SECTOR IN-DEPTH
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Banks – Latin America & Caribbean

2025's key credit drivers: Uncertainty may harm growth, but most risks priced for now

Summary

Operating conditions for banks in Latin America are favorable now but would potentially face a downturn if geopolitical risks crystallize and domestic political and economic uncertainties rise. As of early 2025, banks continue to draw a beneficial scenario from small changes in real GDP compared with 2024, with economic activity expected to inch up in Peru and Colombia, while declining slightly in Brazil, Mexico and Chile, along with inflation that is forecast to be relatively low and labor markets strong. Nevertheless, country-specific obstacles — ranging from high interest rates and weak confidence among individuals and companies to political uncertainties and structural changes — will keep loan growth modest. Fast-developing political uncertainties in the global arena, however, may swiftly revert this scenario. Despite that, liquidity will stay ample, supported by access to core deposits. Capitalization will be fairly stable.

Credit risk will likely normalize in the next 12 months amid banks' efforts to reduce delinquency and generate solid new loan vintages, also supported by their focus on long-term customers and affluent clients to sustain loan growth. Banks have focused on mapping credit risks thoroughly in the past 18 months, but abrupt changes to inflation, employment and growth caused by unforeseen trade and geopolitical skirmishes may lead to another bout of delinquency rise. In a best-case scenario, problem-loan ratios will remain mostly flat or decline slowly as conservative underwriting standards push loan growth just a bit higher than 2024's levels for most countries. In Colombia, however, banks will face difficult loan refinancing for consumers and small and mid-size enterprises (SMEs). Borrowers' payment capacity remains steady as interest rates decline, except in Brazil. In highly dollarized places, including Uruguay, Panama and Central America, potential cuts to the US policy rate will likely contribute with better loan growth. To mitigate credit risk, banks will maintain sizable loan-loss reserves and use technology to better analyze customer behavior and collateral structures.

Profitability will remain mostly stable, with smaller provision expenses. Latin American banks' average profitability will be higher than that of peers in advanced economies, supported by strong net interest margins (NIMs). However, potential for significant NIM improvement is limited because of strong competition for clients, the small but consistent decline in reference rates in most of the region and funding costs that will inch down but remain high historically. Efforts to curb operating expenses and foster non-interest-income origination will help bottom-line profitability. Beyond the outlook horizon, banks' capacity to maintain or strengthen earnings growth over the long run will capture the spotlight.

Economic growth will likely plateau but rising concerns could undermine confidence, macro conditions

Economic activity will likely be modest across Latin America in 2025, with GDP growth little changed from 2024 (Exhibit 1) and inflation and employment stable in most countries. However, confidence and demand for long-term financing will remain shaken by uncertainties about structural reforms, government spending and high interest rates in some countries, particularly **Brazil** and **Colombia**. External factors including trade dynamics and geopolitical risk have potential to jeopardize current growth forecasts.

Exhibit 1

Economic conditions in the region's largest countries still provide a good operating environment for banks

Real GDP Growth / Inflation / Benchmark Rate

	Mexico			Peru			Chile			Colombia			Brazil		
	Real GDP Growth	Inflation	Benchmark Rate	Real GDP Growth	Inflation	Benchmark Rate	Real GDP Growth	Inflation	Benchmark Rate	Real GDP Growth	Inflation	Benchmark Rate	Real GDP Growth	Inflation	Benchmark Rate
2023	3.2%	5.5%	11.3%	(0.6%)	6.3%	6.8%	0.2%	7.3%	8.3%	0.6%	11.7%	13.0%	2.9%	4.6%	11.8%
'24F	1.5%	4.9%	10.0%	2.7%	2.7%	5.0%	2.5%	4.2%	5.0%	1.7%	7.2%	9.5%	3.0%	5.1%	12.3%
'25F	1.3%	4.3%	8.5%	3.1%	2.3%	4.5%	2.2%	3.3%	4.5%	2.5%	4.7%	6.6%	2.2%	3.9%	14.0%
'26F	2.2%	3.8%	8.0%	2.9%	2.0%	4.5%	2.3%	3.0%	4.1%	3.0%	3.7%	6.0%	2.5%	3.5%	12.0%

Source: Benchmark rates from Bloomberg as of January 2025 / GDP and inflation from Moody's Ratings. Benchmark rates for December 2024 are actual.

In most of the region, inflation will be low when compared with recent years. Although inflation will likely stay under 5% in **Brazil**, it will exceed the central bank's upper target range, which has already pushed the central bank to return to monetary tightening. Meanwhile, monetary authorities elsewhere will continue to gradually ease policy interest rates.

In **Mexico**, lower economic activity is possible because of uncertainties related to the new government. There is some risk that institutional frameworks may weaken because of judicial changes that could weigh on companies' long-term investment decisions and reduce banks' appetite for increasing their credit risk exposure. Despite these concerns, banks are still on track to maintain good profitability and loan quality in 2025.

In **Chile** and **Peru**, economic activity will be fairly stable in 2025-2026. In Chile, GDP growth will be slightly lower than in 2024; in Peru, it will be modestly higher. A less-volatile economic scenario could offer better conditions for consumers and companies to plan for long-term investments in both countries, provided inflation and policy rates remain in low single digits. A combination of these factors would help make the operating environment more favorable for banking activity.

Overall, loan risk for the region is normalizing at the beginning of 2025, following a year of banks' conservative measures to reduce loan delinquency. However, should possible challenges to banks' operations crystallize still in the first months of the year, there could be some weakening in loan quality. Despite that, banks will likely maintain robust liquidity, while their funding structure will continue to be supported largely by steady core deposits. In addition, their capital positions will be steady, underpinned by internal earnings origination. While profitability is likely to remain steady for the next 12 months, banks' longer-term earnings performance hinges on their ability to fend off competition from leaner newcomers, foster client loyalty and increase efficiency through new technologies. Additionally, a downshift in economic conditions would reduce profit by the end of 2025.

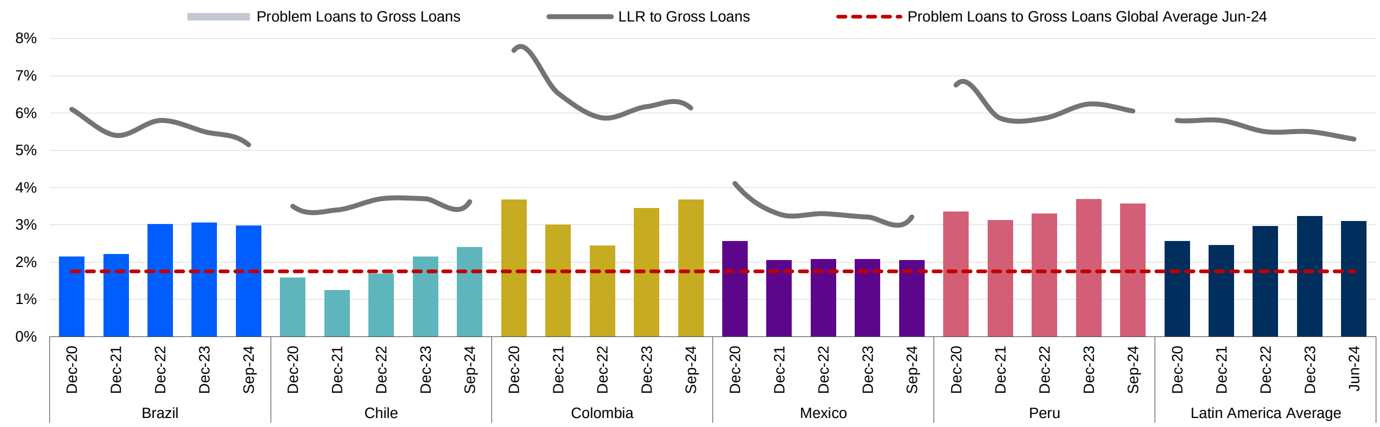
Loan risk normalization aided by conservative underwriting, falling interest rates

In 2025, loan quality will likely benefit from vintages originated in 2024 that have helped gradually reduce problem-loan formation. Banks will maintain rigid underwriting, cut exposure to risky clients, reinforce renegotiation and collection processes and write off bad loans, sustaining measures that kept systemwide problem-loan ratios relatively stable in 2024 (Exhibit 2).

Exhibit 2

Lower credit risk, new vintages underlie quality normalization, but sudden operating condition changes could hurt problem-loan ratios

Problem loans to gross loans and loan-loss reserves to gross loans



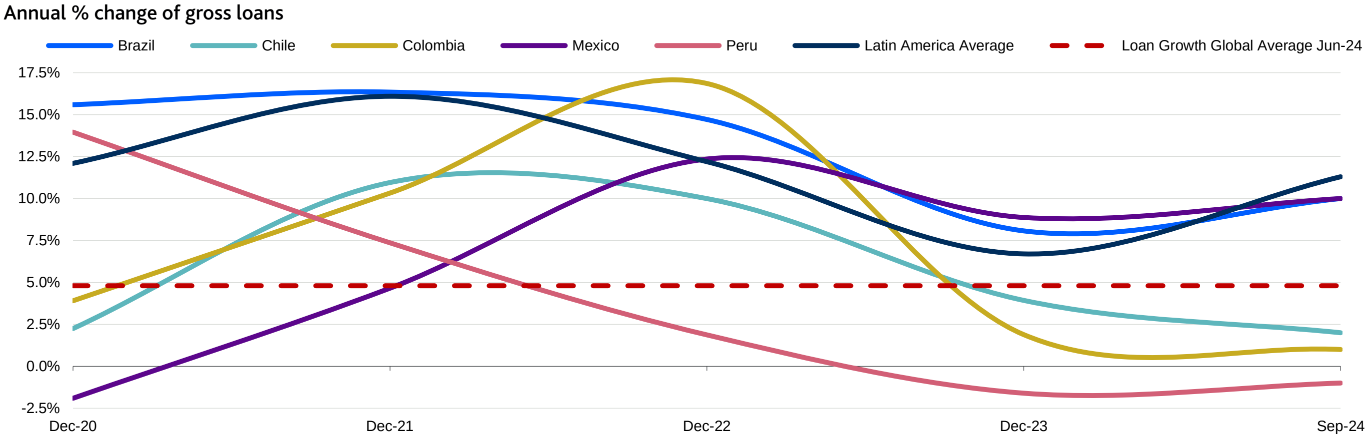
Source: Moody's Ratings

As of early 2025, problem-loan ratios will likely plateau or even decline mildly, as loan portfolios match or rise slightly above last year's levels (Exhibit 3), in addition to forecasts of small changes in economic activity. Growing uncertainties, however, could revert these factors and challenge banks to curb problem-loan deterioration.

Exhibit 3

Appetite for loan growth will remain subdued, driven by economic and political uncertainty

Annual % change of gross loans



Source: Moody's Ratings

Overall, banks have maintained good volumes of loan-loss reserves to cover problem loans, following measures to mitigate exposure as delinquency rates rose between 2022-2024.

In **Brazil**, the system's total problem-loan ratio will likely end 2025 slightly below the 3.2%-3.3% range seen in the first 10 months of 2024, but it will not drop meaningfully below 3%. Our view of loan risk for Brazilian banks also takes into account uncertainty about the country's fiscal position. There is a risk that loan quality could weaken if household and business confidence deteriorates abruptly in the event of a material increase in government expenditures, an excessive rise in benchmark interest rates or higher inflation from a strong devaluation of the Brazilian real. Despite that, banks will likely stay focused on originating secured products, such as payroll loans, vehicle financing and mortgages, while strengthening relations with longtime clients and high-income individuals, particularly in originating riskier products such as credit cards and personal loans.

Excess domestic liquidity has favored corporate debt issuance in Brazil's local capital market and, at the same time, lowered banks' exposure to loans with large companies. Local market liquidity will likely remain high, which may continue to facilitate companies' direct access to investors. However, further policy rate increases will likely drive investors' interest in less-risky government debt. Banks' exposure to loans with large companies may be hampered by lack of significant long-term investment plans. Companies' credit risk exposure will remain centered on SMEs, with banks relying on sale receivables as robust collateral against potential loan losses.

In **Mexico**, banks will keep rigid underwriting policies amid prospects of decelerating economic activity, particularly in riskier consumer financing loan portfolios, including credit cards. Banks' conservative approach to credit risk will likely partly offset pressure on problem-loan ratios from potential changes to trade and economic challenges conditions. Relatively low bank intermediation and high loan write-off volumes may also help keep problem-loan ratios from rising materially.

The quality of loan portfolios in **Chilean** banks will likely remain steady in 2025, despite limited loan quality weakening within individual banks, including Banco de Crédito e Inversiones (A2 stable, baa1) and Banco Santander Chile (A2 stable, baa1), which briefly showed an uptick in problem loans in commercial loan and mortgage portfolios at the end of 2024. Despite that, the system's overall loan quality will likely remain well-behaved throughout 2025, reflecting banks' conservative underwriting.

In **Peru**, banks will maintain conservative loan origination, particularly for commercial loans — mostly in consumer and SME lending — after two years of cleaning up loan portfolios. Banks will likely report better loan quality in high-risk credit cards and personal loans, reflecting increased household liquidity. Improved loan-collection procedures, including for SMEs, will also help stabilize problem-loan ratios. Additionally, Peruvian banks' high loan-loss reserve holdings — originally built up to protect against an El Niño event that turned out to be less severe than anticipated — will help offset asset risk.

Colombia's banks will face more problem loans than regional peers — supporting our view that asset risk remains a challenge. Weak economic growth and high interest rates led to high delinquencies in commercial lending and mortgages in 2024, after a steep deterioration in consumer loans in 2023. At some banks, these segments will likely partially offset improvements in overall loan quality, driven by less exposure to consumer loans and healthier new loan vintages. New problem-loan numbers showed signs of improvement in late 2024, which will likely help stabilize the system's problem-loan ratio by the end of 2025. Such a scenario would crystallize if inflation remains under control and interest rates continue to decline.

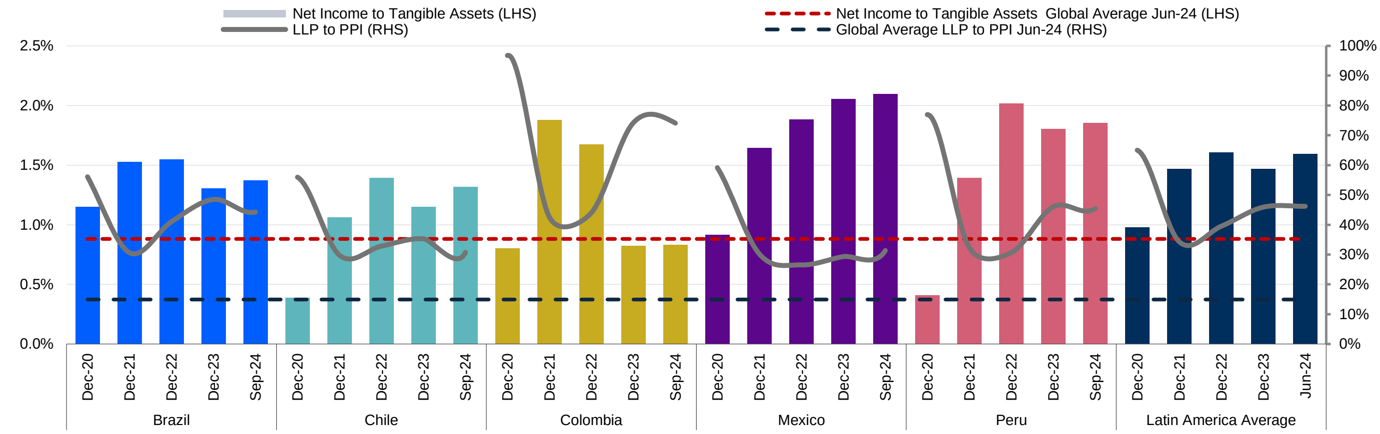
Profitability will benefit from slightly higher loan growth, gradual decline in provisions

Our view that profitability will be stable for most Latin American banking systems in 2025 is based on our forecast of modestly higher economic activity in many countries and banks' prudent approach to credit risk, which will lead to more limited income from lending. However, a sudden weakening of operation conditions would constrain banks' ability to stabilize profit. We expect the region's profitability to remain fairly steady and higher than banks in advanced economies (Exhibit 4).

Exhibit 4

Positive effects from lower provisions and funding costs will be balanced out by competition and modest growth

Net income to tangible assets and loan-loss provisions to pre-provision income



Source: Moody's Ratings

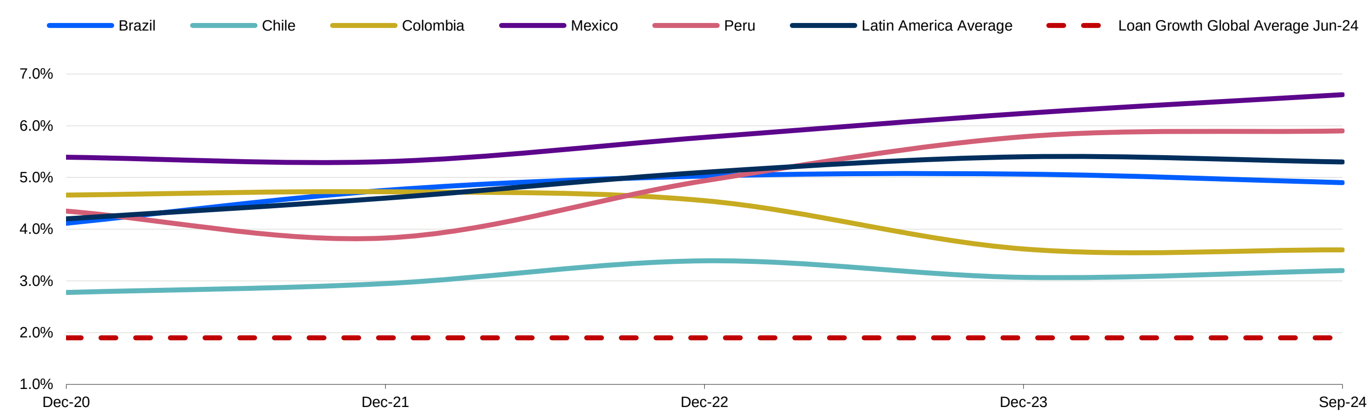
Brazil's banks will remain conservative on lending amid uncertainties about inflation rising more than expected and the economy growing at a slower pace. Nevertheless, banks will likely benefit from earnings from local capital market operations and investment banking activities, fees from asset management operations and lower funding costs from institutional clients. Revenue from these segments will complement more conservative growth in loan income compared with 2024 as well as pressure on lending spreads because of competition.

Banks in **Mexico** will face more competition from neobanks and fintechs as they seek growth by raising deposit yields to attract clients. Although incumbent banks still enjoy strong access to core deposits, they will be forced to do more to retain market share and clients. At the same time, demand for high-yield time deposits remains strong, driving funding costs higher and shrinking margins. While margins will continue to benefit as falling policy rates (Exhibit 5) foster growth in lending, more material earnings improvement will be limited for Mexican banks because of high loan-loss provisions and operating expenses. Mexico's banking system trails its regional peers in digitalization investments, which, in turn, also poses a challenge to foster wider financial inclusion.

Exhibit 5

Mexican banks will maintain the region's highest margins despite growing competition

Net interest margins



Source: Moody's Ratings

Colombia's profitability scenario will continue to evolve, with some banks managing to report positive bottom-line results after losses in 2023 and 2024. Earnings will likely increase gradually, but the pace of growth for each bank will vary. Bancolombia S.A. (Baa2 negative, ba1) and Banco de Bogotá S.A. (Baa2 negative, ba1) will maintain ratios of net income to tangible assets above 1.0%. Banco Davivienda S.A. (Baa3 negative, ba2) and BBVA Colombia S.A. (Baa2 negative, ba1) will post lower profit because of efforts to curb loan delinquency and bring down loan-loss provisions. Funding costs will remain a common challenge, although they will likely gradually decline with the government's monetary expansion policy. Despite that, there is small chance funding costs will fall to levels seen before NSFR[1] requirements became more stringent in March 2023.

In **Chile**, we expect banks' profitability will be mostly stable. Household loan demand will benefit from low inflation and monetary easing (policy rate at 5.25% as of 24 January). A reduction in loan-loss provisions, funding costs — thanks to lower interest rates — and operating expenses, reflecting banks' focus on digital transformation, will offset margin strains from timid generation of loan revenue — both because of lower volume growth and lending rates.

Peruvian banks will report a steady pattern of profitability after higher-than-expected earnings origination at the end of 2024, mostly on lower loan-loss provision expenses. Banks' cautious policies will help keep margins steady, balancing with the advantages of lower funding costs as the government eases monetary policy. This conservative lending, in addition to rising competition, will also keep margins from improving materially despite higher business volumes and loan repricing. Banks will maintain efforts to improve cost efficiency through significant investments in digitalization and cybersecurity.

Endnotes

1 The Net Stable Funding Ratio (NSFR) measures the amount of stable funding a bank has compared to the amount it needs. The goal of the NSFR is to reduce the risk of liquidity issues for banks.

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