LATAM SPOTLIGHT
Latin America
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ABOUT

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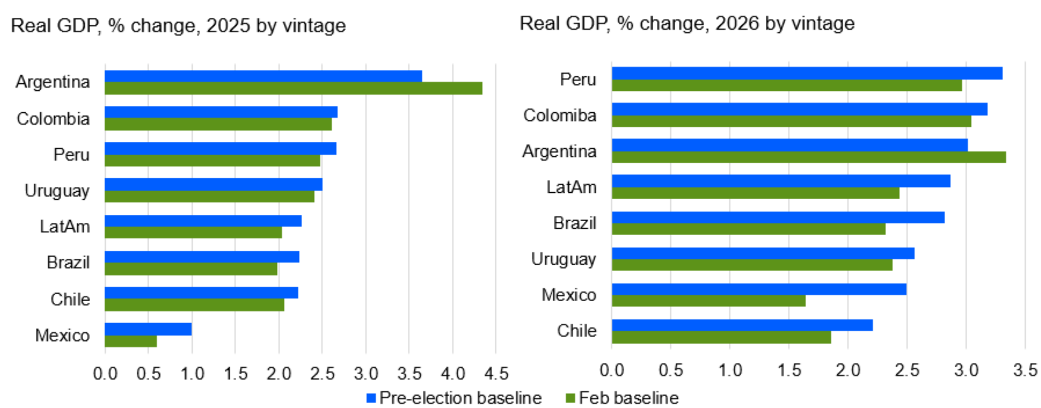
The Trade War in Latin America: Opening Salvos

- Our baseline outlook still avoids recession.
- Further tariff escalation could easily flip the script.
- Trade diversion will be less of a shock absorber this time around.
- Aluminum and steel tariffs will hurt locally but are less of a concern at the macro level.

The opening salvos of the global trade war have already been exchanged, and while Latin America has narrowly stepped out of the firing line, difficult days are ahead. In contrast to the trade war of 2018-2019, when the region was able to partially offset slower global growth by exporting a greater share of its commodities to China and the rest of Asia, higher tariffs and greater unpredictability will take a larger toll on growth. We have cut our forecast for Latin America by 0.3 percentage point in 2025 and 0.4 percentage point in 2026 to reflect the direct impact of U.S. tariffs as well as a decelerating global economy. The hit to growth in Latin America would be even higher if not for the nascent rebound in Argentina, whose economy is recovering from a nearly yearlong recession.

The Trump administration's tariffs—both announced and anticipated—dictate the contours of our new baseline forecast. Mexico will be the most affected by the Trump administration's trade and immigration policies, given its reliance on the U.S. for exports and investment and the importance of remittances as a backstop for consumer spending. We expect the U.S. to ultimately impose across-the-board tariffs on Mexican exports, though at a lower threshold than the 25% tariff rate initially slated to take effect at the start of February. Beyond Mexico, the direct impact of the Trump administration's tariff, fiscal, and immigration policies will not be as large, but a slower U.S. and global economy will curb growth across the region.

LatAm Forecast Marked Down in 2025 and 2026



Source: Moody's Analytics

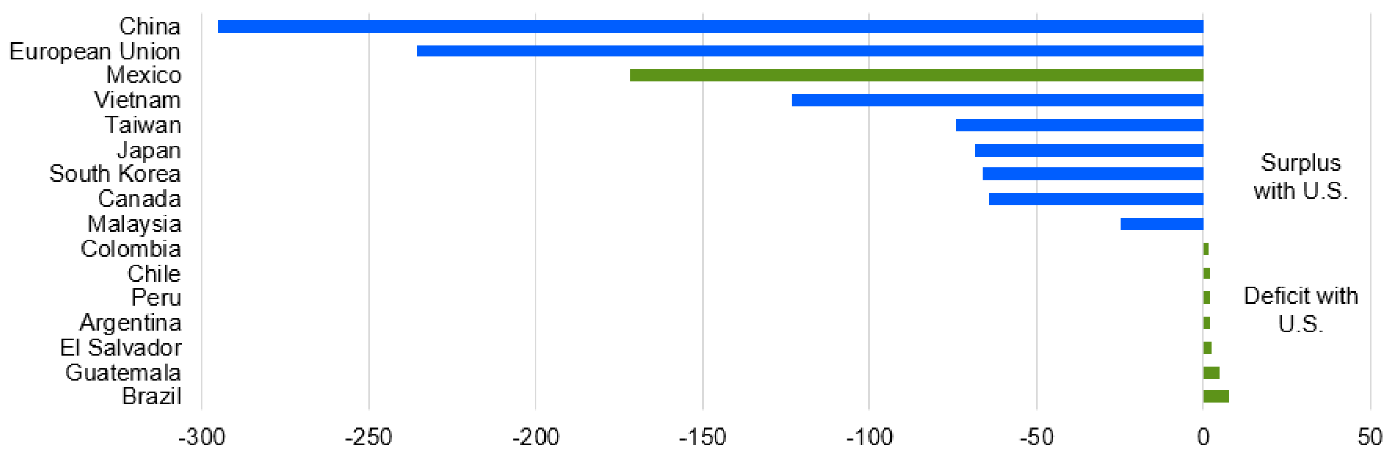
While we expect Latin America to ultimately avoid recession under our baseline forecast, further tariff escalation could nudge the region into a broader downturn. Using our Global Macroeconomic Model, we simulate the effects of an additional 10-percentage point increase in the U.S. effective tariff rate for Mexico and the rest of Latin America above and beyond what we are anticipating in our baseline. The result is a broad-based downturn in the region, with a contraction in output, elevated unemployment, surging inflation, and a collapse in trade.

Opening salvos

Latin America was a major focal point for the Trump administration during the presidential campaign and Trump has stayed true to form, threatening tariffs on Mexico, Colombia and Brazil in the first two weeks of his administration. At the core of Trump's disputes with the region are large trade imbalances—primarily with Mexico—the flow of undocumented migrants and illegal drugs, and efforts by Brazil and its BRICS partners to reduce the role of the dollar in international trade.

Mexico Deficit in the Eye of the Storm

U.S. trade balance, $bil, by country, 2024

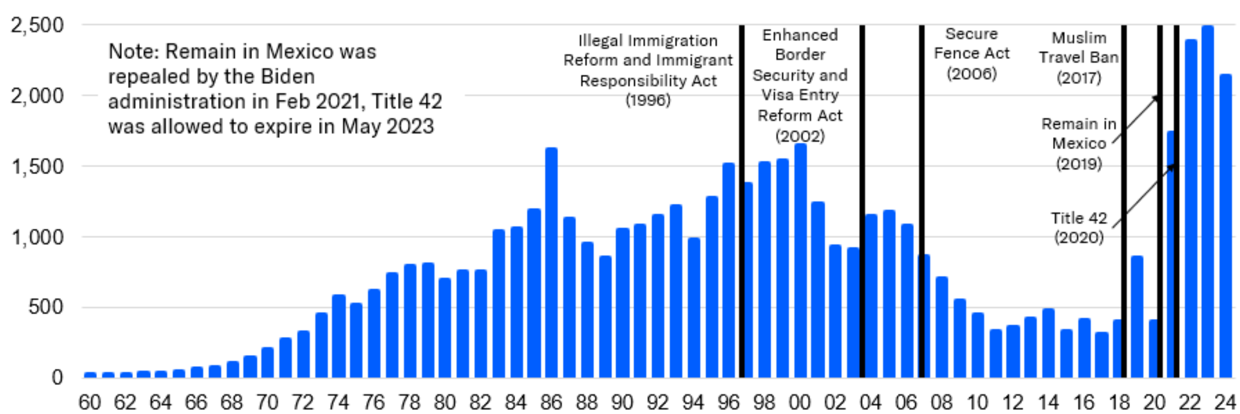


Sources: Census Bureau, Moody's Analytics

Though Trump has since postponed tariffs on Mexico and retracted his threat of punitive tariffs on Colombia, we expect the effective tariff rate on U.S. imports from the region to rise meaningfully. This is because Trump's main sticking points—the large trade deficit with Mexico and surging immigration from across the region—are unlikely to be resolved via negotiations alone.

U.S.-Mexico Border Crossings Still at All-Time High

Southwest border encounters, ths



Sources: CBP, Moody's Analytics

While Mexico is the U.S.'s second-largest export market after Canada and a growing buyer of U.S. manufactured goods and agricultural products, Trump has linked the large trade deficit with Mexico to the long decline in U.S. manufacturing employment. This spotlight is mistaken. While there have been gains and losses from trade, and several high-profile relocations of U.S. factories to Mexico, our work shows that China's rise has had a far greater impact on U.S. manufacturing employment.[1]

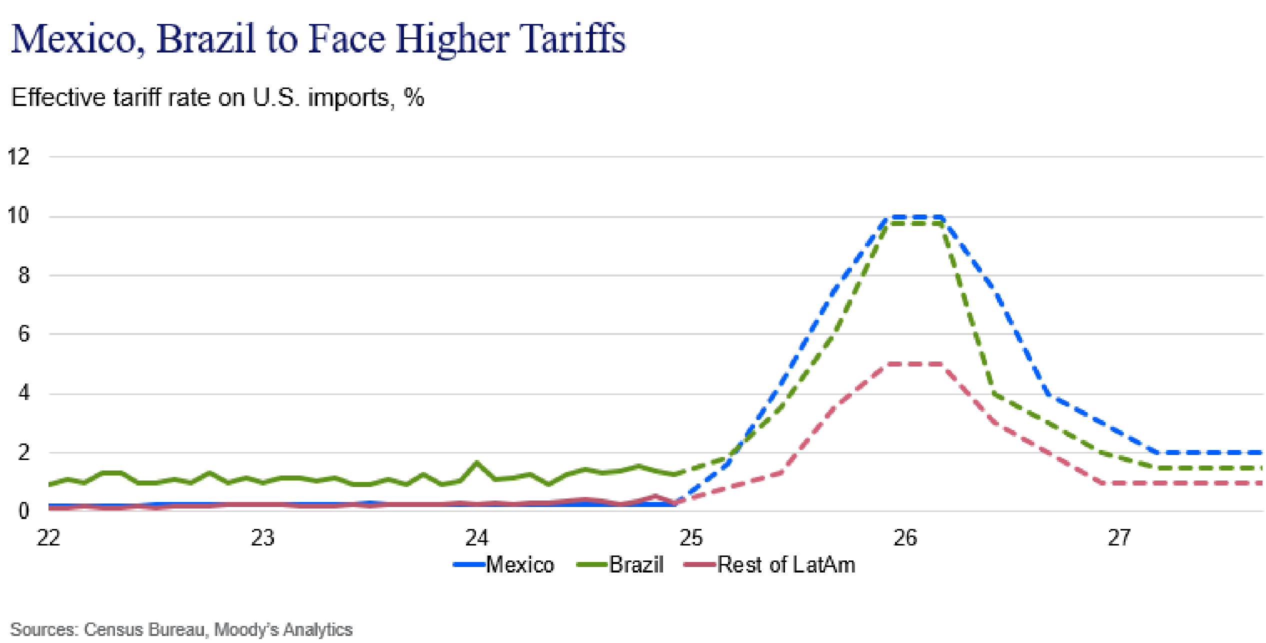
Despite pledges of increased cooperation in border security, migration flows from Mexico will remain elevated in coming months as a consequence of the political crisis in Venezuela and security troubles in Central America. While border crossings by Mexican nationals have fallen over the past decade, large inflows from Venezuela and the Central American countries of Guatemala, Honduras, Nicaragua and El Salvador have pushed unauthorized border crossings to an all-time high.

These inflows will remain a focal point of the Trump administration and are a potential wild card in U.S. tariff policy. With inflows of undocumented migrants unlikely to fade as fast as Trump would like, the stage is set for higher tariffs on Mexico. If the tariff spat between the U.S. and Colombia is any guide, any Latin American nation that refuses to cooperate with U.S. deportations could find itself on the receiving end of tariffs regardless of the proximity of diplomatic and economic ties.

The tariffs

With no easy solution to the trade deficit with Mexico and the challenges of immigration and the inflow of illegal drugs, we assume the Trump administration raises tariffs on U.S. imports from Mexico by spring and that Mexico retaliates. Looking past recent volatility in tariff threats, we expect the effective tariff charged on U.S. imports from Mexico to rise to 10%. This is not enough to push the Mexican economy into recession, but it will cause it to experience a significant slowdown.

The tariffs will be phased in throughout 2025, reaching a peak at the end of the year and remaining at their maximum point until this time next year. The combination of tariffs on Mexico and China will take a toll on the U.S. economy, forcing Trump to walk back tariffs on Mexico and Latin American countries at the beginning of 2026 as the damage to the U.S. and global economies grows increasingly apparent.



Brazil is the other major Latin American economy to face higher tariffs. As in Mexico's case, we expect in-kind retaliation. The Trump administration has taken issue with Brazil's attempts to find alternatives to the U.S. dollar for international trade and financial transactions. So far, these efforts have not progressed much. The Chinese renminbi—the most likely base for an alternative payments system—is still only

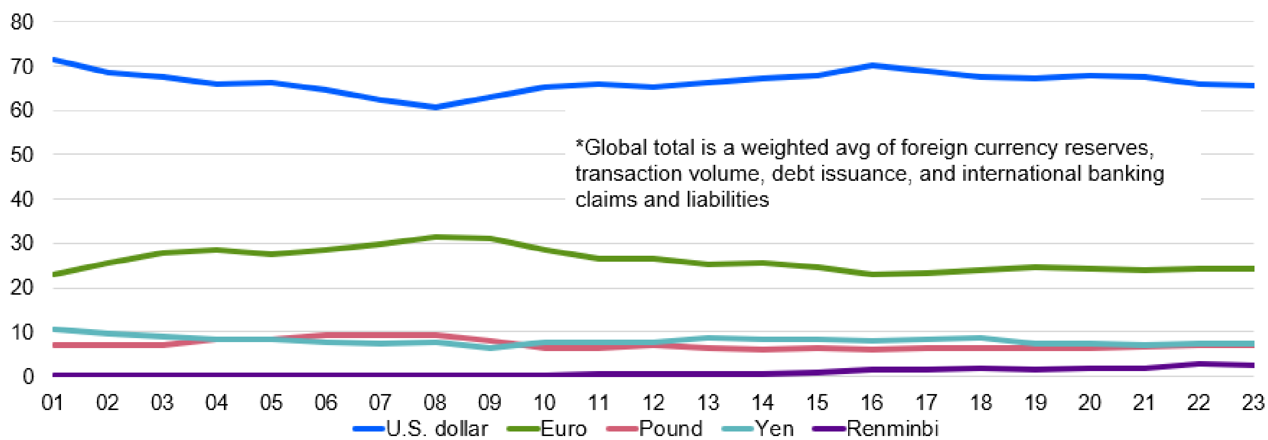
[1] See "How Everything Came to Be "Made in China", Angrick, Stefan and Bang, Jeemin, September 10, 2024: https://www.economy.com/economicview/analysis/407113

a tiny slice of global reserves, and the China Investment Information Platform, a proposed alternative to the West-led global payments system, still relies on the infrastructure of the SWIFT global interbank messaging system.

Additional indicators of de-dollarization show little momentum. The Federal Reserve's index of international currency usage shows little advancement in the global usage of the renminbi for trade, debt issuance, international banking claims, and reserves. Most BRICS nations continue to invoice the majority of their trade in U.S. dollars. Nonetheless, efforts by Brazilian President Luiz Inácio Lula da Silva to promote the use of the renminbi as well as other BRICS nations' currencies have drawn the ire of the Trump administration and will continue to prove a flash point.

Little Momentum for De-dollarization

Index of international currency usage, share of global total*



Sources: Federal Reserve, Moody's Analytics

Aside from Venezuela and Nicaragua, there are no obvious disputes between the U.S. and other Latin American nations that stand as trigger points for new tariffs. However, the recent standoff between the U.S. and Colombia suggests there certainly can be. It is prudent to assume that tensions will flare with the rest of Latin America at some point over the next year, whether related to deportations, U.S. policy around the war on drugs, or countries' approach to the constitutional crisis in Venezuela. We thus assume that tariffs for the rest of the region will rise by an average of 5% over the course of this year and similarly wind down in the first quarter of 2026.

Aluminum and Steel

Steel and aluminum tariffs announced this week and set to take effect in March add further uncertainty to the global economic environment and constitute another downside risk to our outlook for Brazil and Mexico. The two countries are the second and third largest sources of U.S. steel imports. However, while the tariffs will be painful for local steel producers—Mexico sends almost 90% of its steel exports to the U.S., while the U.S. is the destination for just under 50% of Brazilian steel exports—we do not expect large impacts economy-wide. Steel products account for less than 1% of total exports for Mexico and just under 5% for Brazil. Despite their importance in steel, neither country is a large supplier of aluminum for the U.S. market.

More concerning for the Brazilian economy will be the broader-based slowdown of the Chinese and global economies. Brazil boasts the whole market basket of commodities, from industrial metals to agricultural products and even oil, with iron ore and metals exports accounting for around 15% of Brazil's total exports alone. While the U.S. is Brazil's most important export market for steel, most Brazilian steel production is destined for domestic consumption. It is not unreasonable to think that steel exports priced out of the U.S. could find a home elsewhere.

Trade diversion less of a shock absorber

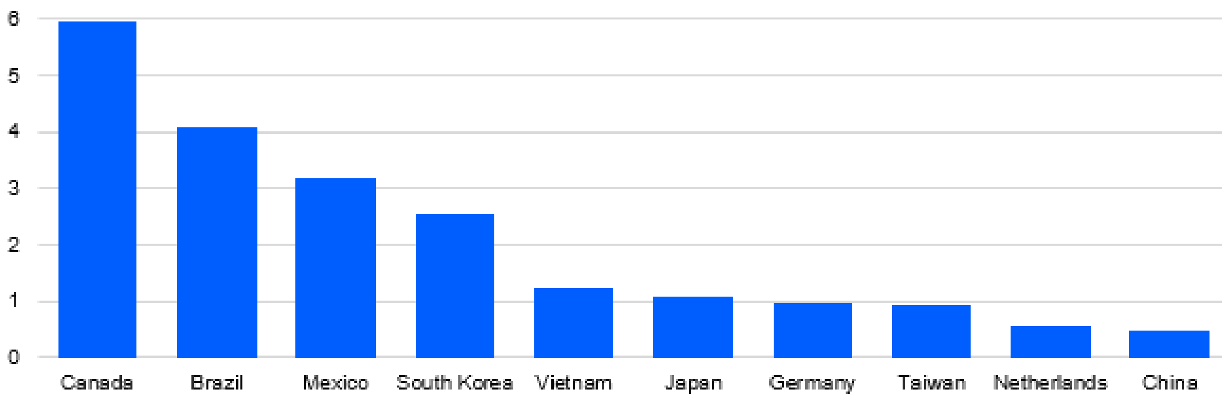
The re-routing of global commodities trade during the first trade war bolstered the fortunes of commodity exporters in Latin America and helped dull the pain of sluggish global growth. As China imposed stiff retaliatory tariffs on U.S. soybeans, countries such as Brazil and

Argentina filled the void, with Brazil's total soybean exports nearly doubling that of the U.S. Brazilian agricultural exports to China continued to surge even after China lifted retaliatory tariffs on U.S. soybeans following the Phase One trade agreement with the U.S.

Increased domestic consumption of animal protein in China and emerging Asia has increased the need for soybeans, corn, and other feed crops, bolstering agricultural output in Brazil and Argentina in the past decade. However, changing diets in China and the rest of Asia won't do as much to curb trade war blows this time around.

Canada, Brazil, Mexico Dominate U.S. Steel Imports

Steel imports, U.S., million metric tons, 2024

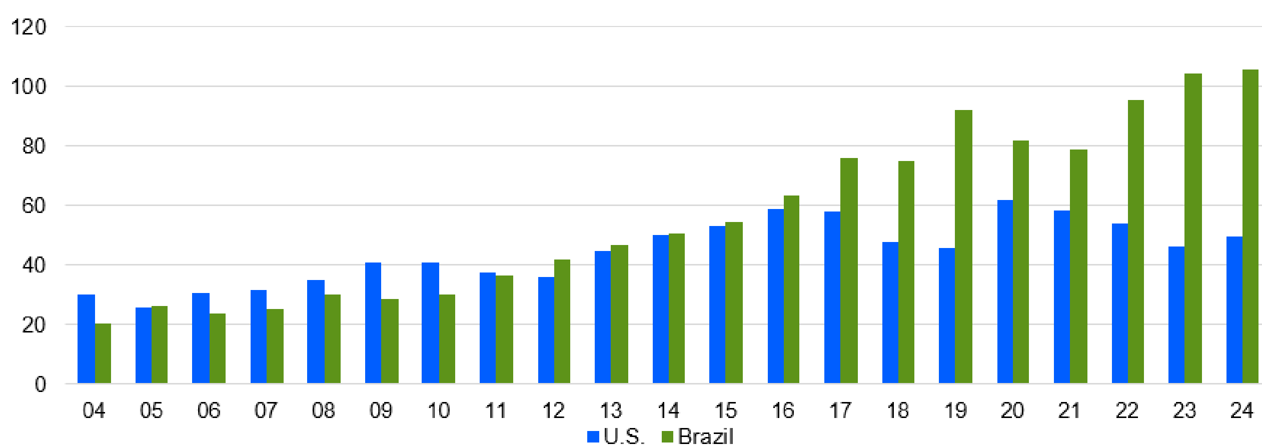


Sources: U.S. Department of Commerce, Moody's Analytics

While Chinese meat consumption continues to grow, the bulk of the transformation of Chinese diets has already occurred. As a result, commodity exports to China and emerging Asia will be less of a shock absorber. While agricultural producers such as Brazil, Argentina and Chile will contend with a decelerating Chinese economy, metals producers such as Chile and Peru will similarly struggle amid a rocky property market and reduced demand for copper and iron ore.

Brazil Soybean Farmers Pull Ahead

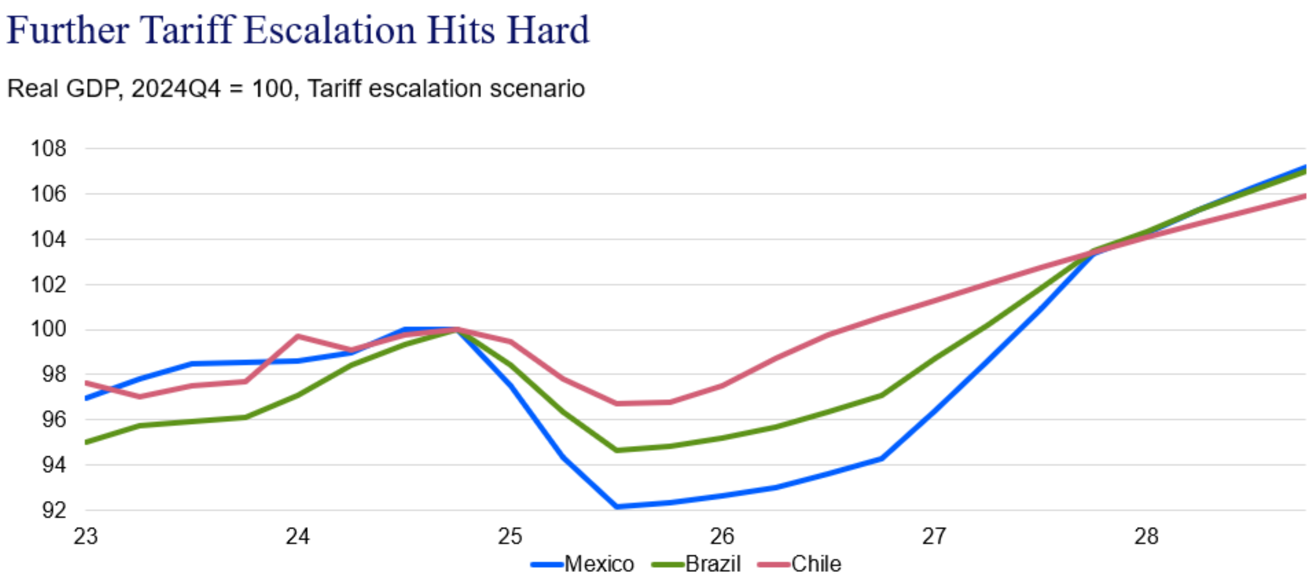
Soybean exports, metric ton, ths, marketing yr beginning in



Sources: USDA Foreign Agricultural Service, Moody's Analytics

It could get darker

It is possible that tariff escalation will exceed our baseline assumptions. To gauge the impact of more rapid tariff escalation between the U.S. and Mexico and the U.S. and China, we input more aggressive tariff assumptions into our Global Macroeconomic Model, bringing the effective tariff rate between the U.S. and Mexico and the U.S. and Brazil to 20% and the effective tariff rate on Chinese imports to 40%. The global economy rapidly falls into recession, with outsize impacts on Latin America.



Source: Moody's Analytics

Of Latin America's two largest economies, Mexico is most heavily affected given its reliance on the U.S., which experiences a steep contraction in this scenario. Brazil also sees a decline in output primarily because the Chinese economy falls into recession. Chile, which is more reliant on a single commodity, also suffers significant effects, with GDP contracting for three consecutive quarters and taking more than a year to fully recover. Impacts in Peru and Colombia are similar to those of Chile, while those in Argentina and Uruguay are slightly less severe. While the region's economies eventually recover, it is not until 2028 that they completely recoup output and employment losses.