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A Latam Refresher in Challenging Times

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A Latam Refresher in Challenging Times

Macroeconomic conditions across Brazil, Mexico, and Peru are becoming more restrictive, with policy stances remaining tight or only gradually easing as central banks continue to balance inflation pressures against weakening growth.

Political uncertainty is rising ahead of key elections, with recent developments influencing polling trends, policy initiatives, and fiscal discussions across countries.

External pressures – such as higher oil prices and geopolitical tensions – are feeding into inflation and adding complexity to the policy environment across the region.

Regional fixed income markets have recently experienced higher volatility despite their still attractive carry, with performance diverging across countries as macro and political risks evolve.

There is never a dull day in Latin America, especially in an election year such as 2026. We, therefore, take a closer look at recent developments in the region and their implications for the investment landscape. This report includes a dedicated section on each development we have been monitoring, along with some investment takeaways.

Brazil – Master scandal clouds political race

The macro backdrop in Brazil has continued to deteriorate. Inflation has remained above the central bank's target range despite a tightening cycle from mid-2024 through mid-2025. This restrictive rate environment is starting to dent economic activity: the March print of the economic activity index stood at -0.67% MoM, reflecting broad-based weakness.

On the inflation front, April's CPI print exhibited a sharp annual increase, with core inflation showing no signs of easing. Complicating matters for Brazil's central bank, the country's FinMin raised its CPI forecasts sharply and now expects inflation to remain above its 3.0% target through at least 2027. This reflects the impact of the war in Iran on international oil prices and is broadly consistent with market views: the latest Focus Economics survey shows inflation above target through 2029.

Although Brazil's central bank started an easing cycle, it has been mild, with only two 25bps cuts and a cautious approach to future policy adjustments. This high level of interest rates is starting to bode ill for Brazilian companies, particularly through debt burdens. According to

Valor International, Brazilian companies are due to renegotiate close to BRL 670bn in debt with creditors, equivalent to ~10% of the country's total corporate credit stock. This creates a challenging backdrop for Brazilian companies, given both elevated rates and weakening fundamentals of some of those companies. The former does not seem to have an imminent end in sight, since inflation expectations remain unanchored and war in Iran is adding to price instability.

Polls are showing a shift in voters' preferences after reports linked Flávio Bolsonaro to Daniel Vorcaro, former CEO of Banco Master, in allegations first published by the left-leaning investigative outlet *Intercept Brasil*. The claims stated that Flávio Bolsonaro had negotiated a USD 24mn commitment from Vorcaro to produce a film about his father. Banco Master, a Brazilian financial institution recently involved in a corruption scandal, was liquidated in November of last year over fraud allegations totaling close to USD 2.3bn. Hence, the last Datafolha poll conducted before May 13, the day the alleged links between Flávio Bolsonaro and Vorcaro were made public, showed Lula and Bolsonaro in a statistical tie, with each garnering 45% of the vote. However, the latest AtlasIntel poll, based on data collected from May 13 to May 18, shows a recovery in Lula's popularity, placing him at 49% vs. 42% for Bolsonaro. It is also worth noting that Lula recently unveiled a debt relief program that includes fuel subsidies and household debt relief to boost his popularity ahead of the October elections. This only adds more pressure to the country's already strained fiscal accounts. We will continue to monitor the situation, with the next key development being the start of Party Conventions on July 20, when the final presidential candidates will be defined.

On the fiscal front, the situation remains daunting. According to the latest Central Bank data, Brazil's fiscal deficit stood at 9.41% of GDP in March, up 0.94 pp from the previous month and in a sharp contrast to the surplus recorded in March 2025. Additionally, Congress is

currently debating a rural debt renegotiation bill that, according to Valor International, could have an impact of up to BRL 150bn on the 2027 federal budget, with a cumulative impact of up to BRL 817bn over the next 13 years.

Mexico – a deteriorating outlook

Lately, the Mexican macroeconomic outlook has been characterized by almost anemic growth weighed down by trade uncertainty, a monetary easing cycle that has ended, and inflation that remains above target despite trending lower.

Mexico's April inflation came in at 4.45% YoY, still above Banxico's target, but below March's figure. In its last monetary policy meeting, Banxico attributed the decline to a reduction in core inflation, noting that inflation expectations for 2026 had increased, while longer-term expectations remained relatively stable but above the 3% target. Banxico still expects inflation to converge by 2Q27, while underscoring that inflation risks remain tilted to the upside.

Although inflation has remained above target since May 2020, Banxico carried out an easing cycle totaling 475bps in cuts, with the last cut taking place at its May meeting. The Bank considered its stance adequate to address current macroeconomic challenges, including potential inflationary pressures stemming from the war in Iran. The vote on this decision was split 3-2, with two governors favoring rate stability, indicating a more pronounced division within the Banxico board.

At its May meeting, Banxico also highlighted the economic contraction observed in 1Q26, which led to higher expectations of economic slack and downward risks. Some members of the Board are forecasting 2026 economic growth below 1%, especially after the 1Q26 contraction. On this front, **it would be relevant to monitor any upcoming trade developments, especially after Mexico**

signed an agreement with the EU that establishes an investment court expected to promote investor certainty. Additionally, the upcoming renegotiations of the USMCA, scheduled for July 2026, remain a key risk for Mexico's trade outlook.

Last week, S&P downgraded Mexico's outlook from 'stable' to 'negative', on the back of weakening fiscal flexibility, slow economic growth, budgetary constraints, and materializing contingent liabilities, which could result in a very gradual fiscal consolidation, together with a moderate buildup of government debt. The agency also cited an unexpected deterioration in trade relations with the U.S. as a risk to Mexico's otherwise solid external position. Even if the rating agency affirmed Mexico's foreign currency rating, the outlook change is a clear warning for the Sheinbaum administration. This warning was stressed by Moody's after the agency downgraded Mexico's sovereign rating from 'Baa2' to 'Baa3' but improved its outlook from 'negative' to 'stable', citing reasons similar to those of S&P.

S&P and Moody's also warned that the continued fiscal support for both Pemex and CFE could further aggravate

— “The Mexican macroeconomic outlook has been characterized by almost anemic growth weighed down by trade uncertainty, a monetary easing cycle that has ended, and inflation that remains above target.”

Mexico's fiscal rigidities. This is relevant, given that Pemex posted an improvement in 1Q26 amid higher production and a stronger price environment, resulting in a strong EBITDA rebound for the quarter. Still, despite a setback in net cash flow from operating activities (MXN -13.9bn YoY), the company ended the quarter with a positive cash and equivalents balance, helped by USD 3.3bn in direct government capital injections from the approximately USD 14bn promised government support for the year, which proves that sovereign support remains a key topic for Pemex in terms of liquidity.

Another positive point for the quarter was the observed debt reduction that, together with the sharp rebound in EBITDA, led to an improvement in the company's leverage ratios. Going forward, Pemex is expected to benefit from the high oil price environment and from a potential partnership with Petrobras.

Peru: a 2021 repeat?

After a closely watched vote count, Peruvians now know the candidates for the June 7 presidential run-off. According to the latest ONPE data, Keiko Fujimori will face leftist candidate Roberto Sánchez. This situation closely resembles the 2021 election, when Fujimori faced Pedro Castillo and narrowly lost in a runoff marked by delays in the official count and allegations of electoral fraud.

This time, however, there are important differences, including the return of a bicameral Congress. This is especially relevant because, as we noted in a [previous report](#), even if the Senate has no single majority and may lean slightly to the right, coalition-building will be key for the incoming administration to ensure governability. Furthermore, bicameralism could lower the odds of drastic policy changes, such as Sánchez's call for a new constitution, and mitigate potential disruption to the current macroeconomic baseline. For now, markets will focus on the upcoming presidential debate on May 31,

where both candidates are expected to discuss sensitive issues such as public safety and the state of the economy. According to the latest poll, Fujimori holds 39% of voting intention vs. 35% for Sánchez.

While Peru’s political landscape has been turbulent, its macroeconomic backdrop has remained relatively stable. The central bank – BCRP –, widely seen as the country’s macro anchor, kept its monetary policy rate stable at its May meeting. However, it now faces temporary inflationary pressures from rising transportation costs and the oil shock caused by the war in Iran. Meanwhile, economic activity has remained positive, with most leading indicators still optimistic. Here, it is worth stressing that Peru’s Economy Ministry reaffirmed its 3.2% growth forecast for 2026, projecting the same through 2027-2029, underpinned by stronger exports and productivity gains. Bear in mind that Peru is one of the leading countries in mining exports, and higher copper and gold prices are a tailwind for its economy.

Investment Implications

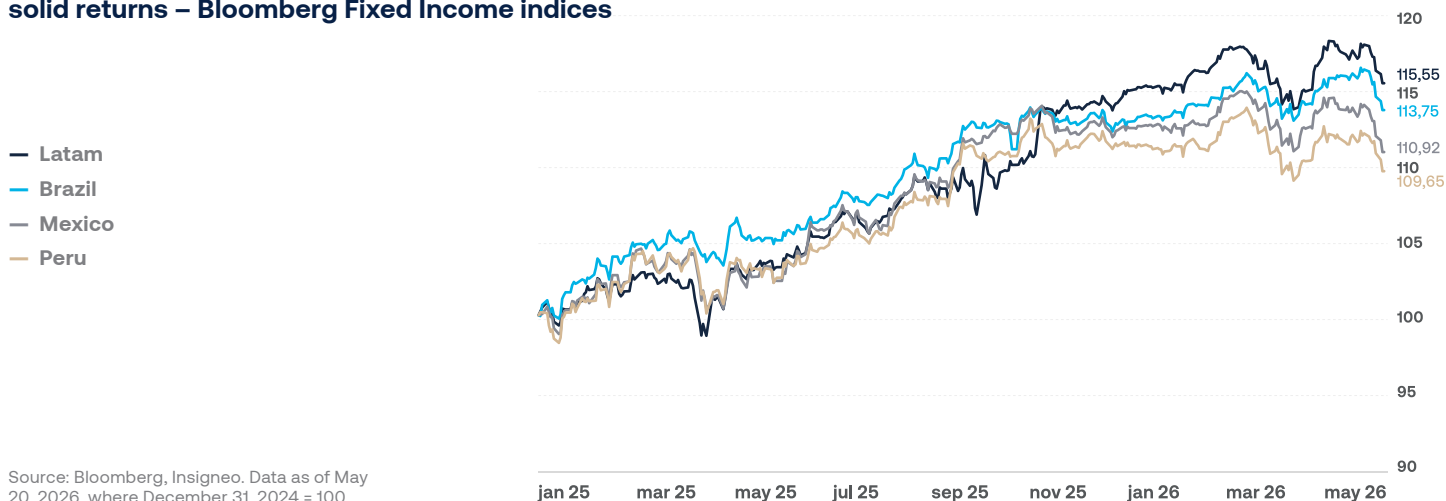
Latin American fixed income stood out as one of the stellar sub asset classes of the year, primarily because of its attractive carry and growing returns. However,

the observed volatility over the last few weeks has undermined the region’s performance. The losses have been generalized across the region; still, Brazilian USD-denominated sovereign debt continues to outperform Mexico’s and Peru’s, as shown in Graph 1.

As current market volatility and political uncertainty dissipate, it would not be surprising to see a recovery in Latin American assets. However, if fiscal discipline is not sustained across the region, the expected recovery trend could instead lead to further reductions in returns. Especially in Peru and Brazil, where elections will take place later this year, the market is leaning towards victories for more orthodox candidates. If that were not the case, the expected market reaction should be a widening of spreads across the sovereign curve – potentially with more pronounced effects on the longer end. Therefore, positioning at the short and middle ends of the curve could prove a more beneficial strategy for navigating political volatility.

Overall, Latin America remains an investment destination favored by seasoned investors and by those seeking attractive yields outside more conventional alternatives. Still, performing a thorough fundamental analysis of countries and companies alike remains a

Graph 1: Latam USD-denominated debt still delivers solid returns – Bloomberg Fixed Income indices



Source: Bloomberg, Insigneo. Data as of May 20, 2026, where December 31, 2024 = 100

key part of the investment process, in which investors should favor countries with a solid macroeconomic backdrop and more orthodox policy management. ■



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