their Latin American peers and are likely to continue growing loans despite forecast GDP growth of just 1.8% for 2022. However, banks in Mexico will mitigate the asset risk deterioration by continuing to focus primarily on lending to corporates and high to middle income individuals, and they also have high levels of reserves for loan losses. Nonetheless, there is growing appetite among Mexican banks for riskier and high-yield products, such as credit cards and personal loans, which will likely increase problem loans in 2022 and 2023 from current low levels, despite banks' historically tight credit underwriting policies and their conservative response to weakened economic activity in the country. Therefore, we expect Mexican banks' 2022 profitability to be above that of 2021 (a roughly 2.0% ratio of net income to tangible assets), as they benefit from asset repricing and access to cheap core funding that has proven to have low elasticity with higher interest rates. However, higher margins will be somewhat offset by an uptick in credit costs.

In Peru, banks' financial fundamentals will be supported by a more benign economic scenario, benefiting from credit and liquidity aid packages that were recently renewed (Reactiva Perú), which will alleviate the effects of increasing inflation and interest rates on SME credit. Peruvian banks' margins will benefit from higher interest rates and a cautious shift toward higher yielding assets, but bank margins will remain below pre-pandemic levels of 4.5%-5.0%. Asset quality metrics in Peru will also be supported by rising commodity prices and forecast real GDP growth of 2.5% in 2022 and 3% in 2023.

Chilean banks' asset quality continues to benefit from past withdrawals of pension funds that supported individuals' repayment capacity. Problem loans increased to a still low 1.4% in May 2022 from 1.2% in December 2021 and will likely continue to deteriorate toward more normalized pre-pandemic levels of around 2% in the next 12-18 months. On top of inflationary pressures on borrowers, there will be a slowdown in real GDP growth to 2% in 2022 and 1% in 2023 because of continued uncertainties around the new constitution and social demands on the Chilean government. A significant share of loans in Chile (59.7% in March 2022) consists of inflation-linked contracts (Unidades de Fomento), mostly for mortgages, which will support earnings but also exposes banks to asset risk, since individuals will have lower disposable income because of inflation as well as higher coupon payments. Chilean banks have nevertheless accumulated a substantial stock of loan loss reserves equivalent to 341% of problem loans as of May 2022.

Colombian banks are poised to grow thanks to a strong economic recovery in the country, which is much more robust than in other countries in the region. The improving operating environment will support lower credit costs and improving profitability in 2022. Banks' delinquencies (measured by 90-day nonperforming loans) have declined to 2.9% of gross loans as of first quarter 2022, in the middle of the peer group, from a December 2020 peak of 4.1% of gross loans, which was then highest in the region. Although immediate, material disruptions are unlikely, increased political uncertainty following recent presidential elections could lower household and investor confidence, postponing investment decisions and reducing loan demand as well as banks' risk appetite. However, for now, banks in Colombia will likely benefit from higher margins and contained credit risks in 2022, which will support profitability in 2022.

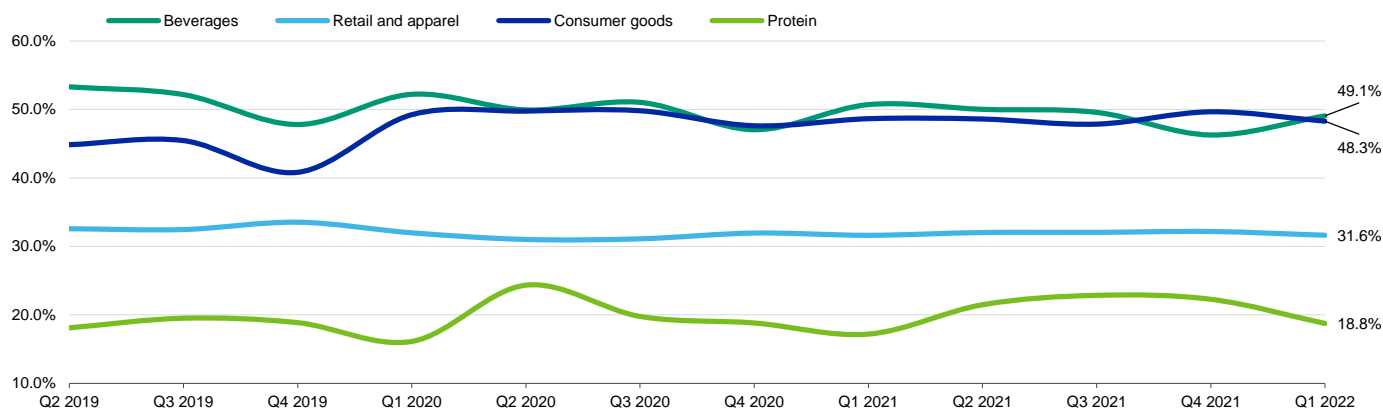
Will credit quality remain stable for Latin American nonfinancial companies amid prolonged high inflation and supply-chain disruptions?

Latin America's consumer-dependent sectors in particular face tighter margins as their costs rise. So far, rated companies in Latin America's consumer-facing sectors have been able to sustain profitability and can generally withstand a period of higher inflation (see Exhibit 14). But rising costs will become more visible to retailers as pandemic-induced distortions fade, and persistent high inflation will strain profitability in consumer-related sectors such as protein producers, auto suppliers and airlines.

Exhibit 14

Even after hiking costs, companies in consumer-facing sectors have so far maintained margins

Gross margin in consumer-facing Latin American sectors, Q2 2019-Q1 2022



Source: Moody's Financial Metrics™

Pent-up demand for **retail** and physical reopening of stores since mid-2021 has more than offset tightening margins for retailers, but rising costs will become more visible to them as pandemic-induced distortions fade. Stimulus spending in Chile and Peru, both key markets for [Cencosud](#) (Baa3 positive), had fueled support for households and businesses. GDP rose by 11.7% in Chile in 2021, and by 13.5% in Peru. More moderate spending in 2022 will bring GDP in those countries down to a 2.0%-2.5% range, preventing retailers from fully passing through higher costs. Cencosud's core supermarket segment is less cyclical, but reduced spending will affect its department stores, home-improvement and cash-and-carry businesses. Meanwhile, [the July 2022 acquisition of The Fresh Market](#) (B3 stable) exposes Cencosud to weaker US business conditions. Working capital needs will intensify for firms such as apparel company [Grupo Axo](#) (Ba2 stable) that will try to secure inventories amid supply-chain disruptions. Brazilian retailer [Americanas S.A.](#) (Ba1 stable) has also benefitted from increasing traffic in its physical stores as well as sustained growth in online sales. Despite the constant growth in revenues and cost controls, interest expenses have picked up. Americanas will see a substantial increase in interest expenses despite having reduced its debt balance. We expect revenues to grow over 15% in 2022 and EBITDA to increase by 24%. Nevertheless, EBITDA/interest expenses will decline to 2.0x in 2022 from 2.4x in 2021.

Most rated Latin American **consumer product** companies are large and well diversified enough to weather inflation through pricing power, flexible product portfolios, efficient operations, strict cost controls and hedging strategies that make costs predictable. Mexican Coca-Cola bottlers [Coca-Cola FEMSA](#) (A3 stable) and [Arca Continental](#) (A3 stable) have successfully implemented price increases above inflation. [Grupo Bimbo](#) (Baa2 stable) has sustained profitability as the world's largest baked-goods company, with strength across products and markets, but they all have little room for missteps in implementing their commercial strategies. [Ambev](#) (Baa3 stable) has managed to pass through some of its higher costs to consumers, but commodity and currency hedges continue to pressure EBITDA margins in 2022.

Margins for Latin American **protein** producers face inflationary risk both from consumers' diminishing purchasing power and higher input costs for grain, fuel and plastics, especially amid robust grain exports and currency depreciation. Despite [BRF's](#) (Ba2 stable) procurement strategy, geographic diversification in Brazil, expansion of grain storage and strong market presence, grain prices and weakening demand will strain its margins during 2022.

Latin American **auto-parts suppliers** face weakening demand with global growth in light vehicle sales [slipping to 0.7% for 2022](#), with reduced economic growth forecasts and continued supply-chain disruptions for semiconductors and other parts restricting vehicle production. With dealer inventories reduced to a minimum over the last two years, lower production will have a corresponding effect on sales. Mexico-based [Nemak's](#) (Ba1 stable) operations are closely linked to the performance of the automotive industry in North America and Europe, which contributes 88% of the company's revenue.

Higher jet fuel prices will hurt Latin American **airlines** if they cannot increase airfares enough to compensate for higher jet fuel costs. Latin America's carriers hedge no more than 20% of their next-12-months jet fuel needs, and jet fuel costs have soared to nearly 50% of operating costs for airlines in Brazil compared to a more typical 30%, leading carriers to seek tax relief for their fuel purchases. Meanwhile, fuel and food comprise more of a consumer's budget in the emerging markets than in the advanced economies, so airlines will ultimately need to reduce capacity if their profitability starts to deteriorate, slowing their recovery. [Gol Linhas Aereas Inteligentes](#) (B3 stable) in April 2022 cut its domestic capacity by around 26%, [Azul](#) (B3 stable) by 10% and LATAM Airlines Group by 18% from the summer December-March peak; all three airlines are targeting higher fares. Domestic airfare sales in Brazil increased by 31% in April 2022 compared to the summer peak. Mexican airline [Aeroméxico](#) (B3 stable) continues to face strong demand. During the first quarter of 2022, domestic revenue increased by 71.5% and international revenue by 160%, allowing it to mitigate the impact of higher fuel costs without capacity adjustments.

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Endnotes

- 1 The bank ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment.

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