

LatAm Strategy Monthly

Love Over Oil: Dire Straits

HIGHLIGHTS

- Global growth faces downside risks as persistent Middle East tensions keep oil prices high, fueling inflation and complicating central banks' trade-offs. Advanced economies are turning more hawkish, limiting easing space in EMs, while commodity gains support LatAm currencies and benefit oil exporters like Brazil. Overall, inflation remains elevated and central banks cautious, but weaker activity could temper further tightening.
- In **Brazil**, the BCB faces not only a severe global energy shock, but also a domestic demand shock driven by fiscal and quasi-fiscal stimulus. Economic activity and inflation have gained momentum, exerting upward pressure on inflation expectations. Against this backdrop, the BCB is likely to adjust its policy trajectory. We have revised our Selic rate forecast for YE 2026 upward to 13.75%. On the positive side, the BRL remains appreciated, even amid a partial global recovery of the USD. This performance reflects Brazil's position as a relative beneficiary of the global energy shock. These flows should help offset a potential increase in risk premia during the election period.
- In **Mexico**, the April decline in inflation was driven by core inflation, amid pressures from perishable food prices and sticky services, but with contained energy prices. The economy also contracted by -0.8% q/q in 1Q26 due to a collapse in domestic demand. Against this backdrop, Banxico delivered a final 25-bps rate cut and signaled an intention to pause for a prolonged period, leaving the policy rate at 6.50%. A solid economic recovery still appears distant, so the pause may not last long, and rate cuts could resume by year-end, in our view.
- In **Colombia**, BanRep unexpectedly held rates at 11.25% in a unanimous decision that, in our view, reflects a game-theoretic equilibrium choice under extraordinary political pressure. Despite the pause, both the policy statement and recent economic data continue to point to a hawkish bias and support further tightening. April CPI and 1Q26 GDP data reinforce concerns over the inflation outlook driven by strong domestic demand, a tight labor market, rising wages, unanchored expectations, and loose fiscal policy, among other factors. We still expect a 50-bps hike in June, although near-term tightening risks have diminished in favor of a higher-for-longer stance.
- In **Chile**, the BCCh held the policy rate at 4.50%, as expected, but struck a more cautious and mildly hawkish tone as the Middle East energy shock has raised upside risks to inflation. April inflation soared to 4.0%, from 2.8% in March, driven almost entirely by energy prices, while core inflation remains well behaved, supporting an extended, data-dependent rate pause for now. We also present key takeaways from President Kast's Reconstruction Plan, which signals a pro-growth shift but faces meaningful fiscal, political, and execution risks.

Note: We wish to thank Luíza Pineze, Economist at the Macro Research team of XP Investimentos in Brazil, for her contribution to this report.

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GLOBAL BACKDROP: The Economic Consequences of the War

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1. The conflict in the Middle East persists, following unsuccessful negotiations between the US and Iran in recent weeks. Oil prices remain near five-year highs. While it is still too early to call a global recession, growth is likely to be affected across several regions—particularly if energy rationing becomes widespread. At the same time, inflationary pressures are building, leaving central banks in an increasingly difficult position.

2. Turning more hawkish as a first reaction, central banks in advanced economies are beginning to signal the possibility of higher interest rates. Market participants broadly expect both the ECB and the BoE to tighten monetary policy in the coming months. In the US, the Fed kept rates unchanged, but three Board members objected to including an easing bias in the post-meeting statement. Short-term Treasury yields moved higher following the decision. Higher rates in developed markets tend to reduce room for monetary easing in emerging markets like Brazil.

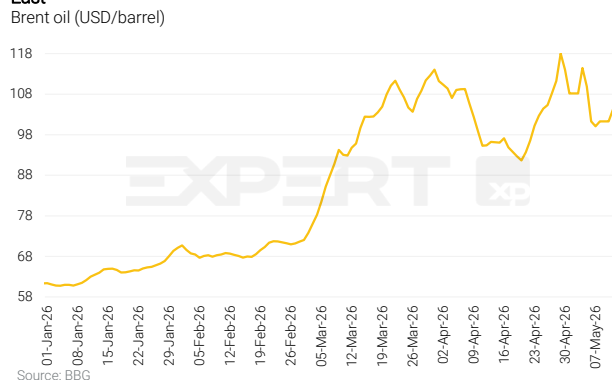
3. Metal prices have surged, supporting some LatAm currencies amid the high inflation environment. In recent days, some metal commodities have risen on the back of supply concerns and risk-averse sentiment. Specifically, silver and copper are up 17% and 13% over the past two weeks, supporting the CLP and MXN, which appreciated more than 2.0%, even as the USD gained traction following high US inflation in April (DXY up 0.8% in recent days).

4. We maintain our baseline assumptions of average Brent oil prices at USD 90/bbl in 2026 and USD 80 in 2027. Risks are skewed to the upside, although we still believe prices could decline materially if—and when—a lasting ceasefire is reached, particularly with the reopening of the Strait of Hormuz.

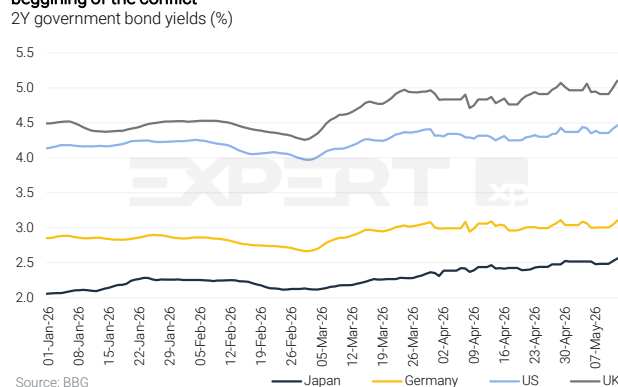
5. Non-Middle East oil producers are better positioned, as is the case for Brazil. Accordingly, we expect a stronger BRL by year-end 2026. Fiscal revenues and exports also benefit from higher energy prices, while inflation is rising. The stronger BRL partially offsets these inflationary pressures.

6. Overall, the outlook points to higher inflation, but downside risks to growth loom. As oil prices stabilize, global inflation is likely to remain elevated, reinforcing a hawkish stance from central banks. While rates could stay pressured, pricing in further hikes, a deterioration in activity could reverse this dynamic, prompting central banks to remain cautious.

Oil prices remain volatile amid the ongoing conflict in the Middle East



Interest rates in developed economies have risen since the beginning of the conflict



KEY LATAM FORECASTS

XP Key LatAm Forecasts

	2019	2020	2021	2022	2023	2024	2025 (P)	2026 (P)	2027 (P)
Brazil									
Inflation (CPI, % y/y)	4.3	4.5	10.1	5.8	4.6	4.8	4.3	5.3	4.0
GDP Growth (%)	1.2	-3.3	4.8	3.0	3.2	3.6	2.3	2.0	1.2
Monetary policy rate (% end of period)	4.50	2.00	9.25	13.75	11.75	12.25	15.00	13.75	11.50
Exchange rate (BRL/USD, end of period)	4.03	5.20	5.58	5.28	4.86	6.17	5.49	5.0	5.3
Mexico									
Inflation (CPI, % y/y)	2.8	3.2	7.4	7.8	4.7	4.2	3.7	4.5	3.7
GDP Growth (%)	-0.2	-8.0	4.7	3.9	3.2	1.5	0.6	1.0	1.6
Monetary policy rate (% end of period)	7.25	4.25	5.50	10.50	11.25	10.00	7.00	6.25	5.75
Exchange rate (MXN/USD, end of period)	18.93	19.91	20.53	19.50	16.97	20.82	18.00	17.50	18.00
Colombia									
Inflation (CPI, % y/y)	3.8	1.6	5.6	13.1	9.3	5.2	5.1	6.5	4.6
GDP Growth (%)	3.2	-7.2	10.8	7.3	0.6	1.7	2.6	2.3	1.8
Monetary policy rate (% end of period)	4.25	1.75	3.00	12.00	13.00	9.50	9.25	12.25	11.25
Exchange rate (COP/USD, end of period)	3277	3430	4080	4853	3875	4406	3780	3800	4000
Chile									
Inflation (CPI, % y/y)	3.0	3.0	7.2	12.8	3.9	4.5	3.5	4.1	3.0
GDP Growth (%)	0.6	-6.1	11.3	2.1	0.2	2.6	2.5	2.1	2.3
Monetary policy rate (% end of period)	1.75	0.50	4.00	11.25	8.25	5.00	4.50	4.50	4.25
Exchange rate (CLP/USD, end of period)	752	712	852	851	881	995	901	870	850

Source: IBGE, INEGI, DANE, INE, Bloomberg, XP Investments

BRAZIL: Tighter Monetary Policy, Stronger BRL

Caio Megale, XP Investimentos Chief Economist, and Team

A more detailed report on the Brazilian economic outlook can be found [here](#).

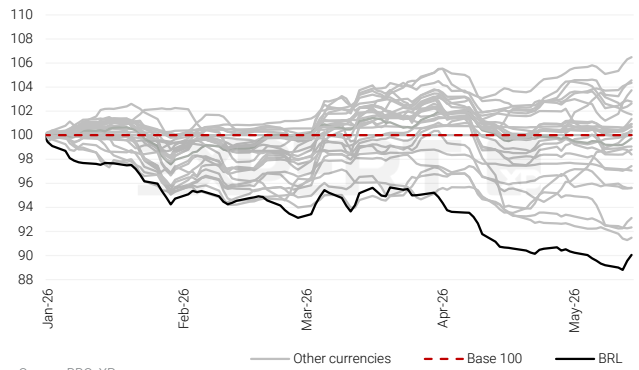
1. We revised our 2026 year-end exchange rate forecast from 5.30 to 5.00 reais per dollar. Despite heightened uncertainty stemming from the conflict in the Middle East, the global environment has remained supportive for Brazilian assets. The BRL continues to rank among the best-performing currencies year-to-date, likely reflecting its status as a “relative winner” in the current environment. Our previous baseline scenario assumed a rise in risk premiums for Brazilian assets during the electoral period, which could weigh on the exchange rate. This risk remains on the table. However, we believe strong global inflows into commodity-exporting emerging markets – particularly Brazil – should help mitigate such pressures

2. Domestically, activity strengthened in Q1. The main indicators for industry, retail, and services gained steam in the early months of 2026. We estimate a 1.1% QoQ increase for 26Q1 GDP, a meaningful acceleration after the stability seen in the second half of 2025. **Our projection for 2026 GDP growth remains at 2.0%.** In the previous Brazil Macro Monthly report, we assigned a downside bias to this expectation, due to the effects of the war in the Middle East. Although Brazil suffers a smaller impact than most countries – given the significant gains in the trade balance from higher oil prices – there are adverse consequences via inflationary pressures, reduced disposable income for consumption, and less room for interest rate cuts. However, considering the additional stimulus measures discussed in recent weeks, we now see an upside asymmetry around our GDP growth forecast.

3. On the fiscal side, our primary deficit forecast increases with measures to mitigate higher fuel prices. The extraordinary gains from higher oil prices, which affect revenues from royalties and other oil production participations, dividends, and sector-related taxes, are expected to be used to offset diesel and other fuel subsidies and the reduction of taxes on gasoline and ethanol. **Accordingly, we have raised our total primary deficit projection to BRL 55.3 billion (0.4% of GDP) from BRL 44.3 billion (0.3% of GDP).**

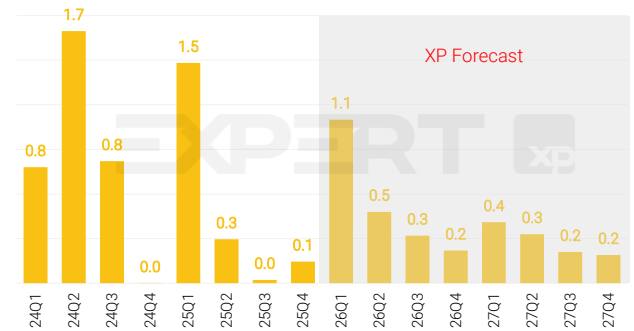
4. Debt growth should accelerate in 2026. Stronger BRL brings relief to government debt in the short term, but high interest rates continue to weigh. A more appreciated exchange rate should reduce the impact of higher interest rates. We now expect the general gross government debt to rise to 83.2% and 87.7% of GDP in 2026 and 2027, respectively (previous: 83.4% and 87.8%). The public sector net debt should reach 69.7% of GDP this year and 74.2% of GDP next year.

BRL outperforms EM and DM currencies in 2026
FX/USD. Selected currencies (drop = appreciation)



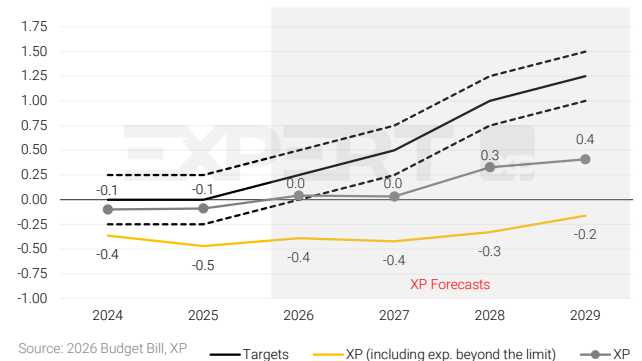
Source: BBG, XP

We forecast GDP growth close to potential in 2026, followed by a weakening in 2027
Total GDP. QoQ SAS (%)



Source: IBGE, XP

Change in court-ordered payments accounting pushes the primary balance below the lower bound of the target in 2027
Primary balance and targets (% of GDP)



Source: 2026 Budget Bill, XP

5. Regarding prices, recent IPCA readings showed a deterioration in the underlying inflation trend. The average of core inflation measures rose for six consecutive prints, reaching 5.2% on the 3-month seasonally adjusted annualized moving average (3M SAAR) in April IPCA. This increase was already evident even before the onset of the war in the Middle East.

6. Looking at the breakdown, (i) industrialized goods prices – one of the components that contributed to the disinflation observed in 2025 – shift to a higher level, (ii) latest data pointed to additional pressure on food prices – the risk is to the upside, given the probability of a stronger *El Niño*, and (iii) service inflation shows no relief. **All things considered, we project the IPCA inflation at 5.3% in 2026.**

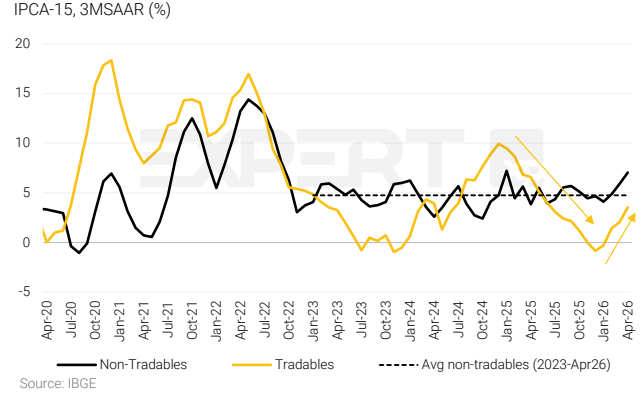
7. Outlook for inflation keeps worsening. Negotiations between the US and Iran have made little progress so far, intensifying and prolonging the global oil shock. In response, major central banks have adopted a more hawkish stance. Domestically, demand is gaining traction, supported by significant fiscal and quasi-fiscal stimulus measures. In addition, the rising probability of a severe *El Niño* event could exert further pressure on food prices in the second half of the year.

8. We had previously expected the oil shock to begin fading by now, opening room for the Copom to accelerate the pace of monetary easing to 50 bps – which we consider the Committee’s “cruising speed.” That scenario no longer holds. Given the deterioration in the inflation outlook, we now expect the Copom to maintain a more cautious pace of 25-bp cuts in the upcoming meetings.

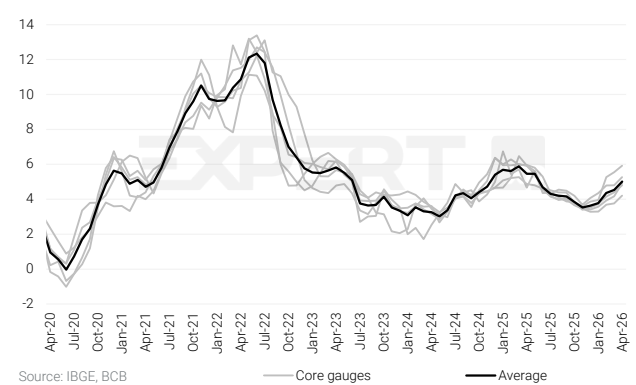
9. Stronger BRL helps, but not enough. The appreciation of the exchange rate helps preserve room for monetary easing. Had the BRL weakened in response to the global shock, the Copom would likely have been forced to interrupt the easing cycle altogether.

10. We now anticipate three consecutive 25-bp cuts in the Selic rate, bringing it to 13.75% (from our previous baseline of 50 bps per meeting, reaching 13.50%), followed by a pause in a wait-and-see mode. We expect the Copom to resume the easing cycle in 2027, contingent on the government advancing fiscal reforms that ensure a more sustainable fiscal trajectory. Under this assumption and anticipating a more conservative monetary policy stance in the short term (to restrain current inflationary pressures), we kept our baseline scenario of 11.50% by year-end 2027.

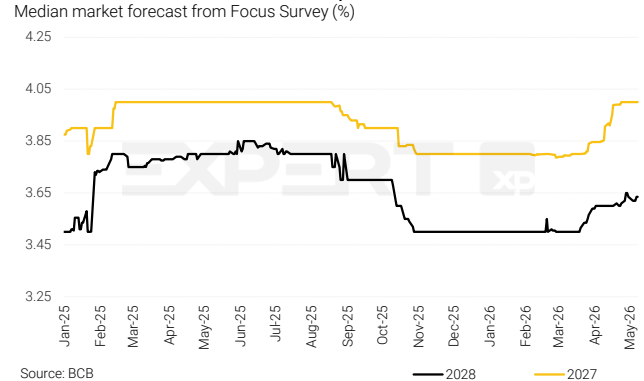
Tradable goods prices no longer drive disinflation, despite a stronger BRL
 IPCA-15, 3MSAAR (%)



Core inflation began to rise even before the energy shock
 IPCA-15, 3M SAAR (%)



Copom minutes showed that the central bank is concerned about the rise in medium-term inflation expectations
 Median market forecast from Focus Survey (%)



MEXICO: Gradual Disinflation, No Growth and Policy Pause

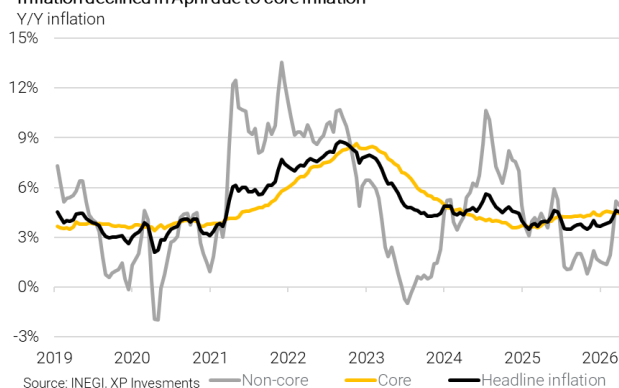
Marco Oviedo, Senior LatAm Macro Strategist

1. Inflation declined to 4.45% y/y in April from 4.59% in March, a 14bp moderation. The report should be interpreted positively, as the deceleration was primarily driven by the core component. Within non-core inflation, offsetting dynamics were at play: modest energy pressures contributed 6bp to headline inflation, while lower livestock prices subtracted 8bp, leaving the non-core component broadly neutral overall. By contrast, the main source of improvement came from core goods inflation, which accounted for 15bp of the decline in headline inflation, evenly split between food and merchandise components. The weak spot in the report remains services inflation, which continues to display sticky dynamics despite the weak economic backdrop. In other words, the higher degree of slack in the economy has yet to translate into a meaningful moderation in services prices, at least not in a sufficiently broad-based manner. Although some marginal improvement has emerged in recent months, particularly in selected categories, the disinflation process is still being led by goods, while services inflation is likely to remain elevated for longer. In this context, Banxico appears set to maintain its pause for several months.

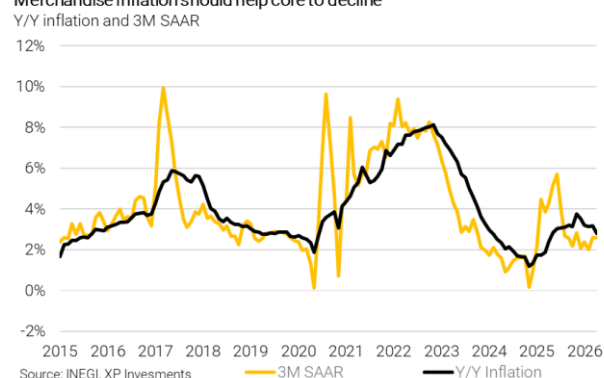
2. Goods inflation performed better than historical averages, explaining the bulk of the disinflation process. Monthly goods inflation printed at 0.31% m/m, 7bp below the 2008–19 historical average. The data suggest that FX appreciation is beginning to pass through more clearly into prices, while there is still no visible impact from tariffs on Asian goods. Core food prices increased only 0.17% m/m, well below the historical average of 0.44%, suggesting limited contamination from recent agricultural price shocks. As a result, goods inflation subtracted 15bp from headline inflation, accounting for most of the disinflation observed in this print. Looking ahead, continued normalization in goods prices should remain the main driver of improvement, particularly within core inflation.

3. Services inflation remains the main challenge for normalization. Services prices increased 0.31% m/m in April, 18bp above the 2008–19 historical average of 0.13%. Housing services inflation printed at 0.33% m/m, also above its historical average of 0.20%, and remained elevated despite the weak economic backdrop. Other services showed only marginal improvement, with still-moderate pressures in categories such as airfares, movie theaters, and cable TV. Restaurant inflation continues to ease gradually at the margin, with annual inflation close to 6.1%, while taco shop inflation remained relatively contained during the month. Overall, “other services” inflation edged down to 5.2% y/y from 5.3%, while housing services inflation increased slightly to 3.6% y/y, leaving the broader services subindex broadly unchanged at 4.5% y/y.

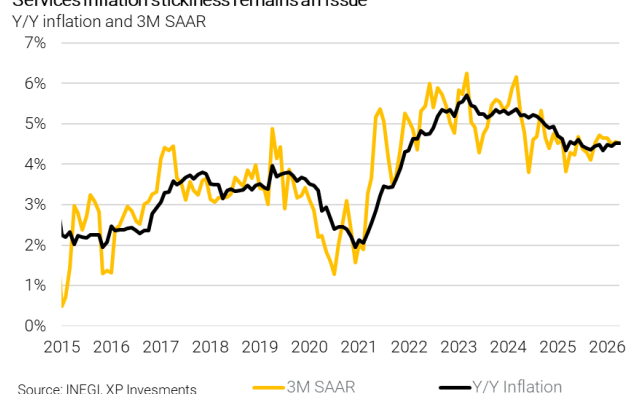
Inflation declined in April due to core inflation



Merchandise inflation should help core to decline



Services inflation stickiness remains an issue



Going forward, the pace of services disinflation will depend on how quickly education and food-related services continue to normalize, as both remain key sources of stickiness.

MEXICO CPI										
	Change, m/m (%)		Incidence, m/m (p.p.)		Change, y/y (%)		Incidence, y/y (p.p.)			
	Apr-25	Apr-26	Apr-25	Apr-26	Mar-26	Apr-26	Mar-26	Apr-26	Change	
Headline CPI	0.33	0.20	0.33	0.20	4.59	4.45	4.59	4.45	-0.14	
Core CPI	0.49	0.31	0.37	0.24	4.45	4.26	3.40	3.26	-0.14	
Goods	0.69	0.31	0.27	0.12	4.38	3.99	1.71	1.56	-0.15	
Food, beverages and tobacco	0.58	0.17	0.11	0.03	5.78	5.35	1.12	1.04	-0.08	
Merchandise ex-food	0.78	0.43	0.15	0.08	3.18	2.82	0.61	0.54	-0.07	
Services	0.30	0.31	0.11	0.12	4.51	4.52	1.67	1.68	0.00	
Household services	0.29	0.33	0.05	0.05	3.53	3.57	0.56	0.56	0.01	
Education	0.00	0.00	0.00	0.00	5.96	5.96	0.15	0.14	0.00	
Other services	0.36	0.34	0.07	0.06	5.26	5.24	0.99	0.98	0.00	
Non-core CPI	-0.21	-0.18	-0.05	-0.04	5.05	5.08	1.19	1.19	0.00	
Agricultural	1.60	0.86	0.19	0.11	8.77	7.98	1.05	0.97	-0.08	
Fruit and vegetables	3.76	3.47	0.20	0.21	21.77	21.43	1.14	1.16	0.02	
Livestock	0.20	-1.19	0.01	-0.08	0.34	-1.05	0.02	-0.07	-0.09	
Energy and gov-authorized tariffs	-1.59	-1.03	-0.19	-0.12	2.21	2.80	0.26	0.32	0.06	
Energy	-2.67	-2.12	-0.20	-0.15	0.13	0.70	0.01	0.05	0.04	
Government-authorized tariffs	0.39	0.87	0.02	0.04	6.03	6.54	0.26	0.28	0.02	

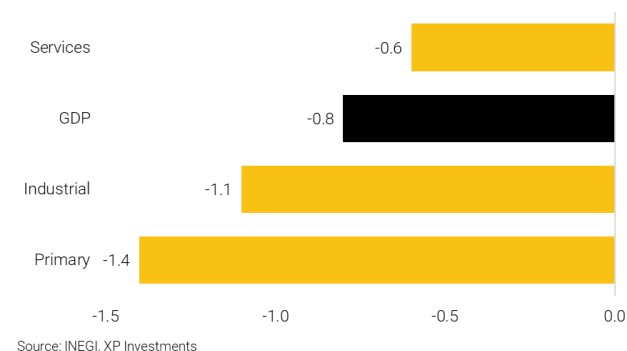
Source: INEGI, XP Investments

4. We expect headline inflation to close the year at 4.5%, with core inflation ending near 4.0%. At this stage, the balance of risks appears relatively balanced. The government still retains room to mitigate pressures stemming from higher international oil prices—through March, excise tax revenues increased 30% y/y in real terms—and gasoline prices were already elevated prior to the recent geopolitical tensions due to high excise taxes. As such, there appears to be sufficient fiscal space to continue financing fixed gasoline prices in the coming months.

On the food side, the cycle in perishable prices appears more benign than in previous episodes. Lower meat and egg inflation has partially offset pressures coming from other categories such as tomatoes, making this episode meaningfully different from the inflation shock observed in 2022. We continue to see downside risks in non-core inflation, particularly if tomato prices normalize faster than expected, while the economy currently lacks any obvious driver capable of generating broad-based inflationary pressures.

5. The economy lost momentum in 1Q26, contracting 0.8% q/q sa according to the preliminary GDP report. The figure was weaker than both our forecast and consensus expectations of -0.6%. The decline was broad-based across all major sectors: services contracted 0.6%, industry fell 1.1%, and primary activities declined 1.4%. On an annual basis, the economy expanded only 0.2%. Following this report, we now estimate GDP growth at only 1.0% in 2026. This forecast already assumes a relatively strong rebound in 2Q26 of 0.9% q/q sa, followed by stabilization thereafter. The revised estimate is below our previous forecast of 1.3% y/y. In our view, downside risks remain significant as political uncertainty and unresolved USMCA-related risks continue to weigh on confidence.

All sectors of the economy collapsed in 1Q 2026
Percentage q/q sa



6. Domestic demand remained weak during 1Q26, partially offset by resilient external demand. Data available through February suggest that domestic demand drivers remain below end-2025

levels, with consumption and investment standing 2.1% and 2.0% below December 2025 levels, respectively.

That said, March trade data suggest that a recovery may be beginning to emerge. Non-oil consumption imports increased 1.1% m/m sa, while capital goods imports surged 7.8% m/m sa. On the external side, exports continued to show positive momentum, expanding 4.1% on a 3m/3m sa basis. More recently, March industrial production data point to a milder contraction in industry overall, although the weakness in construction continues to suggest further declines in investment.

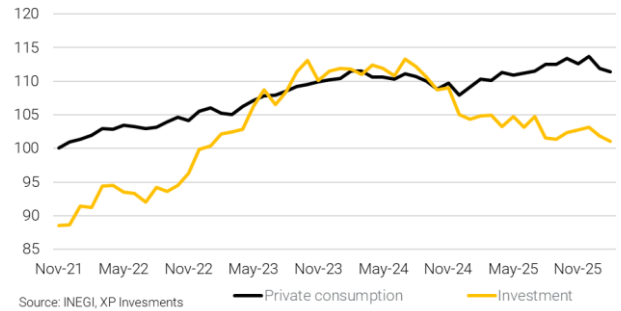
7. The March industrial production report could imply a modest upward revision to GDP. INEGI reported that industrial production declined 0.6% m/m sa in March, mainly driven by a sharp 3.3% contraction in construction, while manufacturing fell only 0.2%. This was partially offset by expansions in mining (1.7% m/m sa) and utilities (0.3%). Following this report, industrial production may have declined only 0.9% q/q sa in 1Q26, somewhat better than the preliminary GDP estimate of -1.1%. If confirmed, this would imply that GDP contracted closer to -0.7% q/q sa rather than the initially reported -0.8%.

8. Recent April data suggest the economy may rebound during 2Q26. The Social Security Institute reported that formal employment increased 0.2% m/m sa in April—adjusting for digital workers—marking a meaningful improvement relative to the weakness observed since December. This suggests that economic activity could regain some traction during 2Q26. In gross terms, the economy created 23.9k jobs in April, equivalent to annual growth of 1.5%. In addition, automobile production rebounded strongly, increasing 4.9% m/m sa during the month.

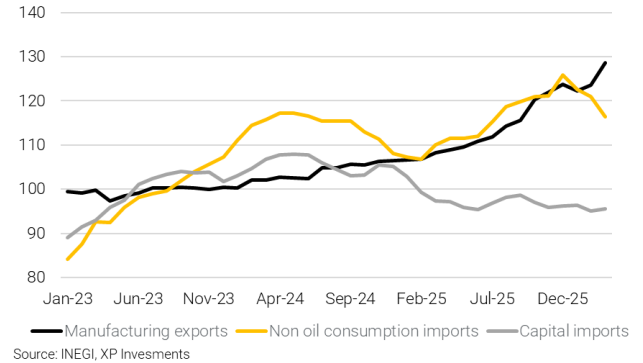
9. One explanation for the economic weakness may be the sharp decline in public investment. The government’s 1Q26 public finance report showed an annualized PSBR deficit of 1.7% of GDP, slightly below the 1.8% observed in 1Q25. However, the composition of the adjustment is concerning: revenues are weakening, some categories of expenditure remain rigid, and public investment continues to contract sharply. Oil revenues declined 9% y/y in real terms, while income tax revenues were 4% below 2025 levels, jointly subtracting around 0.2pp of GDP in revenues relative to last year. The main drag appears to be public investment, which declined 15.6% y/y from already-low levels amid fiscal consolidation. This is likely an important factor behind the economy’s weak performance, among others. In annualized terms, public investment fell to only 1.9% of GDP in 1Q26, down from 2.3% in 1Q25.

10. S&P Global revised Mexico’s sovereign outlook from stable to negative, citing weak growth dynamics. According to the agency, “the negative outlook reflects the risk of very slow fiscal consolidation largely due to low economic growth resulting in a faster-than-expected buildup in government debt levels and higher interest burden.” Given the current fiscal mix—which prioritizes social spending over public investment and growth-

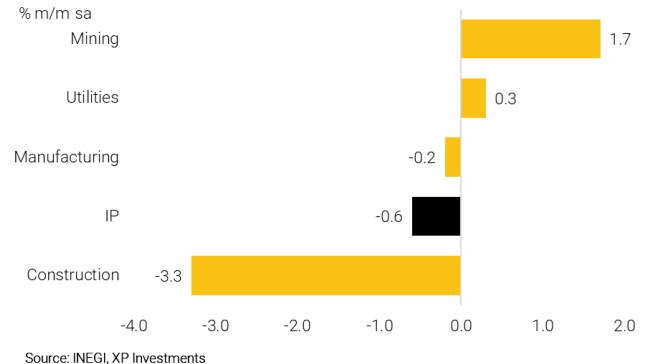
Both consumption and investment lost momentum in 1Q 2026
Index 2018=100



Trade activity tells the story of two demands
3m moving average (2023=100)



Industrial production fell once again in March, mostly driven by construction



enhancing expenditure—it is difficult to envision a meaningful improvement in the trend, particularly amid persistent fiscal pressures from Pemex and CFE. In this context, a sovereign downgrade could increasingly become the base-case scenario.

11. Against this backdrop, Banxico delivered what appears to be one final rate cut. The central bank reduced the policy rate by 25bp to 6.50%, in line with expectations and previous guidance from Victoria Rodríguez Ceja. The decision was once again split 3–2, with Galia Borja and Jonathan Heath dissenting in favor of holding rates at 6.75%. The statement explicitly framed the move as the conclusion of the easing cycle, noting that *“the Governing Board deemed it appropriate to make an additional reference rate cut and thereby conclude the cycle that began in March 2024.”* It also signaled a clear intention to pause, stating that *“looking ahead, the Governing Board estimates that it will be appropriate to maintain the reference rate at its current level.”* The Board considers the current monetary stance sufficiently restrictive to address prevailing macroeconomic risks, including those associated with a potential escalation of the Middle East conflict.

12. We believe this represents a prolonged pause rather than a definitive end to the easing cycle. Following this decision, Banxico is likely to remain on hold in the near term, as current communication leaves little room for immediate policy action. Nevertheless, the broader macro backdrop—characterized by weak growth and an ongoing disinflation process—suggests that the easing cycle may not be fully over. If financial conditions remain supportive, particularly under a stable FX environment, Banxico could eventually regain room to ease further. Continued progress in core disinflation will be crucial. **In this context, we continue to expect one additional cut in December, followed by two more in 2027.**

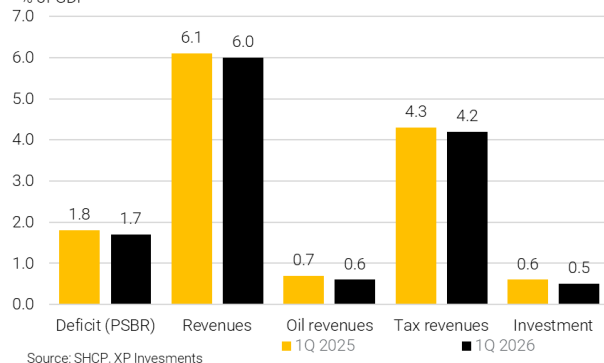
13. On the political front, the case against Rubén Rocha Moya could keep investment sentiment soft for longer. The United States Department of Justice unsealed an indictment on April 29, 2026, accusing the governor and several current and former Sinaloa officials of collaborating with the Sinaloa Cartel, particularly the faction known as *“Los Chapitos.”* According to prosecutors in the Southern District of New York, Rocha Moya allegedly received political and financial support from the cartel during the 2021 gubernatorial campaign, allowed cartel-linked figures to influence appointments within state security and justice institutions, and provided protection for fentanyl, cocaine, heroin, and methamphetamine trafficking operations. Prosecutors further allege that cartel intimidation and violence during the 2021 election cycle helped Morena secure the governorship, while state institutions later protected cartel logistics and leadership structures.

14. The situation is unprecedented, and the federal government appears to be adopting a cautious approach. Claudia Sheinbaum has publicly demanded evidence from Washington and rejected automatic cooperation on extradition, while simultaneously

Formal jobs creation improved in April
% 3M/3M SAAR



Public finances in 1Q 2026 were not stimulative for the economy
% of GDP



allowing domestic investigations to proceed. Mexico's Attorney General's Office (FGR) has already opened a parallel investigation. In our view, the case could eventually spill over into broader aspects of the bilateral relationship, particularly USMCA negotiations, while also prolonging the investment slowdown as markets wait for the political implications to become clearer. More broadly, the episode represents a major test for Mexico-US security cooperation, a stress test for Morena's anti-corruption narrative, and a potentially significant source of political instability in Sinaloa ahead of the 2027 midterm elections. In the meantime, confidence is likely to remain under pressure, keeping the economy on the soft side for longer.

COLOMBIA: BanRep Navigates Political Game Theory

Andres Pardo A., Head of LatAm Macro Strategy

1. BanRep kept its policy rate unchanged at 11.25%, surprising both us and consensus, which had expected a 50-bps hike. The decision was unanimous, marking a rare and unexpected break from recent meetings, which had featured a highly divided Board, with a majority previously favoring aggressive front-loaded tightening and a minority supporting rate cuts or no change. In our view, this was not a conventional monetary policy decision, but a game-theoretic equilibrium choice under extraordinary political pressure.

2. Crucially, the Board explicitly acknowledged differing views on monetary policy but opted for consensus “in the current juncture.” This is a highly unusual signal and points to a temporary shift in BanRep’s reaction function: the decision was clearly more political than technical, as we believe the majority of the Board—and the technical staff—would have preferred additional tightening.

3. Indeed, in our view, the factors behind the decision, as outlined in the policy statement, were mostly supportive of additional tightening. We highlight the following:

(i) BanRep highlighted that both headline and core inflation continued to increase in March, rising materially relative to December levels, with the former moving from 5.1% to 5.6% through 1Q26 and the latter increasing from 5.0% to 5.8% over the same period. This confirms that underlying inflation pressures are still building.

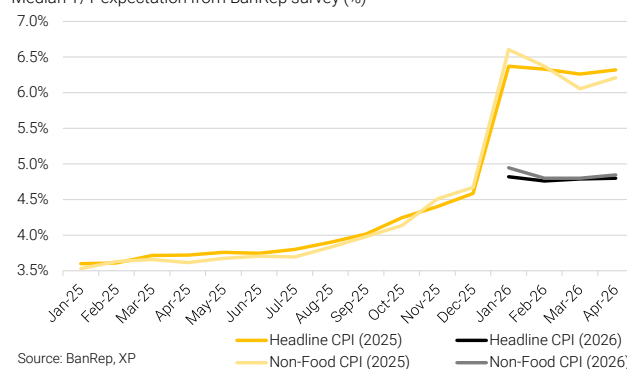
(ii) The Board also underscored that inflation expectations sent mixed signals. While expectations at horizons of one year or longer declined, survey-based expectations for end-2026 increased again (see graph). Still, all measures of expectations remain elevated, pointing to persistent de-anchoring risks at relevant policy horizons.

(iii) Policymakers noted that economic activity appears to be slightly reaccelerating, as high-frequency indicators—energy demand, manufacturing output, retail trade, and goods exports—suggest that economic growth in 1Q26 exceeded that of 4Q25.

(iv) The Board highlighted historically low unemployment and rising salaried employment, suggesting that the labor market remains tight.

(v) BanRep also emphasized that external risks related to a prolonged conflict in the Middle East could push energy, fertilizer, and other import prices higher, and could also lead to tighter financial conditions for Colombia.

Colombia - Inflation expectations for year-end 2026 and 2027
Median Y/Y expectation from BanRep survey (%)



4. However, BanRep was facing a difficult dilemma given the extraordinary intense political pressure from the Executive. Raising rates could have further escalated tensions with President Petro, increased the risk of additional inflationary pressures given Petro's threat of another minimum wage hike, and added fuel to the fire in the run-up to the elections.

5. Keeping rates unchanged may have avoided that clash in the short term. However, this comes at a cost, as it could undermine BanRep's credibility—particularly if markets perceive this as the beginning of a politically influenced reaction function—calling into question its autonomy and even its inflation-targeting framework. The decision could ultimately make it harder to achieve the inflation target in the coming years.

6. One additional concern we would flag is that attacks and pressure tactics against BanRep may continue even after the presidential elections in June. This is because Petro's threat of a new minimum-wage hike is likely to remain in the backdrop. Petro will still be president when the Board meets again in June and July, and may seek to extract political gains through further attacks, regardless of who wins the election:

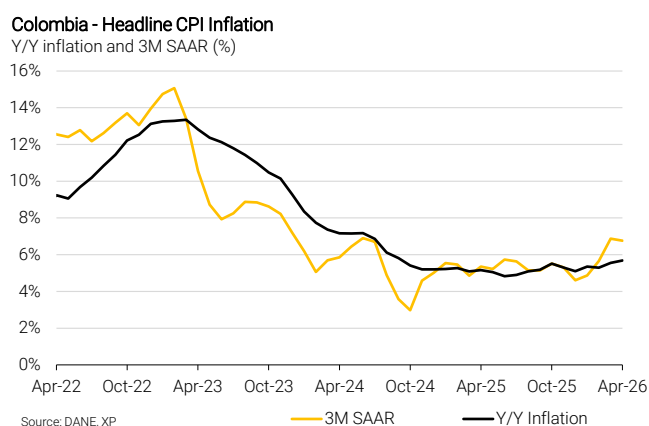
(i) If the left-wing candidate Iván Cepeda wins and BanRep subsequently hikes the policy rate, Petro could insist on another minimum-wage hike, potentially helping him secure the political backing Cepeda would need in Congress.

(ii) If the opposition wins—either with Paloma Valencia or Abelardo de la Espriella—Petro could also push for a hike to generate chaos and create a hostile social environment for the incoming president before taking office, while stirring the streets to build pressure for a Constitutional Assembly.

7. April inflation extended its uptrend. Headline CPI rose 0.78% m/m, slightly above our 0.73% forecast and the 0.74% consensus estimate. Annual inflation edged up from 5.56% y/y in March to a 19-month high of 5.68% y/y (see graph), up 0.12 percentage points (p.p.).

8. Food inflation was the main driver of the headline increase, amid adverse weather conditions that continued to push up perishable prices. Food CPI rose 1.51% m/m, versus 0.66% m/m a year ago, lifting its annual change from 6.27% y/y to 6.70% y/y and adding 0.09 p.p. to headline inflation relative to March. The increase was primarily driven by perishables (adding 0.07 p.p. to headline inflation), reflecting weather-related supply shocks, while processed food prices added only 0.01 p.p. to headline inflation, likely supported by currency strength.

9. Regulated inflation also edged up, led by fuel prices and, to a lesser extent, gas tariffs. Regulated CPI rose 0.73% m/m, versus 0.54% m/m a year ago, lifting its annual change from 4.14% to 4.35% y/y and adding 0.04 p.p. to headline inflation relative to March. Fuel and gas prices were the main contributors, adding 0.07 p.p. and 0.03 p.p., respectively. Fuel prices jumped 2.48%



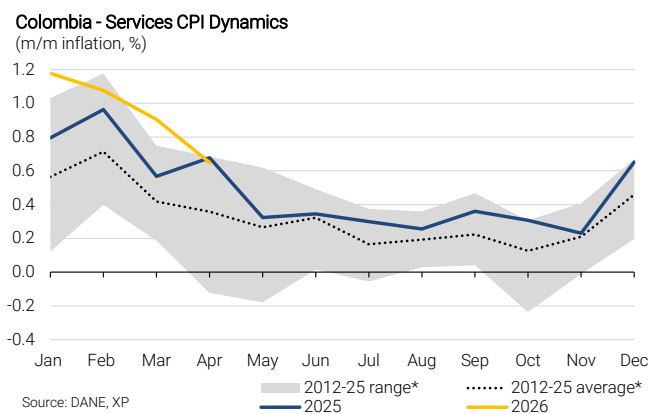
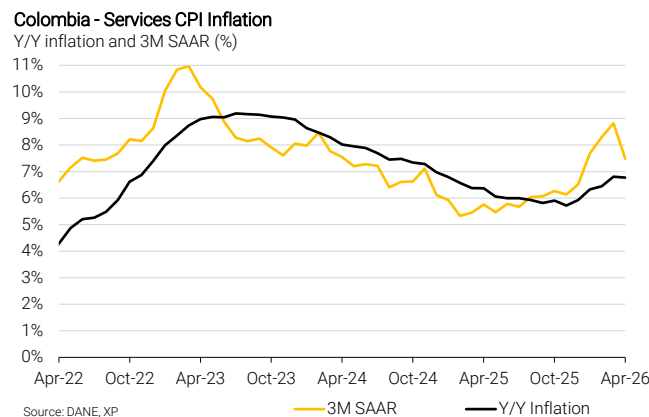
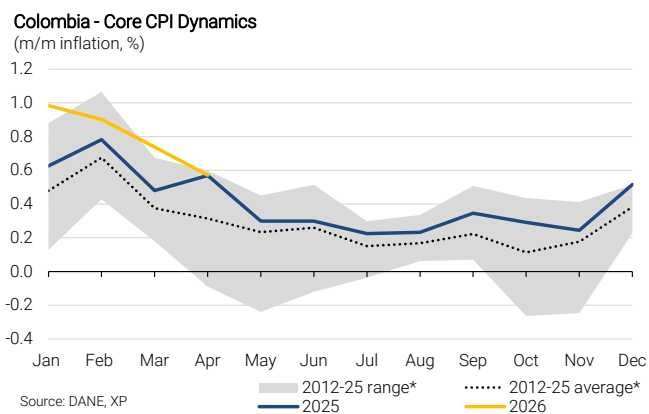
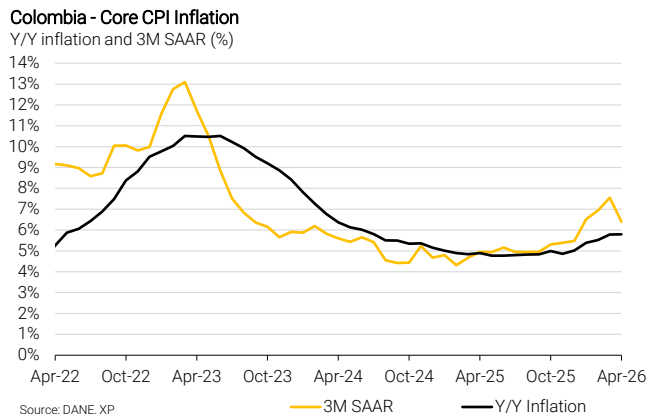
m/m after the government announced a COP 400-per-gallon increase amid higher international oil prices, reversing the short-term relief seen in February and March. For May, authorities have already announced another COP 400 hike, which should add 0.07 p.p. to headline inflation. Meanwhile, gas tariffs continued to increase, albeit more than we had expected, following the sharp adjustment in new contracts effective December 1, as we anticipated. These increases were partly offset by other basic utility prices—such as electricity, water and sewage—which subtracted 0.07 p.p. from headline inflation relative to March.

10. Core inflation held steady, surprising slightly to the downside, but remains at a 22-month high. Core CPI (ex-food and regulated) rose 0.57% m/m, the same as a year ago, coming in below our 0.65% forecast and the 0.63% BanRep survey median. Annual core inflation remained unchanged at 5.79% y/y (see graph). The 3-month SAAR eased from 7.6% to 6.4% after six consecutive monthly increases, but still exceeded every monthly reading throughout 2024 and 2025 (see graph). With this measure still above core’s annual change, further acceleration looks likely ahead. Moreover, the monthly print was well above the 0.36% historical average for this month over the past 15 years (excluding the post-pandemic years 2022-23) (see graph).

11. Core goods inflation climbed to a two-year high, reflecting resilient demand despite FX strength. This measure edged up from 3.06% y/y to 3.14% y/y, adding 0.01 p.p. to headline inflation relative to March. The 0.36% m/m print was in line with our 0.35% forecast, but exceeded both last year’s 0.28% increase and the 0.21% historical average for this month over the past 15 years (excluding 2022-23). Strong demand, partly fueled by expansive fiscal policy, continues to offset FX-driven disinflation.

12. By contrast, core services inflation eased marginally, though its level remains the second highest in 16 months, still reflecting the impact of the 2026 minimum-wage hike. This measure declined slightly from 6.80% y/y to 6.77% y/y (see graph), shaving just 0.01 p.p. from headline inflation relative to March. The index rose 0.65% m/m, versus 0.68% m/m a year ago, and below our 0.75% forecast. Rent inflation—closely tied to the previous year’s CPI print—continued its 25-month downtrend, easing from 4.83% y/y to 4.81% y/y and trimming 0.01 p.p. from headline inflation relative to March. Excluding rent, core services inflation eased marginally from a two-year high of 8.66% y/y to 8.62% y/y. The 3-month SAAR for core services also declined from a three year high of 8.8% to 7.5% (see graph), but still exceeded every monthly print in 2025. Moreover, the monthly print was well above its 15-year historical average of 0.36% (excluding 2022-23) (see graph), continuing to reflect the impact of the large 2026 minimum-wage increase, amid rising labor costs, second-round effects, strong domestic demand, and looser fiscal policy.

13. GDP data for 1Q26 keep inflation concerns alive. The report continues to highlight (1) relatively strong domestic demand—reaccelerating and largely fueled by fiscal stimulus—and consistently outpacing output growth; (2) resilient private



consumption, with durable goods accelerating at a rapid pace, and public expenditure expanding at unsustainably high levels, in contrast to still-weak investment (see graph); (3) a widening trade deficit; and (4) an ongoing positive output gap. A few points stand out from the 1Q26 GDP figures released this week:

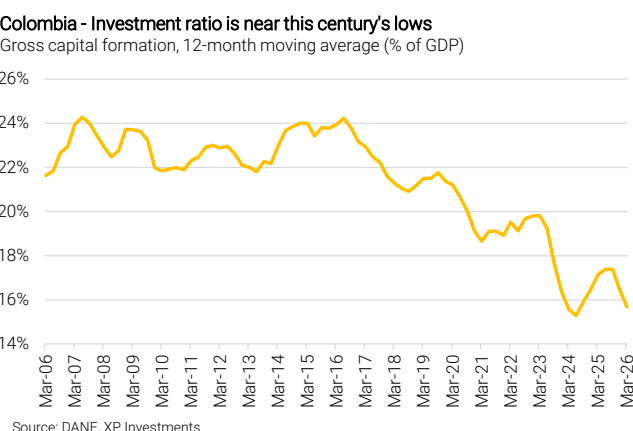
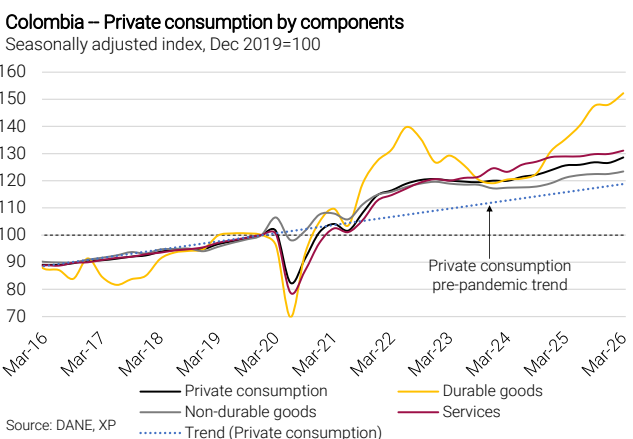
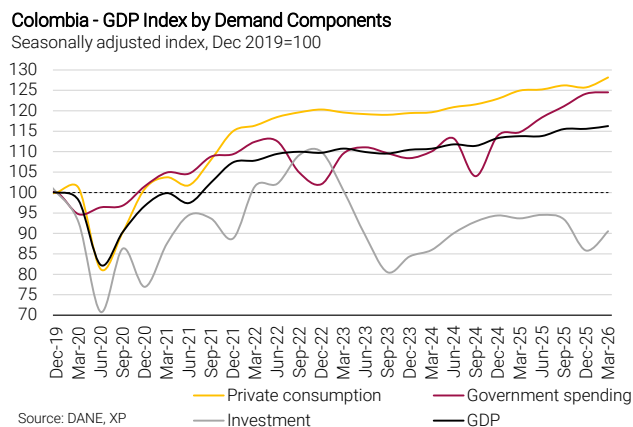
- GDP came in slightly above both market and BanRep expectations, and also accelerated relative to 4Q25. While BanRep staff projected 2.1% y/y GDP growth in seasonally adjusted (SA) terms, the figure came in at 2.2% y/y, both in SA and non-seasonally adjusted (NSA) terms (XPI: 2.1%; consensus: 2.1%), compared to 2.1% y/y NSA in 4Q25. Sequentially, GDP grew 0.6% q/q versus flat growth in 4Q25. This suggests the output gap remains in positive territory.

- Domestic demand rose 2.3% y/y SA, accelerating from 2.1% in 4Q25 and exceeding BanRep’s 1.9% projection. Sequentially, it grew 0.8% q/q, reversing the 0.8% q/q contraction in 4Q25 and continuing to outpace GDP growth.

- Household consumption was the main contributor, rising 2.6% y/y SA (above BanRep’s 2.4% projection and the 2.3% expansion in 4Q25), while investment continued to underperform, falling 3.4% y/y SA (though better than BanRep’s -6.1% forecast and the 9.1% decline in 4Q25), with fixed investment growing 4.9% y/y SA. Notably, durable goods consumption continues to accelerate at a rapid pace (see graph), defying the backdrop of high interest rates and restrictive monetary policy. Government consumption surged 8.5% y/y SA—just below 4Q25’s 9.0% but above BanRep’s 7.3% estimate—reflecting ongoing loose fiscal policy. On a q/q basis, private and government consumption both grew 0.7%, while investment rose 5.5% (fixed investment +2.0%) from very depressed levels. Indeed, the investment-to-GDP ratio remains a key concern, with its 12-month moving average falling from 16.5% in 4Q25 to 15.7%, near this century’s lows and well below the near 23% average in the decade before the pandemic (see graph).

- Imports grew 3.8% y/y SA (1.4% q/q), outpacing exports at 3.6% y/y SA (-1.7% q/q), highlighting concerns about the trade deficit and external vulnerabilities.

13. The April CPI and the 1Q26 GDP reports reinforce BanRep’s majority hawkish stance, suggesting a high likelihood of further rate hikes. This stance reflects persistent concerns around the inflation outlook, stemming from the outsized minimum-wage increase, strong domestic demand, a positive output gap, a tight labor market, a widening current account deficit, looser fiscal policy, still-elevated inflation expectations, and more recently, spillovers from the Iran conflict and upside risks associated with a potentially strong El Niño. That said, given BanRep’s rare consensus hold last month, we still think the probability of additional significant tightening in the short term has diminished, at the expense of potentially larger catch-up rate hikes further ahead and/or the need to keep the policy rate high for longer than previously anticipated. For now, we expect a 50-bps hike at the June meeting.



CHILE: Energy Shock Leaves BCCh More Cautious and Ready to Act

Andres Pardo A., Head of LatAm Macro Strategy

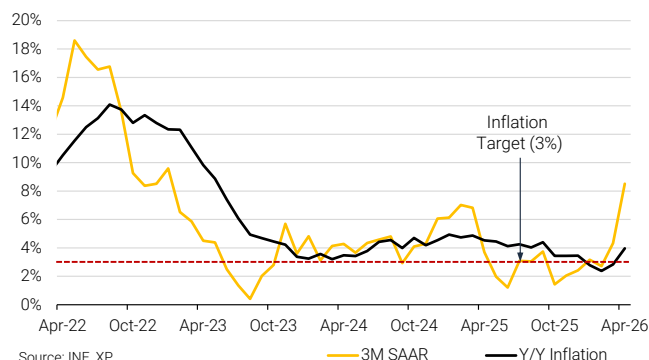
1. The BCCh kept its policy rate (TPM) unchanged at 4.50% in a unanimous decision, aligning with both our forecast and market expectations. The Board made some changes to its forward guidance, with a somewhat more hawkish bias compared to its previous meeting. It noted that the external shock from the Middle East conflict has been more adverse than assumed in the central scenario of the March IPoM, increasing upside risks to inflation and downside risks to global growth. Policymakers also acknowledged that short-term domestic inflation projections have risen and stressed that they will pay particular attention to factors that could lead to stronger inflation transmission or greater persistence. The board reiterated that uncertainty around the macroeconomic outlook is higher than usual, warranting closer monitoring of alternative scenarios that could result in inflation dynamics deviating from current expectations and potentially requiring adjustments to the monetary policy stance, while emphasizing a fully data-dependent approach.

2. April CPI soars, though less than expected, after the second round of March's large one-off fuel price hike. Headline CPI rose 1.29% m/m, coming in below our 1.37% forecast and the 1.5% consensus estimate. Annual inflation jumped from 2.83% y/y in March to 3.96% y/y (see graph), up 1.13 percentage points (p.p.), broadly consistent with BCCh's projection that inflation was set to rise materially toward 4% in 2Q26.

3. Energy inflation was the main driver of the headline jump, led by fuel prices and, to a lesser extent, by gas tariffs, as we had anticipated. Energy CPI rose 11.38% m/m, compared to a 0.70% m/m decline a year earlier. As a result, energy inflation soared from 0.80% y/y to 13.05% y/y, adding 1.17 p.p. to headline inflation relative to March. Fuel prices led the move following the exceptional regulatory hike that began to take effect on March 26, of which only about a quarter was reflected in March, with the remainder feeding through in April, given INE's methodology of collecting prices every Tuesday to compute monthly averages. Gasoline prices rose 25.3% m/m, while diesel prices increased 45.7% m/m, broadly in line with our estimates of 27% and 52%, respectively, with both together adding 1.05 p.p. to headline inflation relative to March. Gas tariffs also contributed meaningfully, increasing 4.5% m/m and adding another 0.11 p.p. to headline inflation relative to March, also impacted by the Iran war energy shock and in line with our expectation.

4. In contrast, food inflation rose only modestly. Food CPI rose 0.04% m/m, compared to a 0.03% m/m decline a year earlier, lifting its annual change from 3.52% y/y to 3.59% y/y and adding just 0.01 p.p. to headline inflation relative to March. The increase was primarily driven by ex-volatile food items, which added 0.06

Chile - Headline CPI Inflation
Y/Y inflation and 3M SAAR (%)



p.p. to headline inflation relative to March. Food prices have yet to reflect spillovers from higher transportation and production costs associated with rising international oil and gas prices.

5. Core ex-volatiles inflation also edged up, albeit marginally. The index rose 0.45% m/m, broadly in line with both our 0.47% forecast and the 0.5% median estimate from the BCCh analyst survey. Its annual change inched up from 3.41% y/y to 3.44% y/y, adding 0.02 p.p. to headline inflation relative to March (see graph). However, its 3-month Seasonally Adjusted Annual Rate (SAAR) slowed to its lowest level in 2026, remaining mostly stable at 2.8% (see graph).

6. Core ex-volatiles goods inflation eased modestly, still reflecting limited pass-through from FX depreciation since the onset of the oil shock in late February. This measure fell from 2.15% y/y to 2.10% y/y, subtracting 0.01 p.p. from headline inflation relative to March. Its 0.46% m/m print came in below both our 0.57% forecast and the 0.56% historical average for that month over the past 15 years (excluding the post-pandemic years 2022-2023) (see graph).

7. By contrast, core ex-volatiles services inflation accelerated, though its monthly print largely aligned with historical patterns. This indicator ticked up from 4.33% y/y to 4.42% y/y (see graph), adding 0.04 p.p. to headline inflation relative to March. Its 0.45% m/m reading was broadly in line with our 0.42% forecast and slightly above the 0.40% historical average for that month over the past 15 years (see graph). Still, its 3-month SAAR increased from 4.0% to 4.3% (see graph).

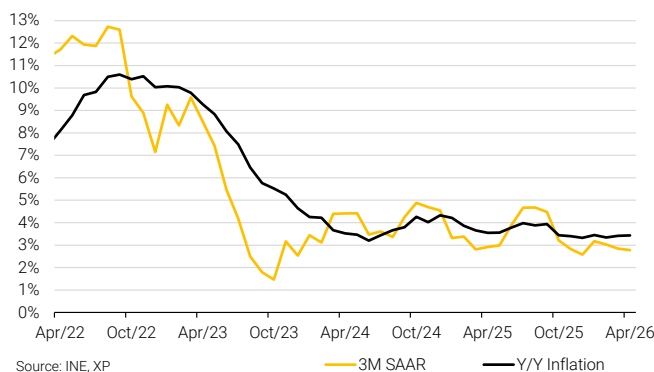
8. The April CPI report reinforces BCCh's more cautious and hawkish bias signaled at its last meeting. The board stressed that the shock from the Middle East conflict has been more adverse than assumed in its latest central scenario, increasing upside risks to inflation and downside risks to global growth. It also noted that the anticipated sharp rise in inflation—led by energy prices—warrants close monitoring of potential second-round effects or greater persistence that could eventually require adjustments to the policy stance. That said, policymakers also emphasized that the macroeconomic outlook continues to evolve amid heightened uncertainty, with insufficient information to assess the magnitude of the conflict's impact.

9. With core inflation still well behaved in April, we believe the scenario remains consistent with an extended rate pause and a fully data-dependent approach. Any shift in stance would likely require clearer evidence of spillovers into core inflation and a rise in inflation expectations, particularly at the two-year horizon. In our view, these factors—also dependent on the duration of the Middle East conflict—will be key in determining whether the BCCh is eventually forced to change course in upcoming meetings.

10. President Kast's Reconstruction Plan reflects a clear pro-growth shift, though it is set to face execution risks on multiple fronts, including fiscal and political challenges. After several years marked by weak investment, low productivity

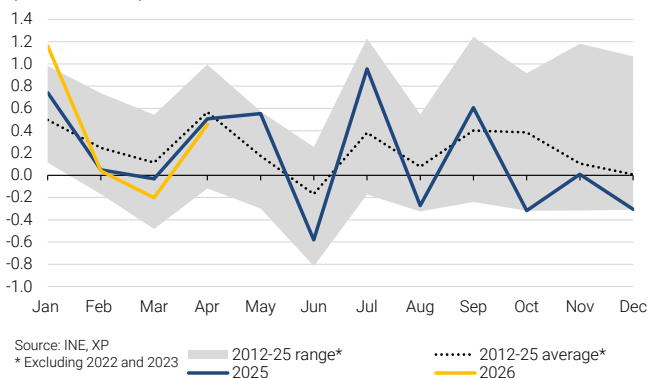
Chile - Core ex-volatiles CPI Inflation

Y/Y inflation and 3M SAAR (%)



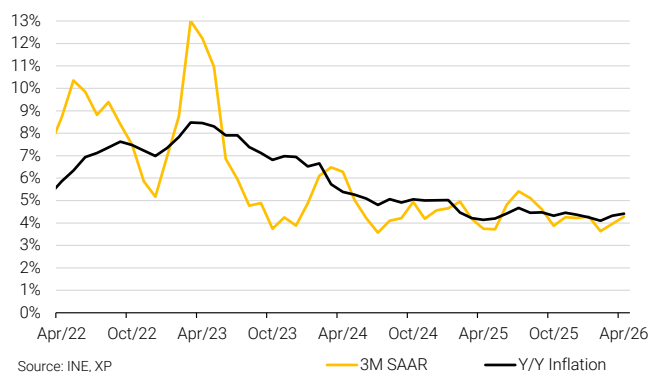
Chile - Goods ex-volatiles CPI Dynamics

(m/m inflation, %)



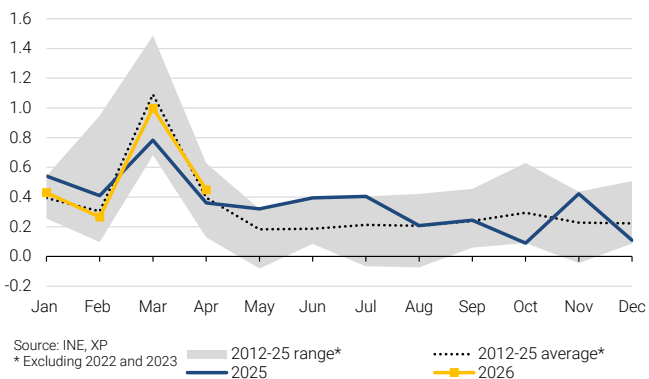
Chile - Services ex-volatiles CPI Inflation

Y/Y inflation and 3M SAAR (%)



Chile - Services ex-volatiles CPI Dynamics

(m/m inflation, %)



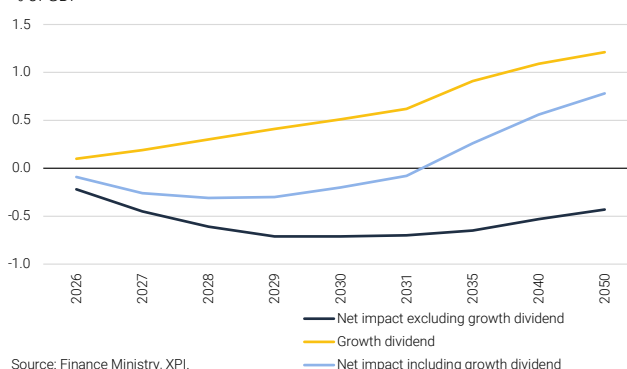
growth, rising fiscal pressures, and elevated regulatory uncertainty, the government is now pursuing a more explicit supply-side agenda aimed at reviving private-sector dynamism. The Reconstruction and Economic and Social Development Plan bill, presented to Congress late last month, includes over 40 measures designed to incentivize investment, protect formal employment, and streamline state bureaucracy. The proposal combines lower corporate taxes, investment incentives, permitting reform, and tax-stability mechanisms in an effort to improve the country’s medium-term growth trajectory. In our view, the reform clearly moves in the right direction. In particular, measures aimed at reducing investment bottlenecks and lowering the cost of capital could help unlock projects that have faced long delays in recent years, especially in mining, energy, and infrastructure. Some of the core pillars of the plan include:

- **Corporate tax rate reduction:** Proposes gradually lowering the corporate tax rate from 27% to 23%, bringing Chile closer to OECD averages and partially reversing the sharp deterioration in tax competitiveness observed over the past decade.
- **Tax incentives and certainty:** Includes the full reintegration of the tax system to encourage profit reinvestment and reinstates a 25-year tax-stability clause for major investments.
- **Housing and social support:** Offers a 12-month VAT exemption on new home purchases and eliminates contributions for senior citizens.
- **Formal job creation through payroll tax credits:** Implements tax credits to boost formal employment and support SMEs.
- **Reducing bureaucracy via permitting streamlining:** Cuts environmental “permisología” (red tape) to unblock delayed investment projects.
- **Emergency funding:** Expands the emergency fund to accelerate reconstruction efforts in fire-ravaged communities.
- **Elimination of capital gains tax in financial markets:** The 10% capital gains tax on profits from the sale of publicly traded securities is abolished, making these gains tax-free.

11. However, the reform also faces important implementation and execution risks. The fiscal arithmetic is tight (see graph), the expected growth dividend could take years to materialize, and some assumptions regarding investment responses may prove optimistic (see graph). At the same time, Chile is entering this process from a weaker fiscal position than in previous reform cycles, with elevated structural deficits and public debt levels approaching the government’s prudent ceiling.

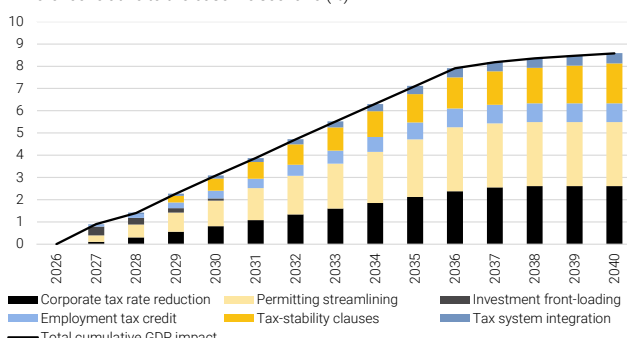
12. In addition, the legislative process will likely be difficult. Congress remains fragmented, and the government may need to negotiate important concessions to secure approval, particularly

Chile - Government-estimated net fiscal impact of Reconstruction Plan
% of GDP



Source: Finance Ministry, XPI.

Chile - Government-estimated cumulative GDP impact of Reconstruction Plan
Difference relative to the baseline scenario (%)



Source: Finance Ministry, XPI.

in the Senate. This raises the probability that some components are diluted, delayed, or offset by additional spending measures.

13. Overall, we believe the reform has the potential to improve Chile's medium-term growth outlook and investment sentiment. However, the ultimate success of the plan will depend less on the direction of the reform itself—which we view positively—and more on execution capacity, fiscal discipline, and political feasibility.

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