S&P Global
Ratings

Latin American Banking Country-By-Country Outlook First Quarter Of 2022:
So Far So Good, But New Risks Emerge

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This report does not constitute a rating action

PRIMARY CONTACT

Cynthia Cohen Freue
Buenos Aires
+54-11-4891-2161
cynthia.cohenfreue
@spglobal.com

SECONDARY CONTACTS

Alfredo Calvo
Ciudad de México
+52-55-5081-4436
alfredo.calvo
@spglobal.com

Sergio A. Garibian
Sao Paulo
+55-11-3039-9749
sergio.garibian
@spglobal.com

Claudia Sánchez
Ciudad de México
+52-55-5081-4418
claudia.sanchez
@spglobal.com

Key Takeaways

- We expect Latin American banks' profitability to continue improving in 2022, given lower provisioning needs. As interest rates pick up, net interest margins should be resilient thanks to the banks' ability to transfer the higher funding costs to ultimate borrowers, and given the high share of variable-rate loans and the short tenor of the bulk of fixed-rate loans.
- Lending growth should be slower in 2022 than historical levels, due to the soft economic performance and political uncertainty which curtail private investment and internal demand. We expect retail loans to grow at a higher pace, thanks to the high demand in this sector, than for corporate loans due to limited growth prospects for companies.
- Asset quality metrics remain stronger than expected and should weaken slightly due to the likely flagging economic growth, still sluggish labor market, and the modest credit growth in 2022. But asset quality should remain manageable thanks to banks' conservative growth strategies that were implemented prior to the pandemic.
- Residual stress is a key risk for the small- to mid-size enterprise (SME) and retail sectors, given that the recovery so far has been uneven. Government-guaranteed loans have been key in supporting the SME sector, but the expected weak economic performance in 2022 could pressure solvency of struggling companies.

We expect banks in Latin America to continue posting a resilient operating performance in 2022. Sound profitability allowed the region's banks to withstand credit cycles and economic downturns in the past and had once again helped them during the pandemic-induced economic crisis. Latin America's banks generate high margins because of their ability to price for risk and their diversified business profiles. This is particularly the case among Brazilian banks, given that they're market leaders in lending but also in insurance and asset management. We expect profitability to continue improving in 2022 across most banking systems in the region, reflecting lower provisioning needs thanks to the extraordinary levels banks raised at the onset of the pandemic. We forecast Brazilian banks to post strong results in 2022, similar to those in 2021. As interest rates pick up, net interest margins should be robust thanks to the banks' ability to transfer the higher funding costs to ultimate borrowers and given the high share of variable-rate loans and the short tenor of the bulk of fixed-rate loans. Fee income has also rebounded as the use of credit cards and other banking products resumed growing and we forecast this trend to continue because we don't expect social-distancing measures to be reimposed.

We expect lending growth to remain modest in 2022 due to the soft economic performance and political uncertainty, which curb private investment and internal demand. We expect retail loans to grow at a higher pace, thanks to the high demand in this sector, while we expect corporate lending to grow modestly.

Digitalization will remain a key trend for the industry. For many years, banks in Latin America have been investing in digital transformation and adopting new technologies to meet customers' shifting preferences and to gain efficiencies. Amid social-distancing requirements, digital platforms have enabled most banks transition a large part of their operations away from offices and branches, while continuing to offer services to customers. We believe large banks' embrace of new technological platforms and their capacity to invest considerably, and the universal banking model will help preserve their dominant market share. However, smaller banks will find it increasingly difficult to keep up with these trends. In the medium term, we expect competition to continue and banks' investments in technology to keep up with this competition to continue weighing on profitability until the benefits from cost reduction through digitalization materialize. This will likely lead to further consolidation among the struggling banks and fintechs.

The rapid spread of the Omicron variant highlights the inherent uncertainties of the pandemic but also the importance and benefits of vaccines. While the risk of new, more severe variants that evade existing immunity can't be ruled out, our current base-case scenario assumes that existing vaccines can continue to provide significant protection against severe illness. Furthermore, many governments, businesses, and households around the world are tailoring policies to limit the adverse economic impact of recurring COVID-19 waves. Consequently, we don't expect a repeat of the sharp global economic contraction of the second quarter of 2020. Meanwhile, we continue to assess how well individual issuers adapt to new waves in their geography or industry.

Asset quality metrics remain stronger than expected. Our expectations vary country to country. In countries, such as Mexico, that provided lower stimulus packages and levels of loan moratoriums, banks' metrics will likely improve. On the other hand, we would likely see deterioration among banks in countries with more generous relief packages such as Brazil or Chile.

Our Banking Industry Country Risk Assessments (BICRAs) of seven Latin American countries have a negative trend on either the economic or industry risk. This reflects the challenges among these banking systems, which we address in further detail in this report. The pandemic's political and social fallout may constrain the region's long-term growth prospects, sovereign ratings trajectory, and our BICRAs. The short-term challenge in the region is to accelerate economic growth and job creation. However, there's a bigger obstacle to create political support for new social and economic policies to address the weaknesses exposed by the pandemic and to maintain political stability and resume economic progress.

We're monitoring the following key risks for banks in Latin America:

Social unrest and political instability could pressure investment. This could undercut internal demand, slowing lending growth and weakening asset quality. As a result, banks' operating performance could struggle.

Problem loans could rise above our expectations. Latin American economies were in precarious condition prior to the pandemic's outbreak; a persistently weak economy could pressure some businesses' sustainability.

Residual stress is a key risk for the SME and retail sectors, given that the recovery so far has been uneven. Government-guaranteed loans have been integral in supporting the SME sector, but the expected weak economic performance in 2022 could act as a drag on solvency of struggling companies.

Appendix

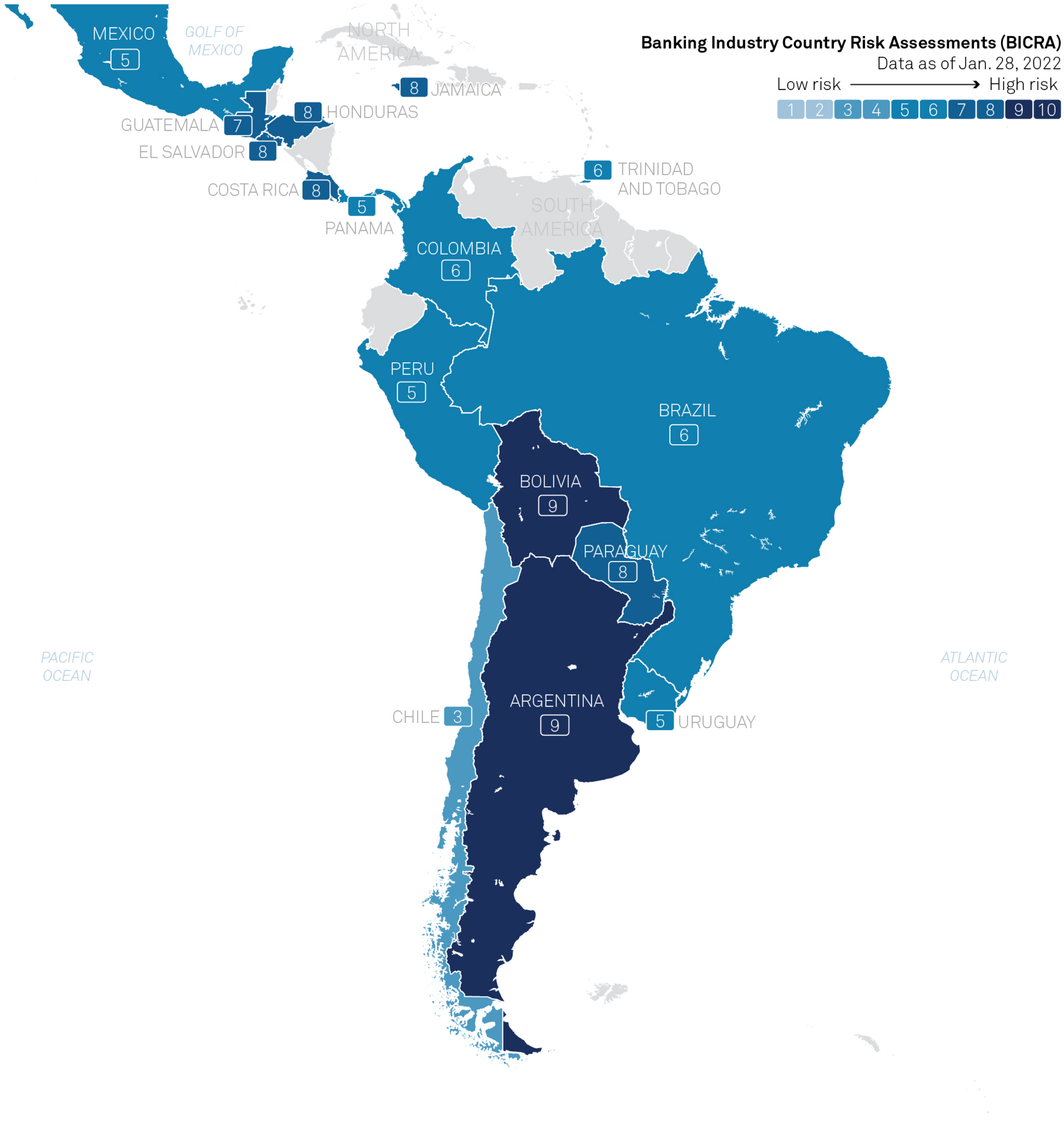
Table 1

Latin America: GDP Growth And S&P Global's Forecasts

(%)	2019	2020	2021F	2022F	2023F	2024F
Argentina	(2)	(9.9)	7.5	2.1	2.1	2
Brazil	1.4	(4.4)	4.8	0.8	2	2.3
Chile	0.9	(6)	11.4	2	2.8	3
Colombia	3.3	(6.8)	9.2	3.5	3	3.2
Mexico	(0.2)	(8.5)	5.8	2.8	2.3	2.1
Peru	2.2	(11.0)	13.5	3	4	3.7
LatAm 5	0.7	(6.6)	6.2	1.9	2.2	2.3
LatAm 6	0.8	(6.8)	6.6	2	2.3	2.4

Note: The LatAm GDP aggregate forecasts are based on PPP GDP weights. LatAm 5 excludes Peru. PPP--Purchasing power parity. Source: Oxford Economics; F--S&P Global Ratings forecast.

Latin America



Source: S&P Global Ratings.

The table below presents S&P Global Ratings' views on key risks and risk trends for banking sectors in Latin American countries. For more detailed information, please refer to the latest Banking Industry Country Risk Assessment (BICRA) on a specific country. According to our methodology, BICRAs fall into groups from '1' to '10', ranging from what we view as the lowest-risk banking systems (group '1') to those with the highest risk (group '10').

BICRA Summary Table

				Economic Risk			Industry Risk		
Country	BICRA Group	Economic risk trend	Industry risk trend	Economic Resilience	Economic Imbalances	Credit risk in the economy	Institutional framework	Competitive dynamics	Systemwide funding
Argentina	9	Stable	Negative	EH	H	EH	H	H	VH
Bolivia	9	Stable	Stable	VH	H	EH	VH	VH	H
Brazil	6	Stable	Stable	VH	I	H	I	H	I
Chile	3	Negative	Stable	H	L	I	I	L	L
Colombia	6	Stable	Stable	H	H	H	H	I	I
Costa Rica	8	Negative	Stable	H	H	VH	H	EH	H
El Salvador	8	Negative	Negative	EH	I	EH	H	I	VH
Guatemala	7	Stable	Stable	EH	I	VH	H	I	I
Honduras	8	Stable	Stable	VH	I	EH	VH	I	H
Jamaica	8	Negative	Stable	EH	I	VH	H	VH	VH
Mexico	5	Stable	Stable	VH	I	I	I	I	L
Panama	5	Negative	Stable	I	H	I	I	L	VH
Paraguay	8	Stable	Stable	VH	I	EH	VH	VH	H
Peru	5	Negative	Stable	H	VL	VH	L	I	I
Trinidad and Tobago	6	Stable	Stable	VH	I	VH	H	H	L
Uruguay	5	Stable	Stable	H	L	H	H	H	I

Positive economic or industry risk trend	Stable economic or industry risk trend	Negative economic or industry risk trend

Very low risk (VL)	Low risk (L)	Intermediate risk (I)	High risk (H)	Very high risk (VH)	Extremely high risk (EH)

Data as of Jan. 28, 2022. Source: S&P Global Ratings.

Argentina | BICRA Group: 9

Challenges Stem From Sovereign-Level Developments

Key takeaways

- Argentina's banking industry continues to be influenced by fragile economic conditions and by developments at the sovereign level, limiting ratings on financial entities.
- Profitability has plummeted given high inflation and low credit growth. Profitability continues to be heavily influenced by results from holdings of central bank securities.
- Asset quality metrics deteriorated following the withdrawal of relief measures, but should remain manageable, given lenders' focus on less risky segments and satisfactory provision levels. The system charged off large problematic corporate loans prior to the pandemic.
- To withstand volatility and the adverse operating conditions, the system maintains high liquidity and regulatory capitalization metrics.

Key credit drivers

Ratings on financial institutions continue to be constrained by the sovereign's weak fundamentals We Significant economic imbalances and challenges posed by Argentina's feeble fiscal and external profiles, monetary inflexibility, and limited financing options have been taking a toll on the banking system even prior to the pandemic. This is occurring amid the sovereign's debt service difficulties.

Banks keep high liquidity and regulatory solvency to cope with volatility . Banks have reduced lending in foreign currency, while keeping high levels of liquidity in domestic and foreign currencies. Also, they maintain high regulatory capital metrics, given the greater weight of liquid assets and limits on dividend distributions.

Key assumptions

Tepid economic recovery after a rebound in 2021. We expect economic activity to be soft in 2022-2023 amid high inflation, weak currency, and negligible foreign-currency availability--factors that depress investments and purchasing power of individuals. Therefore, we expect credit growth to be flat or to contract in real terms.

Profitability in real terms will remain pressured . We expect profitability metrics (in real terms) to remain subdued, with return on assets at about 1% or lower in the next two years with inflation of about 50% and the credit-to-GDP ratio of only about 11%. Profitability will continue to be heavily influenced by results from holdings of central bank securities and the trajectory of inflation.

Asset quality metrics are manageable after the pandemic relief measures were lifted. Since mid-2021, the system's asset quality metrics deteriorated, given that the relief measures taken due to the pandemic were withdrawn, and due to slow lending growth. But they should remain manageable given lenders' focus on less risky segments and satisfactory provision levels, with nonperforming loans of about 5% in 2021. The system (particularly, public banks) wrote off large corporate bad loans generated prior to the pandemic.

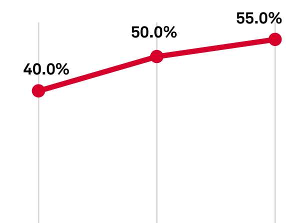
What to look for over the next year

Economic and political developments. Our Banking Industry Country Risk Assessment of Argentina has a negative industry risk trend, incorporating the potential impact that developments from the sovereign could have on the financial system's funding and credit profile. We're closely monitoring political and economic developments, and the sovereign debt dynamics and their influence on domestic financial institutions.

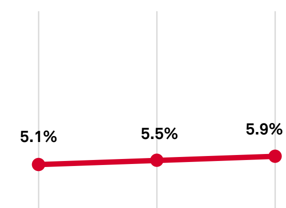
Primary Credit Analyst
Ivana Recalde
Buenos Aires
ivana.recalde@spglobal.com
+44-11-4891-2127

Argentina

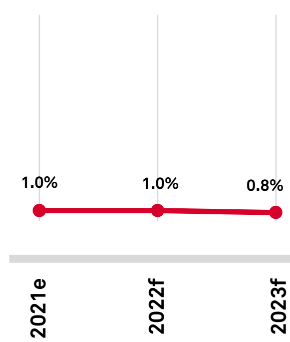
Loan growth



NPA ratio



RoAA



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of systemwide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Bolivia | BICRA Group: 9

The Pandemic Fallout And Government-Mandated Lending Heighten Credit Risks

Key takeaways

- Risks in the domestic financial system, due to the pandemic-induced economic shock, will remain in 2022.
- Government-directed lending will continue to pressure the banking industry's net interest margins and profitability.
- The government will continue struggling to manage fiscal and external imbalances, as well as the social and economic impact of COVID-19, given limited resources and healthcare infrastructure.

Key credit drivers

Unstable macroeconomic conditions weigh on asset quality. The pandemic has increased risks in the Bolivian financial system because the lockdowns are widening credit losses, and pressuring profitability and capital metrics. Moreover, although the banking system has lessened its exposure to dollar-denominated loans and deposits in recent years, we still believe the deterioration in the country's external conditions could weaken the domestic financial industry during the next two years.

Directed lending narrows profits. The mandated lending is likely to continue intensifying competition and depressing margins among domestic banks. This is because the law regulates ceilings on lending rates and requires banks to comply with minimum credit quotas aimed at the low-income homebuyers and productive sectors such as agriculture, mining, manufacturing, and tourism.

Key assumptions

GDP recovery. We forecast Bolivia's economy to grow about 4.0% this year as a result of higher domestic demand, including social and infrastructure spending, and recovery of exports amid a rise in commodity prices.

Manageable credit losses amid fallouts of the lockdowns. We believe banks' credit losses will widen in 2022 after debt moratorium policies were lifted last year, but impact would be manageable thanks to the banks' conservative provisioning policies and the high share of collateralized loans. Stiff lending competition and underwriting standards could pressure further credit losses afterwards.

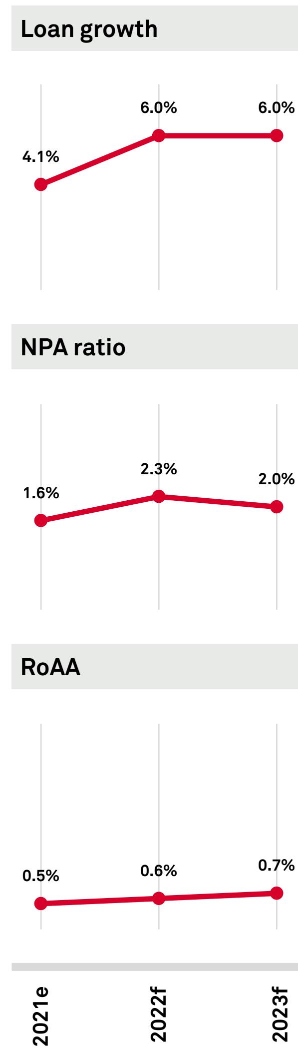
What to look for over the next year

Role of the administration. President Arce, who was elected in 2020, still has to confront the economic and social implications of the pandemic, as well as Bolivia's weak public institutions and high levels of corruption. Although the country's trade balance rebounded in 2021 thanks to a recovery of the mining sector, the president has to address fiscal and external weaknesses, primarily due to soft exports of natural gas.

Enterprises' high debt levels and lending concentration. Regulatory lending quotas and interest-rate caps have encouraged rapid credit growth among the productive sectors, which could lead to high debt levels. At the same time, Bolivian laws encourage increasing lending volumes and concentration in cyclical sectors with high loan amounts and longer durations in order for banks to meet targets, which could ratchet up credit risks in the system.

Primary Credit Analyst
Camilo Pérez
Mexico City
camilo.perez@spglobal.com
+52-55-5081-4446

Bolivia



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Brazil | BICRA Group: 6

High Provisioning Coverage Will Cushion Profitability From Economic Slump

Primary Credit Analyst
Cynthia Cohen Freue
Buenos Aires, Argentina
cynthia.cohenfreue@spglobal.com
+54-11-4891-2161

Key takeaways

- Brazil's economy should weaken in 2022 due to the supply-chain disruptions in manufacturing, abrupt monetary tightening amid persistently high inflation, and volatile political scenario.
- Asset quality will slip as a result of the economic downturn, low credit growth, and residual effect of the pandemic on certain economic sectors, but credit losses should be manageable because of the high provisioning coverage.
- Profitability will likely remain supportive due to stable provisioning, banks' efforts to improve efficiencies, and resilient margins.

Key credit drivers

We forecast GDP growth of 0.8% in 2022 and 2.0% in 2023. We have lowered our projections for Brazil due to the impact of supply-chain disruptions on manufacturing, abrupt monetary tightening to tamp down persistently high inflation, and a more challenging fiscal scenario. Uncertainty over this year's general election--in which former President Luiz Inácio Lula da Silva is likely to run--could also result in investment delays. We view the risks to our 2022 growth outlook skewed to the downside.

Lending growth should continue moderating in 202 due to the lower credit demand from the corporate sector and banks' lower risk appetites. The soft economic performance and political uncertainty, which limit investment and internal demand, will curb credit growth. We expect credit growth to be mainly driven by the retail sector.

Banks' profitability should remain resilient in 2022. We expect profitability to be supported by moderate provisioning needs and stable net interest margin despite the increase in interest rates. The shift in the credit portfolio towards higher margin loans as consumer lending and the banks' ability to reprice their portfolios should support profitability. Banks' efforts to improve efficiency, which accelerated during the pandemic, should also help.

Key assumptions

We expect nonperforming (NPL) loans to increase slightly in 2022. The likely weaker economic performance in 2022 and the lower credit growth will likely push up the NPL ratio, but it should remain manageable thanks to banks' conservative growth strategies prior and during the pandemic.

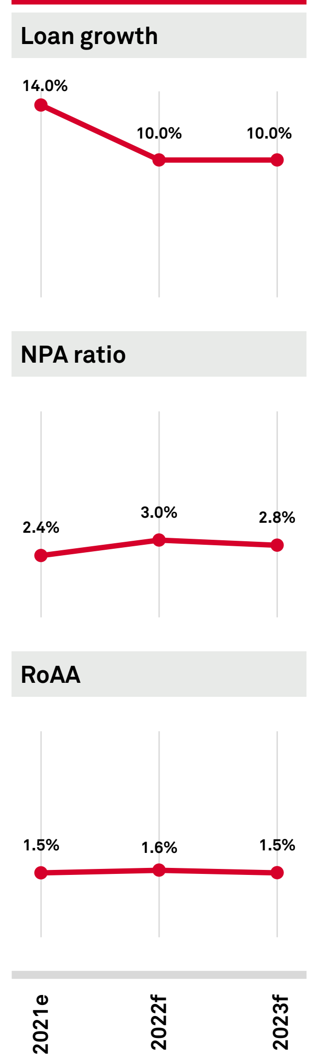
However, we expect credit costs to be manageable as provisioning coverage has strengthened during 2020, and we expect provisioning needs to be lower in 2022. In addition, loan moratoriums have continued declining, accounting for a lesser share of total loans, most grace periods ended in September, and the performance of deferred loans was more resilient than expected.

What to look for over the next year

The presidential election in October 2022 creates uncertainty over economic and fiscal policies in a highly polarized political landscape. It will be difficult to advance fiscal consolidation and reforms as the election approaches and as the pandemic-related risks persist. Post-election policy initiatives and the ability to formulate strong political coalitions will be key to Brazil's creditworthiness.

Problem loans could rise. The Brazilian banking system was recovering from the previous economic crisis before the pandemic hit; therefore, a number of corporations entered the pandemic in fragile conditions. If the economic rebound is weaker than we expect, it could pressure some businesses' sustainability.

Brazil



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a--Actual. e--Estimate. f--Forecast.

Chile | BICRA Group: 3

Navigating Through A Series Of Domestic And External Issues

Primary Credit Analyst
Ivana Recalde
Buenos Aires, Argentina
ivana.recalde@spglobal.com
+54-11-4891-2127

Key takeaways

- After a sharp economic rebound in 2021 to above pre-pandemic levels due to sizable stimulus packages, we expect single-digit growth for 2022-2023.
- The upcoming constitutional amendments and the new administration's policies will set expectations for the next few years. This has a direct impact on business confidence and investments.
- Global developments, such as the trajectory of interest rates, commodities prices, and supply-chain problems, also influence performance.

Key credit drivers

Developments on domestic and external fronts raise challenges in 2022 and afterwards. The policies of the new administration, which takes office in March, and the constitutional amendments will influence business confidence and investments over the short and medium term. External factors--the trajectory of international interest rates, geopolitical issues, and supply-chain bottlenecks--also impact business prospects and funding costs for Chile.

The government's support to the economy has helped maintain fundamentals during the pandemic and set favorable conditions for 2022. The government took several actions to help ensure liquidity, solvency, and credit availability in the financial system. Also, the withdrawal of pension funds and support programs boosted consumption and GDP in 2021, while improving asset quality metrics to better-than-historical levels.

Key assumptions

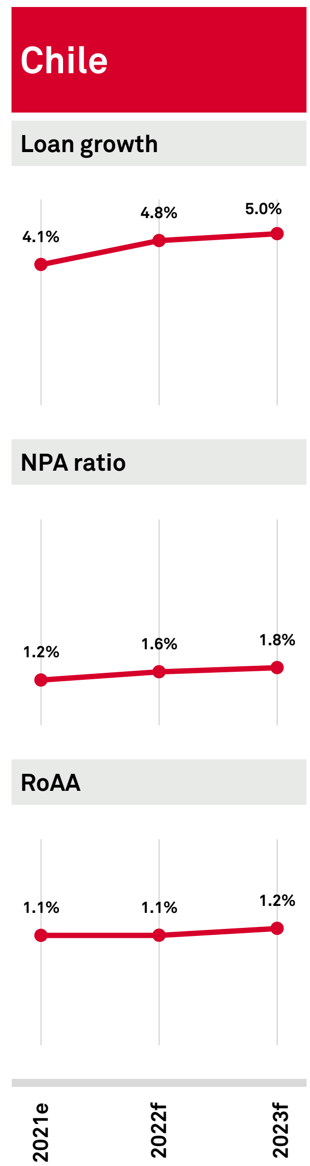
GDP growth to moderate after the rebound in 2021. Economic growth to slow in the next few years as support measures are unlikely to implemented again. We expect GDP to increase by 2.0% in 2022 and 2.8% in 2023. We expect low-single digit credit growth due to modest levels of investments and consumption.

The rising inflation prompted a rapid tightening in monetary policy. Chile's inflation increased to 7.2% in 2021 from 3%, given high consumption and fuel prices. The central bank has raised reference rates to 5.5% in January 2022 from 0.5% in July 2021 and 4% at the end of 2021. While increased inflation benefits results of Chilean banks due to long positions in assets in indexed currency (Unidad de Fomento), this could cause nonperforming loans to rise.

Asset quality to fall from healthy levels. Non-performing loans (90-day past-due loans) improved to 1.2% at the end of December 2021 from the 2% pre-pandemic average, given individuals' lower leverage due to debt prepayments with proceeds from pension fund withdrawals and support packages. Also, banks post high provision coverage metrics. We expect asset quality to fall amid a deceleration in economic growth, the effects of higher rates transferred to clients, and higher inflation.

What to look for over the next year

The new administration and constitutional amendment. Our Banking Industry Country Risk Assessment of Chile has a negative economic risk trend, reflecting downside risks until the medium-term prospects improve amid the constitutional amendment and the new administration' s agenda, and/or adverse global developments. This includes decisions about the country's pension system that historically sustained economic growth, given that it's a funding source for the financial system. In the meantime, individual incomes are lower and corporate leverage is higher than those of global peers.



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Colombia | BICRA Group: 6

Credit Growth Is Recovering Hand In Hand With The Economy

Key takeaways

- The strong economic rebound in Colombia is supporting banks' business and operating conditions.
- However, the removal of stimulus measures and uncertainty surrounding the legislative and presidential elections this year will limit consumption and keep investment subdued in 2022. Therefore, we expect credit demand to moderate after the rebound last year.
- High inflation, increasing interest rates, and slow recovery in the labor market will squeeze Colombian banks' asset quality and profitability this year.

Key credit drivers

Colombia's economy is returning to pre-pandemic growth levels. We expect GDP to grow about 3.5% in 2022 and 3.0% in 2023, following the 6.8% contraction in 2020. Unemployment has lagged the economic recovery, but is improving.

Expansion to Central America provides diversification but pressures capitalization. About a third of Colombia's three largest banks' balance sheets are exposed to Central America. This boosts diversification, but goodwill from acquisitions and higher economic risk stresses capitalization.

Colombia's regulation is strengthening and aligning with international standards. Colombia began adopting Basel III capitalization rules in January 2021, and this year banks must comply with the 100% stable funding ratio (net). In our view, the regulator is strengthening supervision and boosting proactivity and transparency to prevent a potential hit to banks' credit fundamentals.

Key assumptions

We expect credit to expand 8%-9% in 2022-2023. After the economic rebound in 2021 that boosted credit demand, we expect economic headwinds--including high inflation, increasing interest rates, slow employment recovery, a full election cycle, and the new tax reform--to slow the recovery in credit growth.

Asset quality metrics are stabilizing, supported by the rebound in credit demand. After peaking at 4% during the pandemic, we expect the nonperforming assets (NPA) ratio to stabilize near 3.3% in 2022-2023--fully covered by reserves-- while new loan loss provisions will represent about 3.0% of total loans in 2022 (after peaking at 3.7% in 2020).

Banks have brighter profitability prospects after the severe damage in 2020. In 2020, banks provisioned large amounts to anticipate a potential dip in asset quality, significantly hurting profitability. Similar to in 2021, we expect lower provisioning requirements to support bottom-line results. Therefore, we forecast return on assets to be about 1.75% in 2022-2023.

What to look for over the next year

After an initial setback, the government was able to pass a fiscal reform with support of the business community. The recent passage of fiscal reform, which includes a higher corporate income tax rate (35%), corporate income tax surcharges to the banking sector, and limits on tax deductions, should pressure banks' profitability.

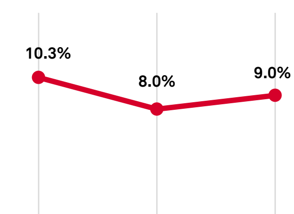
Shift in the central bank's monetary policy. The recent repricing of the Fed's policy increased interest rates expectations across Latin America, and Colombia is no exception. This could have positive implications for banks' revenues from their investments and loan portfolios in 2022-2023.

Colombia enters a full election cycle in 2022. We expect Colombia's stable democracy and political institutions, which have had predictable economic policies and cautious macroeconomic management for many years despite several economic shocks, to persist after the national elections.

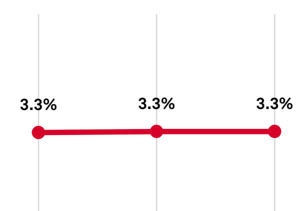
Primary Credit Analyst
Alfredo Calvo
Mexico City
alfredo.calvo@spglobal.com
+52-55-5081-4436

Colombia

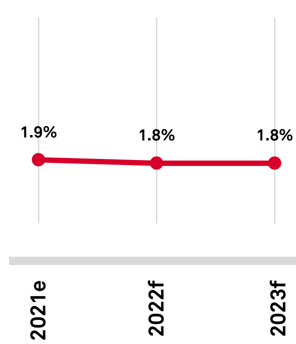
Loan growth



NPA ratio



RoAA



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Costa Rica | BICRA Group: 8

Slow GDP Growth And The Pandemic Will Hurt Asset Quality

Key takeaways

- High loan-loss reserves will decrease banks' bottom-line results and profitability.
- Already weakening asset quality will take a further hit from the pandemic and continue worsening throughout the first half of 2022.
- Credit conditions will remain depressed for 2022 with high unemployment, which will continue to hamper the consumer lending portfolios.

Key credit drivers

Insufficient fiscal reform. Limited fiscal reform will continue weakening public finances, resulting in wide fiscal deficits and higher debt levels. The economy continues to show resiliency, although growth has slowed in the past two years, and we expect GDP growth to remain sluggish because of the slow post-pandemic recovery. We expect GDP to grow 2.6% in 2021 and 3.6% in 2022.

Borrower relief programs provided short-term breathing space but will lengthen the recovery. Given the withdrawal of measures that the regulator and banks implemented to support customers amid the pandemic, we believe nonperforming assets (NPAs) will rise in the first half of 2022 and plateau for the remainder of the year. This will widen credit risk and losses, pressuring the system's financial flexibility.

Distorted competitive dynamics in the banking system bite into profitability. The two largest banks in the country are state-owned and control about 35% of market share in terms of loans, which causes market distortions and depresses profitability (average return on equity for the past four years was about 5%).

Our ratings on Costa Rica continue to be pressured by lingering uncertainties. The negative outlook on our 'B' rating on Costa Rica indicates the risk of a downgrade if Legislative Assembly fails to achieve the steps needed to reimburse the Extended Fund Facility from the IMF or other policy measures under debate, straining domestic market conditions that complicate financing for the government or signal a weakened commitment to sound public finances. The negative economic risk trend in our Banking Industry Country Risk Assessment of the country reflects pressures on its political, economic, fiscal, and debt trajectories, exacerbated by COVID-19.

Key assumptions

Asset quality will worsen. We expect NPAs to peak at about 3.5% in 2021--fully covered by reserves--and remain at similar levels for 2022. Additionally, we expect that the cost of risk in the system will remain above 1% for the next two years.

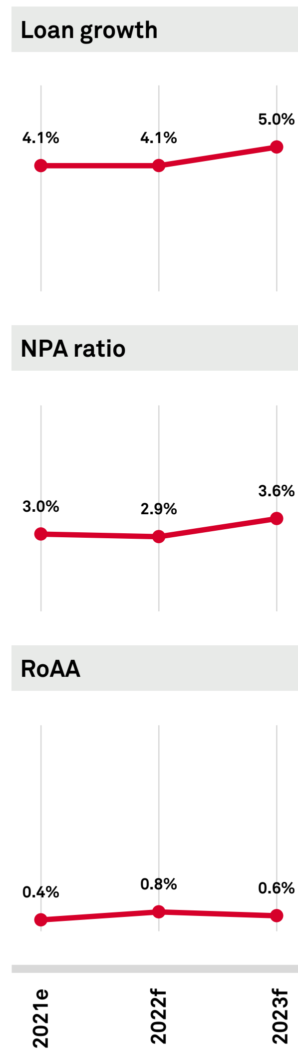
Higher provisions and lower interest rates will dent profitability. For the past couple of years, we saw profitability in the Costa Rican banking system decline steadily. Due to the pandemic-induced economic shock, we believe that profitability will remain subdued as banks increase their cost of risk to mitigate the effects in asset quality. Additionally, interest rates declined toward historically low levels during the pandemic and remain low, ratcheting up pressure on net interest margins and active lending rates for core banking products.

What to look for over the next year

Financial flexibility within the system will mainly depend on the additional disbursements of the EFF. The presidential elections of the beginning of the year, will be key to assess the continuity of the EFF and other policy measures that are currently in the Costa Rican Legislative Assembly.

Primary Credit Analyst
Alejandro Peniche
Mexico City
alejandro.peniche@spglobal.com
+52-55-5081-2874

Costa Rica



Loan growth – Sector-average growth in loans.

NPA ratio – Nonperforming assets as a % of system wide loans.

RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

El Salvador | BICRA Group: 8

Uncertainty About Sovereign's Financial Flexibility Could Weaken The Banking Industry's Asset Quality, Capitalization, And Liquidity

Key takeaways

- El Salvador's uncertain access to liquidity, its limited financial flexibility regarding debt management, and a deterioration in the quality of its policies could intensify operating challenges for domestic banks.
- We expect asset quality to worsen after the pandemic-related economic shock. We forecast delinquency levels of about 3.0% and profitability around 1.0% this year.
- Despite the country's economic and political challenges, the banking system continues to have relatively stable funding sources and liquidity needs and relies on a large and diversified deposit base.

Key credit drivers

Banks' financial fundamentals are strongly correlated to El Salvador's creditworthiness. If the country's economy continues to worsen and its external position keeps weakening, it could strain [the payment capacity of banks' customers, weakening asset quality, capitalization, and liquidity. Additionally, given the banking industry's exposure to government risk in the form of sovereign bonds, we think this exposure could pose risks if El Salvador is unable to close the agreement with the IMF and fails to service its short-term domestic debt.

Credit risk in the economy is rising. Despite the still manageable delinquency levels and credit losses, we think that the pandemic-related fallout and the country's inherent economic, social, and political challenges could harm banks' asset quality metrics.

Room to improve institutional framework. In response to the pandemic, the regulator allowed banks to undertake voluntary loan restructurings with troubled borrowers, and was proactive in monitoring banks' liquidity, solvency metrics, and credit losses. On the other hand, Bitcoin (BTC) adoption as legal tender could affect the industry's stability if regulations and controls aren't robust enough to prevent tax evasion and money laundering, or to mitigate risks related to cybersecurity and BTC market volatility.

Key assumptions

We expect economic growth to return to its pre-pandemic level. We expect the economy to expand at 2.4% in the next three years with a GDP per capita of about $4,300. Despite the economic rebound of almost 10% in 2021, the country's main challenges remain low investor confidence, political gridlock, weak competition, and high emigration.

Moderate credit expansion. We expect credit to keep expanding modestly in El Salvador, reflecting the country's sluggish economic growth and the challenging operating conditions. We forecast credit to expand 4.0% in 2022 amid modest profitability.

What to look for over the next year

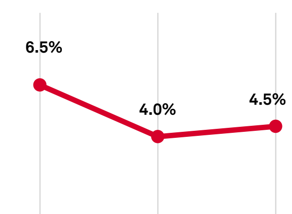
Government's ability to reach an agreement on a multiyear program with the IMF to secure additional funding. The government faces a significant external amortization of $800 million in January 2023. Therefore, it will be key for the government to close an agreement with the IMF to mitigate its large financing risks.

Bitcoin as legal tender could come with greater scrutiny and operating costs for the banking industry. Monitoring compliance and controls associated with Know Your Customer (KYC) and anti-money-laundering guidelines are likely to represent additional operating costs, which could dent the already modest profitability of the banking system.

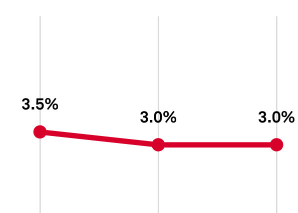
Primary Credit Analyst
Eric Ramos
Mexico City
eric.ramos@spglobal.com
+52-55-5081-4482

El Salvador

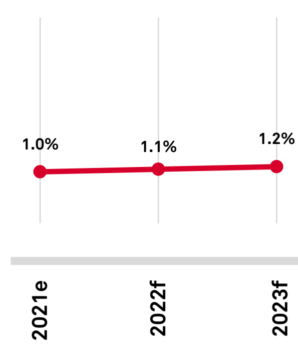
Loan growth



NPA ratio



RoAA



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a--Actual. e--Estimate. f--Forecast.

Guatemala | BICRA Group: 7

Low GDP Per Capita, Large Informal Sector, And Low Household Debt Capacity Still Limit Credit Growth, Although It's Recovering

Primary Credit Analyst
Jesús Sotomayor
Mexico City
jesus.sotomayor@spglobal.com
+52-55-5081-4486

Key takeaways

- The country and the financial system have weathered the recent economic turmoil, However, if economic conditions remain unchanged--still volatile political climate and sluggish GDP growth--credit growth will remain subdued.
- Pressure on asset quality metrics could limit banks' profitability, although metrics should remain manageable.
- The banking system continues to have a large, diversified, and stable funding structure that relies mainly on a retail deposit base.

Key credit drivers

Largest banks are focused on the commercial segment. We believe the credit growth of the Guatemalan financial system will come mainly from lending to corporates, specifically large and midsize companies. On the consumer side, we expect pressures on credit losses to remain due to the low and gradual economic recovery, along with still low GDP per capita and household income capacity.

Guatemala will benefit from the U.S. economic rebound. The Guatemalan economy relies heavily on its exports to the U.S. and remittance inflows from it. The better-than-expected recovery in the U.S. will boost trade activity while keeping remittances high, and consequently will boost private consumption.

Large informal sector and weak rule of law limit investments. The large segment of population living with very low income levels results in low access to banking that limits the population's debt capacity. Improving productivity, strengthening rule of law, and enforcing contracts more strictly could attract more foreign direct investment.

Key assumptions

Moderate credit expansion for 2022. We expect credit to grow about 6% in 2022, because we believe the demand for credit--mainly in households--will continue to be limited until the pandemic eases as the vaccination program gradually evolves.

Pressure on asset quality metrics ahead. However, we forecast these metrics to remain manageable, with nonperforming assets close to 3.0% in 2022. We believe Guatemala's largest banks have enough capital to absorb potential larger credit losses.

Stable macroeconomic indicators. We expect GDP growth to rebound, but not enough to reduce high poverty, inequality, and improve the country's historically low GDP per capita. We expect access to banking to remain low at about 37.5% in 2022. Moreover, we expect asset quality indicators to slightly worsen, although they should stay manageable and consistent with our economic risk score.

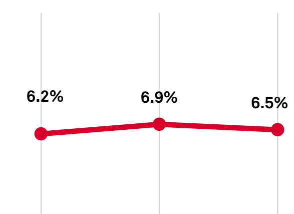
What to look for over the next year

Infrastructure projects and public investment. The development of the infrastructure sector remains slow. Public investment and the growth of infrastructure programs will be crucial to boosting recovery of the country's economy and credit expansion in the next few years.

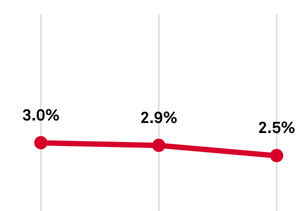
Fight against corruption. The high level of corruption in the country weighs on investor confidence and restricts private investments.

Guatemala

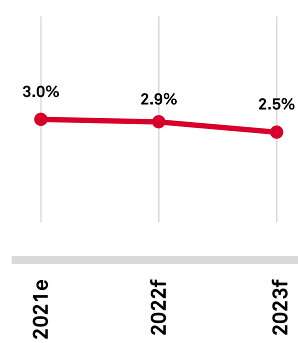
Loan growth



NPA ratio



RoAA



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Honduras | BICRA Group: 8

Persistent Challenges In The Retail Sector Will Hobble Recovery Of Banks' Profitability

Primary Credit Analyst
Erick Rubio
Mexico City
erick.rubio@spglobal.com
+52-55-5081-4450

Key takeaways

- We expect Honduran banks' profitability not to return to pre pandemic levels in 2022 because of the slow and varied recovery of retail business segments in the country.
- A resurgence of COVID-19 cases due to the emergence of the omicron variant threatens a higher potential recovery of household consumption.
- We think the effects of the pandemic and the 2020 tropical storms will continue weakening the system's asset quality, although it will stay manageable.

Key credit drivers

The consumer lending segment will continue taking the brunt of the pandemic's effects. The country's largest banks are focused on commercial lending, which we expect will continue recovering faster than the consumer and retail lending segments, where we forecast still low consumption and credit demand.

Honduras will continue benefiting from the recovery of its main commercial partner, the U.S. Honduras relies heavily on the U.S. economy, which represents about 38% of its total exports. In addition, we think some of Honduras' main industries will recover this year, but we estimate the still depressed consumer segment will hamper domestic demand, limiting banks' profitability.

Banking system has a large deposit base. The biggest banks in the country still have a large retail deposit base that provides them with solid liquidity flexibility. We believe deposits are likely to continue growing steadily given the high amount of remittances and the narrow range of investment products.

Key assumptions

Low credit growth for the banking system. We believe overall lending will grow more slowly than in 2021 as economic recovery pace slows. Additionally, we believe the retail and consumer segments will continue to see sluggish growth and will likely recover slowly in the next few years.

Weaker asset quality metrics, but still in line with peers in the region. In our opinion, the weak economy and the rise in unemployment will continue damaging banks' asset quality metrics, especially smaller banks and those highly exposed to consumers and small to midsize enterprises. However, these metrics remain similar to other countries in the region. In addition, banks' coverage ratio of nonperforming assets will rise.

What to look for over the next year

Political climate under the new administration. Xiomara Castro took office as president of Honduras in January 2022. We believe her capacity to reach agreements with the opposition to carry out the main points of her agenda will be very relevant for the country and investor confidence.

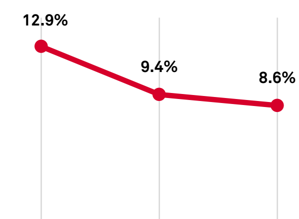
Energy sector. The government-owned electricity company Empresa Nacional de Energía Eléctrica (ENEE) poses a major fiscal weakness. Focusing on reducing ENEE's losses leaves the government with little room to expand basic services, which require long-term expenditures.

Macroeconomic stability and government's spending controls. The Honduran government has taken steps to bolster its long-term economic and fiscal resilience. We consider macroeconomic and fiscal sustainability as key to improving the country's business conditions.

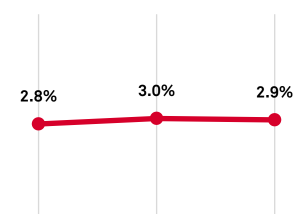
Prices of several commodities and performance of key sectors. Economic sectors such as agriculture, services, manufacturing, and communications services together account for close to 75% of GDP, so GDP expansion will depend on the growth pace and investment in these sectors.

Honduras

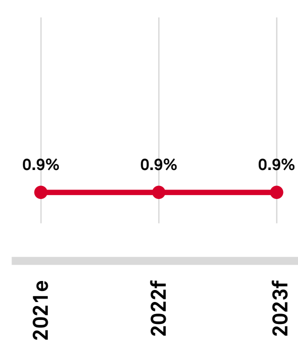
Loan growth



NPA ratio



RoAA



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Jamaica | BICRA Group: 8

Receding Macroeconomic Risks Help Stabilize The Financial System

Key takeaways

- Jamaica has demonstrated commitment to fiscal consolidation, despite the ongoing pandemic, and we believe the risks to its economy and government finances have diminished.
- The temporary halt in Jamaica's tourism sector and higher unemployment due to COVID-19 have been pressuring the performance of the domestic financial system, but we expect the banks' asset quality and profits to start recovering this year.
- As systemic risks rise because of increasing connections among businesses in various Caribbean countries--as a result of mergers and acquisitions (M&As)--Jamaica's banking regulator has made advances toward centralized supervision to mitigate such risks.

Key credit drivers

Lower risks in the domestic economy. Despite an estimated fall in GDP of 9.9% in 2020, recent fiscal reforms and savings helped the government limit the pandemic's fiscal fallout and the rise in sovereign debt. We view the pandemic-related risks to the Jamaican economy and public finances as receding. We expect the economic recovery will continue gaining strength into 2022 and that the government will cautiously manage public finances and repay debt to lower its debt and interest burden.

The pandemic pressures the industry's metrics. The pandemic has raised risks in the Jamaican financial system because the economic lockdown dented the banks' asset quality, profitability, and capital metrics. Compounding the situation, the tourism sector is one of the main drivers of the local economy--it provides employment to about 30% of the labor force. Consequently, lockdowns have been eroding household incomes, which ultimately took a toll on the banks' asset quality. However, we expect the performance of banks to recover during 2022 as the effects of the pandemic fade.

M&As demand centralized oversight. Caribbean conglomerates have been undertaking M&As, which could introduce spillover risks in events of distress, because of increased cross-border business links across the region. In our view, it's crucial that acquisitions move in parallel with strengthened systemic risk management. The Jamaican regulator is leading initiatives to move towards an integrated oversight.

Key assumptions

Prospects for solid economic growth this year. We expect real GDP growth of 5.5% and unemployment rate to drop slightly to about 9.5% this year after a marked spike in 2020 due to the lockdowns.

Pressures on asset quality to lessen. We estimate that asset quality slipped in 2021 due to challenging domestic business conditions and high unemployment. However, our current base-case scenario assumes that credit losses will be manageable, while asset quality metrics will likely return to pre-pandemic levels by 2023.

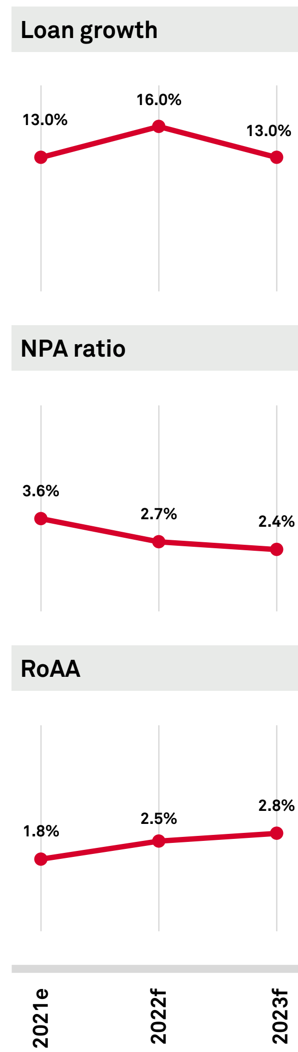
What to look for over the next year

Adoption of stronger regulations. We expect regulatory bodies to continue advancing towards setting up the basis for a more developed financial industry, which could attract foreign investors in the medium term. For example, an improved and centralized oversight framework is important, given the increasingly interconnected risks across the Caribbean.

Non-regulated players introduce market distortions. The increasing presence of unregulated credit unions, which generate stiff competition through lower lending interest rates, will continue pressuring the system's stability, in our view. However, regulators have started an initiative to supervise these entities formally, which should help lessen market distortions if the initiative goes into effect.

Primary Credit Analyst
Camilo Pérez
Mexico City
camilo.perez@spglobal.com
+52-55-5081-4446

Jamaica



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a--Actual. e--Estimate. f--Forecast.

Mexico | BICRA Group: 5

High Inflation, Low Growth, And Weak Labor Market Will Limit Credit Expansion

Primary Credit Analyst
Alfredo Calvo
Mexico City
alfredo.calvo@spglobal.com
+52-55-5081-4436

Key takeaways

- Credit growth will remain subdued in 2022-2023 amid low consumption and weak investment.
- Asset quality is stabilizing, but downside risks loom that could pressure profitability.
- Solid capitalization will continue to be a credit strength in 2022-2023, and healthy liquidity will persist amid slow credit demand.

Key credit drivers

Uncertainties about business climate and concerns about policy predictability will limit economic growth. The investment outlook remains weak in Mexico, partly due to government policies that have undermined investment incentives in key sectors, especially energy. This will limit economic growth and pressure banks' business and operating conditions.

Mexican banks entered the pandemic with good credit fundamentals and remain resilient. Low access to banking--measured by credit to GDP--has allowed banks to grow with healthy asset quality and adequate profitability, while liquidity and capitalization metrics remain solid.

The pandemic is still far from over, so risks for banks persist. Low economic growth, high inflation, and weak labor market dynamics will make it a challenge for Mexican banks to keep healthy asset quality and good profitability.

Key assumptions

Credit growth will be moderate this year. Mexico's economic rebound after 2020 has been limited by weak private investment and low consumption, so we expect moderate credit demand in 2022-2023.

Asset quality could worsen amid economic headwinds. We expect the nonperforming assets ratio to be about 2.4% this year--fully covered by reserves--while new loan loss provisions will represent about 2.7%-3.0% of total loans in 2022-2023.

Lower provisioning and increasing margins will support profitability. After banks built large provisions in the first year of pandemic, these have been moderating and stabilizing, releasing pressure on profitability. In addition, we expect still slow recovery in credit demand, but increasing margins will support profitability.

What to look for over the next year

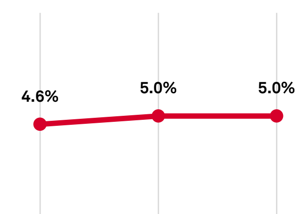
Bolstering private-sector confidence remains a key challenge for encouraging greater investment. In our view, reversal of some government policies, particularly in the energy sector, or a weakening of key institutions could undermine investor confidence and complicate banks' business and operating conditions.

More persistent and higher inflation will keep central bank on a tightening bias. We expect inflation to remain above the central bank's target throughout 2022. During 2022, markets are pricing around 200 basis points in rate hikes in Mexico. This could affect Mexican banks, which depend on wholesale funding.

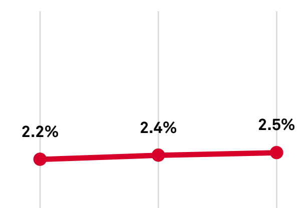
Mexican banks will implement new regulatory requirements in 2022. Starting in January 2022, Mexican banks will start adopting IFRS-9 accounting standards. By December 2022, six large banks--considered domestic systemically important banks (D-SIBs)--will have started building their respective total loss-absorbing capacity (TLAC) requirement, which will gradually increase their regulatory capitalization levels.

Mexico

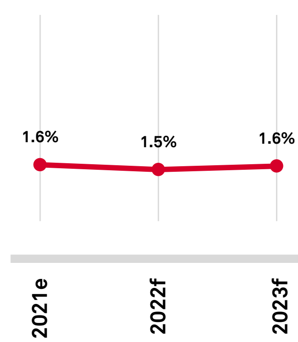
Loan growth



NPA ratio



RoAA



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RoAA – Sector-average return on average assets.

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Panama | BICRA Group: 5

Modest Credit Growth This Year With Still Weakening Asset Quality

Primary Credit Analyst
Ricardo Grisi
Mexico City
ricardo.grisi@spglobal.com
+52-55-5081-4494

Key takeaways

- We expect weaker asset quality metrics in the next 12 months because loan forbearance measures will end.
- Profitability will remain lower than pre-pandemic levels and start gradually recovering in 2023.
- Although Panama doesn't have a central bank or formal lender of last resort, the government has successfully used the public-owned bank, Banco Nacional de Panama, as the vehicle to provide liquidity to the banking system during the pandemic.

Key credit drivers

Weakening asset quality indicators in the next 12 months We think the risk of challenging operating conditions in the country could result in larger-than-expected credit losses that could hamper Panamanian banks' asset quality. Despite the government measures to offset the impact of social distancing measures and the still high unemployment rate, the pandemic's effects have significantly hurt Panama's economy. As a result, lending remains modest with an expected gradual recovery in the next two years. We think credit losses will peak at 1.7% and nonperforming assets (NPAs) at 3.7% in 2022, and then will gradually decrease--returning to pre-pandemic levels after 2023.

Lack of lender of last resort. Panama doesn't have a central bank or formal lender of last resort, or an effective deposit insurance system to support distressed financial institutions. However, the government has successfully used the public-owned bank, Banco Nacional de Panama, as the vehicle to provide additional liquidity to the domestic financial sector, corporations, and small and midsize enterprises (SMEs) amid the pandemic-induced economic fallout. Additionally, the regulator allowed banks to undertake relief programs until June 30, 2021, with a three-month extension for additional loan restructures. It also allowed banks to use the accumulated provisioning to absorb the impact of credit losses and to create a generic provision equivalent to 3% of the gross balance of the modified loan portfolio.

Key assumptions

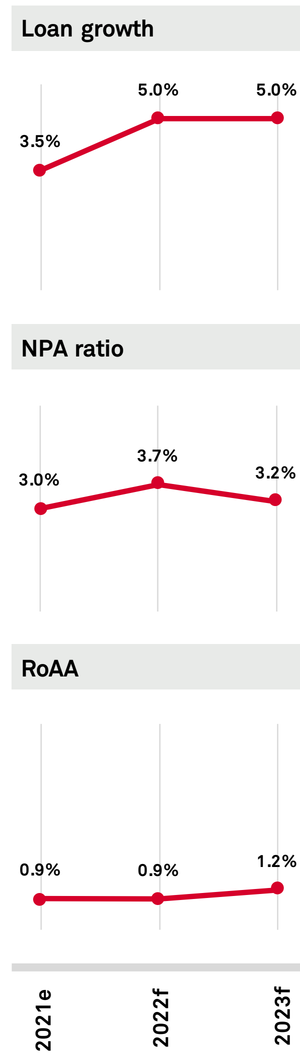
Economy is somewhat recovering. We expect that the Panamanian economy recovered only partially in 2021--growing about 9% due to a carryover effect and supported by mining exports and higher private consumption as mobility restrictions lessen and vaccination efforts continue. We forecast growth to return to about 6% in the following three years as private and public investment picks up. Therefore, we expect that credit growth for Panama's banking system was about 3.5% in 2021--still reflecting loan moratorium programs--and will be 5.0% in 2022-2023; more in line with Panama's economic growth.

What to look for over the next year

Still low profitability for the next 12 months. Profitability will be lower than pre-pandemic levels and start gradually recovering in 2023. Systemwide returns will represent about 0.9% of the sector's adjusted assets in 2022 and slightly improve to 1.2% in 2023, compared with about 1.4% pre-pandemic. The latter reflects higher loan-loss provisions, as well as slightly lower interest income and fees/commissions.

Efforts to strengthen the banking system's supervision and institutional framework. The country's financial system regulation continues to improve, reducing the gap with international regulators, although implementation challenges remain. In addition, the EU added Panama to its blacklist of uncooperative jurisdictions in terms of tax transparency and financial information, although the EU's decision hasn't yet damaged the financial system, in our view.

Brazil



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RoAA – Sector-average return on average assets.

a--Actual. e--Estimate. f--Forecast.

Paraguay | BICRA Group: 8

Trajectory Of Asset Quality Will Be Key

Primary Credit Analyst
Henrique Sznirer
São Paulo
henrique.sznirer@spglobal.com
+55-11-3039-9723

Key takeaways

- Drought could decelerate Paraguay's GDP growth, but higher commodity prices could partially mitigate the impact.
- The banking system remains highly exposed to dollarization and to cyclical sectors.
- Nonperforming loans may increase this year as previously deferred loans reach maturity, but the central bank's new measures could mitigate the drought's impact on NPAs.

Key credit drivers

New measures to cope with drought's effect should restrain damage to asset quality. After several measures taken in recent years to mitigate the impact of COVID-19 on the banking system, the central bank announced new ones that should help borrowers facing difficulties because of recent drought. This should, to some extent, contain nonperforming assets (NPAs) and credit losses this year. However, lower-than-expected GDP growth is a risk to asset quality.

Dollarization remains high, while the system continues to be exposed to cyclical sectors. The share of foreign-currency lending in Paraguay's banking system likely increased to around 45% of total loans in 2021 from 41% in 2020. The sector remains exposed to cyclical sectors such as agriculture.

Comfortable liquidity. Liquidity in the financial system has remained comfortable, which has given banks room to continue managing the high share of deferred loans. Moreover, deposits have increased about 7% in 2021, after a 20% growth in 2020, pointing to depositors' confidence in the industry, in contrast to the crisis two decades ago.

Key assumptions

Drought should slow GDP growth this year. After strong recovery in 2021, adverse weather will likely drag down performance in 2022, particularly in key agricultural sectors and energy production. However, currently higher commodity prices could partly offset that impact, and we expect the country's growth prospects to brighten starting next year.

Asset quality metrics could weaken this year, but new regulatory measures should contain NPAs. The new loan-deferral measures following the recent drought should restrain NPAs from rising this year. However, the NPAs could still rise if some of the loans, which that were deferred since the pandemic's start, are not paid.

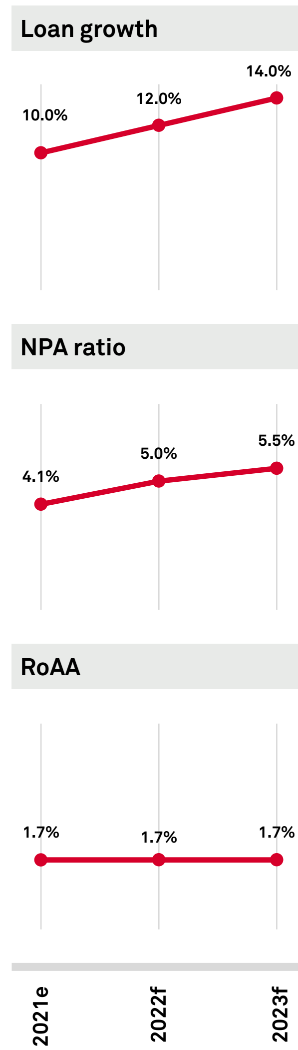
Profitability should remain slightly below historical levels. After lower-than-usual profitability in 2020, the banking sector's bottom-line results increased in 2021, but were still lower than the historical average. We expect profitability to remain slightly below average this year as a portion of deferred loans turn into credit losses. However, the central bank's new measures and higher interest rates could compensate partly for wider credit losses.

What to look for over the next year

Economic activity. We will continue to monitor the economic activity, especially after various shocks in recent years that have weakened the agents' payments capacity. Unemployment remains slightly higher than pre-pandemic levels. Weather events such as droughts are hurting the agribusiness sector, hydroelectric activity, and river levels (the main export channel), and new events or COVID variants could further hurt economic recovery. Finally, inflation is also a key variable to monitor.

Asset quality. The evolution of the significant stock of reprogrammed loans in conjunction with NPAs could potentially increase credit losses in coming years, which could hurt the financial system's profitability and capitalization and in turn limit credit growth.

Brazil



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Peru | BICRA Group: 5

Persistent Risk Amid Political Disruption And Soft Economy

Primary Credit Analyst
Cynthia Cohen Freue
Buenos Aires
cynthia.cohenfreue@spglobal.com
+54-11-4891-2161

Key takeaways

- We forecast a 3% GDP growth in 2022 as political instability keeps investors cautious.
- Asset quality and credit costs will continue moderating but risks remain due to lukewarm economy, a large informal sector, and low-income levels.
- Profitability will keep improving as margins recover due to the change in asset mix towards retail lending and the share of “Reactiva Peru” loans decreases, while provisioning needs remain manageable.

Key credit drivers

We expect Peru’s GDP to grow 3% in 2022 and 4% in 2023. Higher inflation will prompt the central bank to continue tightening monetary policy in the coming months. The removal of fiscal stimulus will also soften domestic demand next year. There's considerable uncertainty over policy direction following the highly polarized presidential election last year, which a largely unknown anti-establishment figure, Pedro Castillo, won. In our view, this will keep investors more cautious toward the country until there's greater visibility on the new administration's policies.

Credit costs to moderate from the peak in 2020, during which banks raised a significant amount of provisions because of the pandemic's harsh effect on the economy. We expect non-performing loans to fall from the 2021 peak. However, asset quality could deteriorate if the persistent instability on the political front undermines the country’s economic performance.

On Oct. 15, 2021, we revised the outlook on six Peruvian financial institutions to negative from stable. The outlook revision was driven by the same action on the sovereign. A fragmented political environment and a difficult social legacy (this was taken from a published article from the sovereign team, I would prefer not to make changes) from the pandemic could hurt Peru's medium-term growth prospects and worsen its debt metrics.

Key assumptions

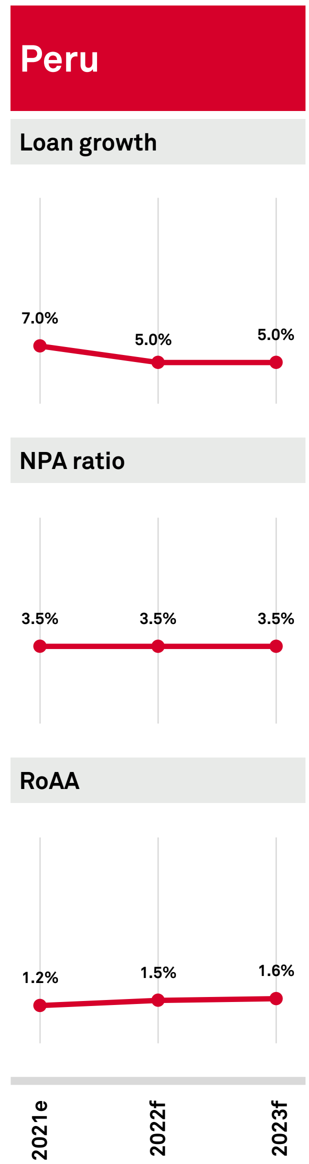
Lending growth should remain slower than historical levels due to more conservative underwriting practices. We expect new lending to be driven by retail loans and mortgages, while the corporate and small business lending drove credit growth in the past two years, supported by the government-guaranteed loans.

Profitability should continue recovering in 2022. We expect margins to improve due to a change in asset mix, as the share of government-guaranteed loans with thin margins falls, fee income continues to rebound, and provisioning charges moderate.

What to look for over the next year

Political instability and social unrest could hinder the economic recovery. In recent years, Peru has experienced political turmoil, including a very tight presidential election in 2021. Governability risks are likely to continue given the fragmentation in Congress and the persistent tensions between the executive and legislative branches.

We consider the small- and medium-size enterprise lending segment represent a significant risk for the banking system. We believe the government guarantees offered through the "Reactiva Peru" program will mitigate the impact, given that the guaranteed amount is generally 90%. As of November 2021, the total amount of guaranteed loans reached PEN44.5 billion, accounting for 11% of total loans. These loans have a term of 36 months with a grace period of 12 months.



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a--Actual. e--Estimate. f--Forecast.

Trinidad and Tobago | BICRA Group: 6

A Rebound In The Energy Sector Will Support Economic Growth

Primary Credit Analyst
Camilo Pérez
Mexico City
camilo.perez@spglobal.com
+52-55-5081-4446

Key takeaways

- We expect that, after reaching their lowest point in over a decade, the country's oil and gas production will rise in 2022-2023. This, together with higher prices, will drive a recovery in the energy sector and economy.
- The pandemic-induced drop in economic activity and a weak energy sector resulted in an economic contraction in 2020 and 2021, the effects of which continue to pressure banks' asset quality and earnings. However, we forecast profits to recover in 2022-2023 as credit growth resumes, interest rates recover, and given that banks already booked the bulk of provisions to cover pandemic-related credit losses.
- The banking system has posted strong results despite the recession in the past few years. Moreover, banks entered the economic crisis--caused by COVID-19 and weak energy sector--with sound loss reserves, capital and liquidity, which help them absorb the economic shocks.

Key credit drivers

Energy dependency. Although banks aren't heavily exposed to oil companies (about 4% of total loans), the economy heavily depends on the energy sector, which has historically accounted for over one-quarter of the government's revenue and real GDP, and accounted for nearly 80% of exports.

Banks remain well prepared to face the effects of COVID-19. The impact of the pandemic, together with the domestic energy sector downturn that began before the outbreak but was exacerbated by it, caused GDP to contract nearly 10% in 2019-2021. This in turn has been pressuring households and enterprises' debt capacity. However, we believe the pandemic's fallout will be manageable thanks to the banks' conservative provisioning policies, sound capital, and liquidity.

Key assumptions

Economic growth. We estimate real GDP growth of 3.9% this year and unemployment rate stabilizing at 6.5% in 2022-2023.

Manageable credit losses. Banks have been able to contain the damage to asset quality stemming from the years-long recession amid weak energy prices but relatively controlled unemployment and inflation rates. However, the still high unemployment, resulting from the lockdowns, could widen credit losses more than we currently expect.

Regulatory reliefs lifted. We believe the hit to asset quality will continue materializing this year as the regulatory and banks' removed measures to lessen the strain on borrowers. However, sound credit provisioning will help absorb potential losses without compromising the banking system's stability.

What to look for over the next year

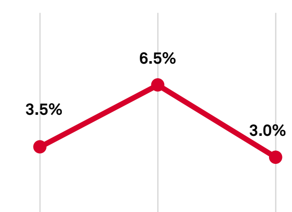
New presidential administration. T&T held elections in August 2020 that resulted in a narrow victory for the ruling party. We expect T&T's stable parliamentary democracy and social stability to continue to anchor the country's institutions in the next few years.

Unemployment. In our view, unemployment is a key indicator for a deeper credit stress in the financial system. Household debt service has risen consistently over the past few years and could be a source of vulnerability if economic activity or the labor market remains soft for a prolonged period.

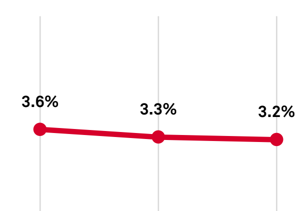
Exchange rate. The country's heavily managed exchange rate has resulted in dollar shortages in the last few years, which have constrained economic activity, weakening local businesses' ability to pay suppliers and obtain key imports. The banking system maintains a long position in dollars and it has limited foreign currency loan disbursements.

Trinidad & Tobago

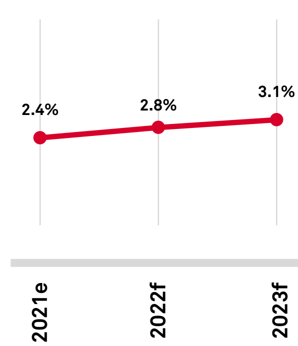
Loan growth



NPA ratio



RoAA



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Uruguay | BICRA Group: 5

Stable Performance Despite Slow Economic Growth

Key takeaways

- We expect Uruguay's economy to continue growing in 2022 and 2023 thanks to recovery in external demand, higher commodity prices, a gradual rebound in consumption, steady progress in the country's vaccination program, and infrastructure investments.
- Asset quality metrics will remain manageable, despite the end of the loan moratoriums, but their trajectory will depend on the pandemic's final impact on the various sectors' payment capacity.
- We expect banks' profitability to improve slightly, liquidity levels to remain sound, deposit bases stable, and solvency levels adequate.

Key credit drivers

We expect asset quality metrics to remain manageable in the next 12-18 months due to conservative credit growth strategies. In 2020 and 2021, nonperforming loans (NPLs) remained contained thanks to regulatory measures to support the financial system and after some banks charged off bad loans in their corporate lending units.

Limited monetary flexibility. High inflation, of about 8% in 2021, and still extensive dollarization continue to limit Uruguay's monetary policy flexibility. Over 50% of resident loans and more than 70% of resident deposits are in dollars.

High dollarization and exposure to cyclical sectors. Significant dollarization in the economy, along with some sector and customer lending concentrations, increases risks. Loans to the agriculture sector represent about 15% of total loans.

Key assumptions

We expect economic growth of about 3.1% in 2022 and 2.5% in 2023, given recovery in external demand, higher commodity prices, a gradual rebound in consumption, and steady progress in Uruguay's vaccination program. Also, infrastructure investments will contribute to growth. At the same time, recovery in key sectors such as tourism will be slower due to pandemic-related restrictions and the country's heavy dependence on rebound of Argentina and Brazil.

Flat real credit growth. Private sector's access to credit remains low, at about 29% of GDP, and we expect it will be at the same level in the next 12-18 months. However, we expect nominal credit growth of 12% in the next two years, because of the depreciation of the Uruguayan peso, high inflation, and the expected economic growth. Also, the central bank reduced the reserve requirement for loans granted in pesos as part of its measures to encourage credit growth and reduce dollarization.

Stable and predictable political institutions. We believe Uruguay's broad political consensus, and stable and well-established institutions have anchored--and will continue to do so--economic stability.

What to look for over the next year

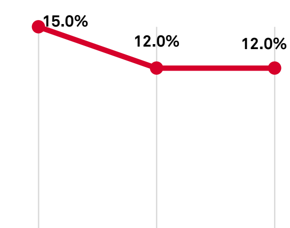
For the next few quarters, we expect banks' profitability to improve slightly as a result of higher returns in investment portfolios, given the potential rise in international interest rates, and lower provisions levels. The banking system's excess liquidity is allocated in low-risk instruments, mainly U.S. Treasury securities. Also, profitability will benefit from exchange-rate fluctuations due to most banks' active long position in dollars and credit growth, as long as the economy continues to recover.

Banking system is mainly funded with stable deposits. In 2021, deposit base increased 16% in nominal terms, with nonresident deposit base accounting for 9.5% of total deposits, most of which consist of Argentine citizens, given that country's financial turmoil. We expect the deposit base to remain stable in the next 18 months.

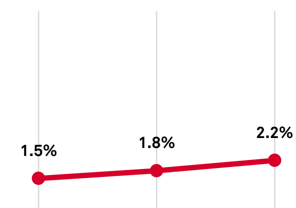
Primary Credit Analyst
Sofia Ballester
Buenos Aires
sofia.ballester@spglobal.com
+54-11-4891-2136

Uruguay

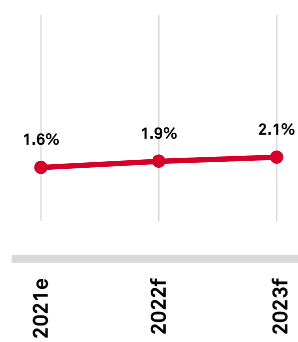
Loan growth



NPA ratio



RoAA



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