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Latin America: The Boom Ahead and Its Risks

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Abstract

Latin America is rich in commodities and moving towards sound public finances. It can be an alternative to debt-laden economies and to the AI-driven boom. How long it lasts is anything but certain.

Zusammenfassung

Lateinamerika ist rohstoffreich und setzt auf Markt und solide Staatsfinanzen. Für Anleger wird die Region damit zur Alternative zu Schuldenstaaten und KI-Boom. Wie lange der Kurs hält, ist offen.



Over the past three years, Latin America has undergone an economic policy shift towards fiscal discipline, a smaller and more efficient state, and freer markets. This shift is making the region more attractive to international investors seeking alternatives to heavily indebted advanced economies and looking to diversify their portfolios away from the AI boom. Rarely have the push and pull factors been so favourable for the region. Capital inflows could support growth and give reforms political momentum, at least until the pendulum swings back to the left. Following the surprising victory of 81-year-old Luiz Inácio Lula da Silva in Brazil's presidential election, it remains unclear whether Brazil will join this shift and benefit from it.

Improving Pull Factors

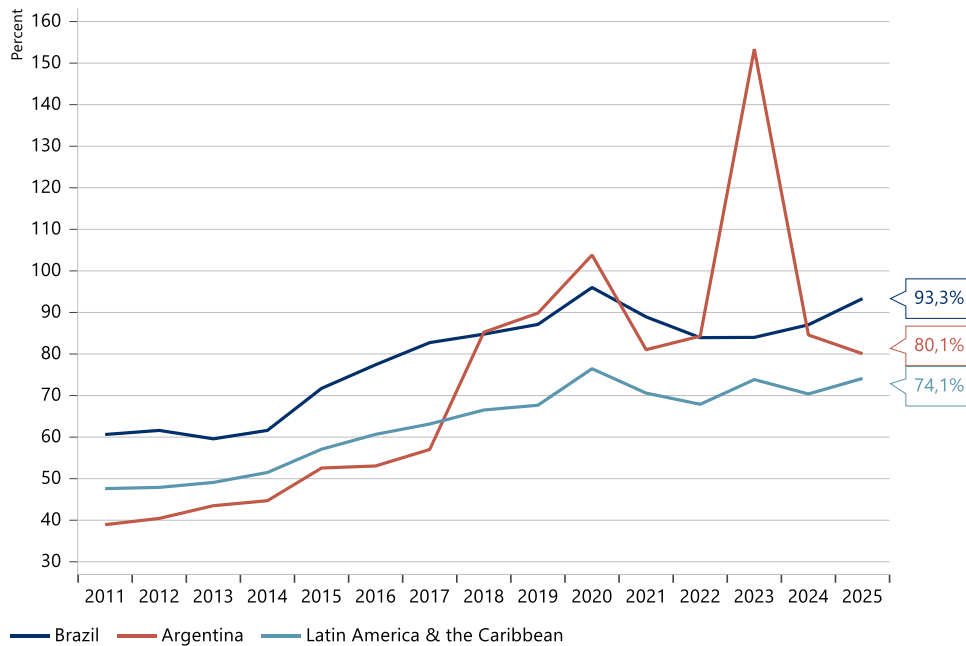
A region becomes more attractive to investors when its macroeconomic conditions improve or when the alternatives become less appealing. The literature distinguishes between pull factors (domestic conditions) and push factors (international conditions) as drivers of growth.

Credible fiscal consolidation is an important pull factor. When a government faces financial difficulties, it may resort to printing money to finance its spending. This depreciates the currency and worsens investment conditions. Sound public finances, by contrast, strengthen private-sector activity. The more stable the macroeconomic environment, the more attractive the region becomes for both domestic and foreign investment.

Low international financing costs during the 2010s made it easier for many Latin American governments to finance higher public spending through borrowing. Across Latin America, public debt rose from just under 50 percent of gross domestic product (GDP) in 2011 to 74.1 percent in 2025 (Figure 1). In Brazil, the debt ratio increased from 60 to 93.3 percent of GDP. In Argentina, it rose from 40 percent to more than 80 percent in 2022. In 2023, it jumped abruptly to 106 percent or even more than 150 percent, depending on the measure used. Following Javier Milei's electoral victory and his decisive move to balance the government budget, Argentina's public debt ratio fell to around 80 percent in 2025. As the reforms have been accompanied by stronger growth, Argentina has since become a model for other conservative politicians in Latin America seeking to consolidate public finances.



Figure 1: Rising Public Debt Ratios in Latin America

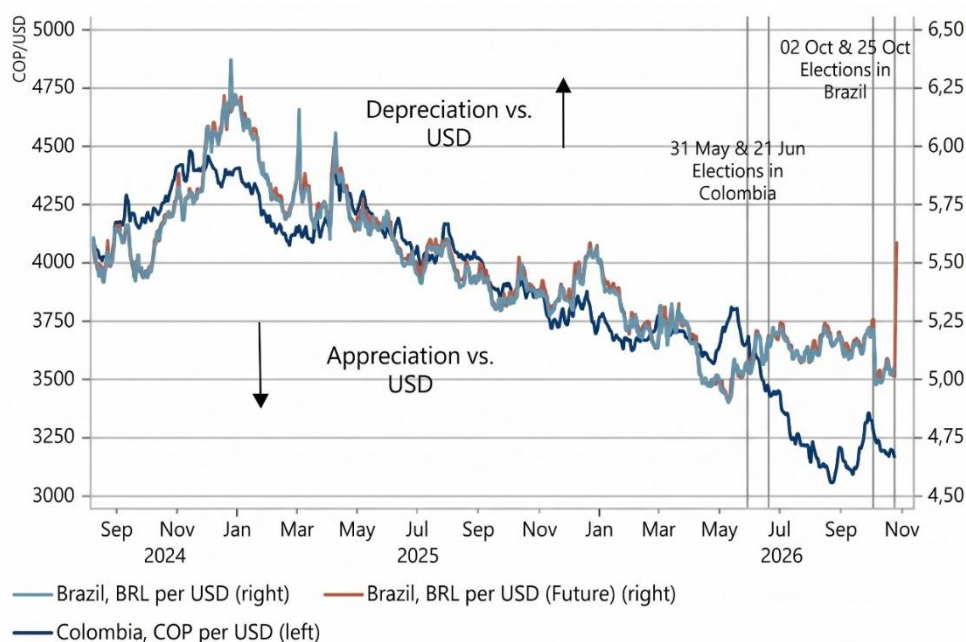


Source: IMF, Macrobond, Flossbach von Storch Research Institute. Data as of 2026.

Overall, markets welcomed the political shifts. In Colombia, the reaction was immediately visible in the exchange rate. Since 2024, both the Colombian peso and the Brazilian real had already been appreciating against the US dollar, driven by interest rate cuts by the Federal Reserve (Figure 2). In May 2026, when conservative candidate Abelardo de la Espriella unexpectedly won Colombia's presidential election, the Colombian peso appreciated even more strongly, particularly against the Brazilian real. The peso's sharp appreciation immediately after the election suggests that markets welcomed the prospect of fiscal stabilisation. In Brazil, the real initially strengthened following conservative presidential candidate Flávio Bolsonaro's unexpectedly strong performance in the first round of voting in early October. However, forward markets point to a sharp depreciation in response to the election of left-wing candidate Luiz Inácio Lula da Silva.



Figure 2: Exchange Rate Movements Following the Elections in Colombia and Brazil



Source: Macrobond, Flossbach von Storch Research Institute. Data as of 26 October 2026.

The Role of Push Factors

Growing concerns about public debt in advanced economies could provide an additional boost to Latin America. Many advanced economies face high tax burdens, rising public debt, and delayed reforms, leaving their growth prospects weak. Recently, government bond yields in highly indebted countries such as Japan and France have risen sharply. Higher yields in advanced economies can, of course, attract capital away from emerging markets. But when rising yields reflect growing fiscal risks and inflationary pressures, countries pursuing credible fiscal consolidation become relatively more attractive.

Despite the decline in recent days, ten-year government bond yields in several advanced economies remain between 0.7 and 1.5 percentage points above their levels at the beginning of the year (Figure 3). Investors are thus demanding higher risk premiums to hold these government bonds.

By contrast, Brazilian government bond yields were 0.87 percentage points below their level at the beginning of the year on the Friday before the presidential election. This advantage is likely to disappear for the time being following the election result. Colombia illustrates how quickly expectations can change. Between the presidential election in May and July, Colombian government bond yields fell by almost three percentage points. When the new government disappointed investors with its fiscal consolidation plans, yields rose again, although they remain below their pre-election level. Against a backdrop of growing debt problems, particularly



in France and potentially in the United States, expectations of fiscal consolidation in an increasing number of Latin American countries could make the region more attractive to international investors.

Figure 3: Changes in Ten-Year Government Bond Yields Since the Beginning of 2026, in Percentage Points



Source: U.S. Treasury, Central Bank of Colombia, Macrobond, Flossbach von Storch Research Institute. Data as of 23 October 2026.

Latin America may also appeal to investors seeking diversification. Asian emerging markets are heavily exposed to the AI boom through semiconductor production and AI infrastructure, particularly in Taiwan and South Korea. Latin America, by contrast, plays almost no role in these industries. As commodity exporters, many Latin American countries instead benefit from geopolitical tensions that are not directly related to the AI boom.

Information technology accounts for 52.5 percent of the MSCI Asia Index, while the sector is absent from the MSCI Latin America Index. Materials and energy, by contrast, account for a combined 30.8 percent of the Latin American index, compared with only 5.6 percent in Asia. Following the outbreak of the war in Ukraine, Latin American equities rose sharply while Asian equities declined. With the Federal Reserve's interest rate cuts beginning in autumn 2024 and the AI euphoria since 2025, both Asian and Latin American equity markets rallied. The recent setback in the AI boom has hit the Asian index hard, while Latin American equities have benefited from the surge in oil prices following the outbreak of the Iran war (Figure 4).



Figure 4: MSCI Asia and Latin America Indices, 1 January 2022 = 100



Source: MSCI, Macrobond, Flossbach von Storch Research Institute. Data as of 23 October 2026.

Tailwinds Until the Pendulum Swings Back

If Latin American governments continue with their announced fiscal consolidation efforts, capital inflows into the region are likely to persist, not least because of the still unstable macroeconomic environment in advanced economies. These inflows bring both opportunities and risks.

Capital inflows can facilitate fiscal consolidation and help bring down inflation, thereby supporting growth. International capital inflows tend to strengthen local currencies, making imported goods cheaper. If governments maintain their consolidation efforts, inflationary pressures ease, giving central banks room to cut interest rates. This loosens financing conditions and encourages investment. How much real growth this generates depends on the extent to which capital inflows finance productive investment. Low inflation and economic growth also give governments political momentum ahead of the next elections.

The question, however, is whether all segments of society will benefit from stronger growth. Informal employment remains widespread in many Latin American countries. In 2025, the share of informal employment ranged from 22.3 percent in Uruguay to as much as 82.3 percent in Bolivia. In Brazil, it stood at 35.8 percent (ILO 2025). Weak or insufficiently protected property rights make it difficult to access the formal financial sector. As a result, large parts of the population have only limited opportunities to benefit from improved financing conditions.



If capital inflows primarily benefit established firms while large segments of the population continue to have only limited access to finance, a political risk emerges. Even if living standards improve, the perception that the rules of the game are not the same for everyone may persist. Support for governments could then fade, while demands for greater redistribution and state intervention could return. Without institutional reforms that allow broader segments of society to participate in the formal market economy, the political shift may therefore prove temporary (Duarte 2026).

Conclusion

The recent policy shift in several Latin American countries, including Argentina, Bolivia, Honduras, Chile, Peru, and Colombia, towards fiscal stability, a smaller state, and freer markets is making the region more attractive to international investors seeking alternatives to heavily indebted advanced economies and the AI boom. Whether Brazil will join this shift following Lula's re-election remains uncertain.

This could usher in a period of strong growth across the region, provided inflation remains low and people perceive an improvement in their living standards. So far, however, there has been little sign of reforms aimed at curbing the privileges of small groups and giving more people access to the formal economy. As long as not everyone has equal access to a market-based economic order, macroeconomic stabilisation could once again lead to disappointment and cause the political pendulum to swing back to the left.

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