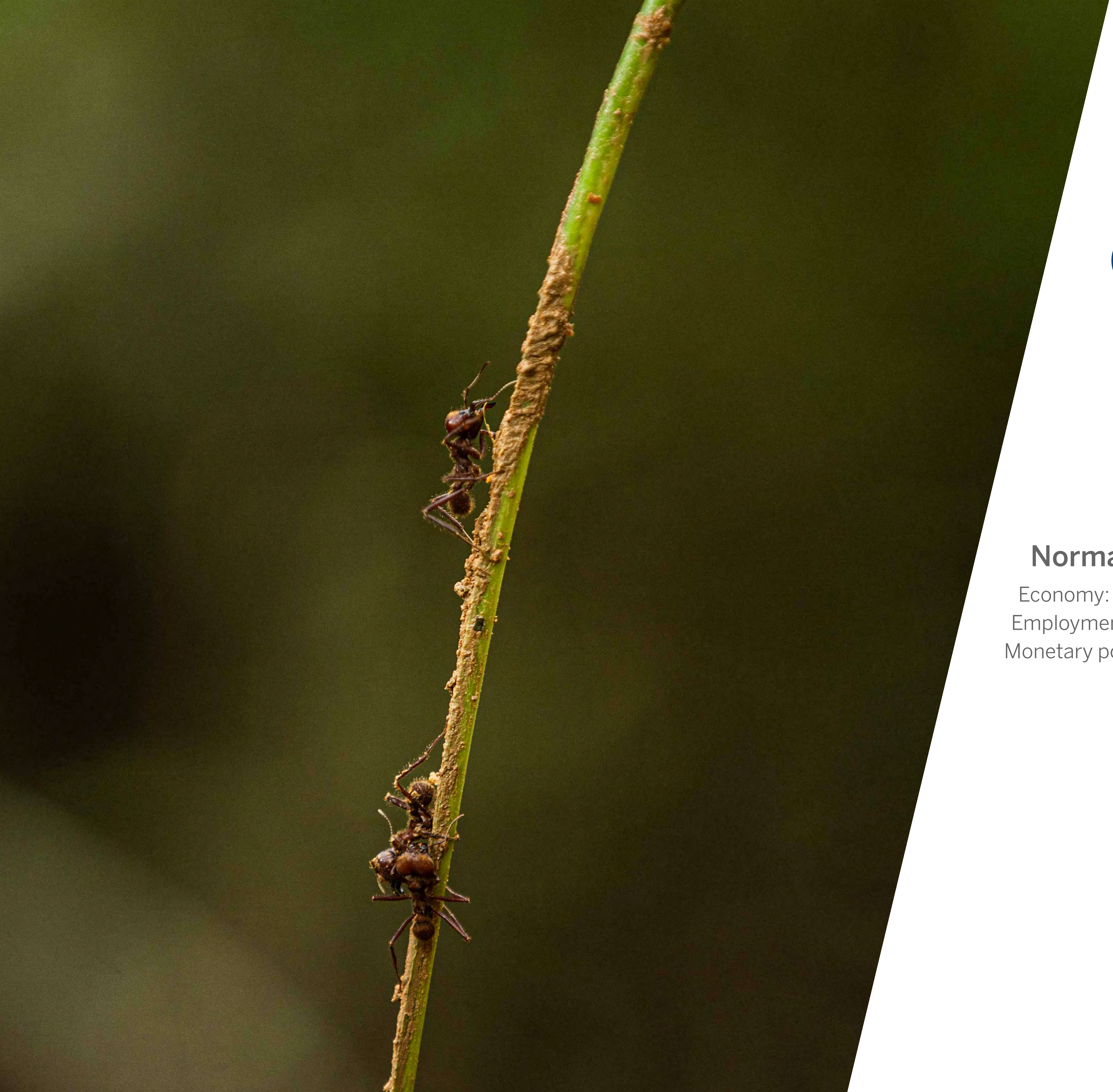


Macroeconomic context

Normalization in a high-inflation environment

Economy: Activity returns to normal levels[1]

During 2022, the economies where the institutions belonging to BBVAMF operate (hereinafter our *footprint*[2]) experienced three events that have affected their performance: the COVID 19 pandemic, Russia's invasion of Ukraine and the hardening of financing conditions in the second half of the year.

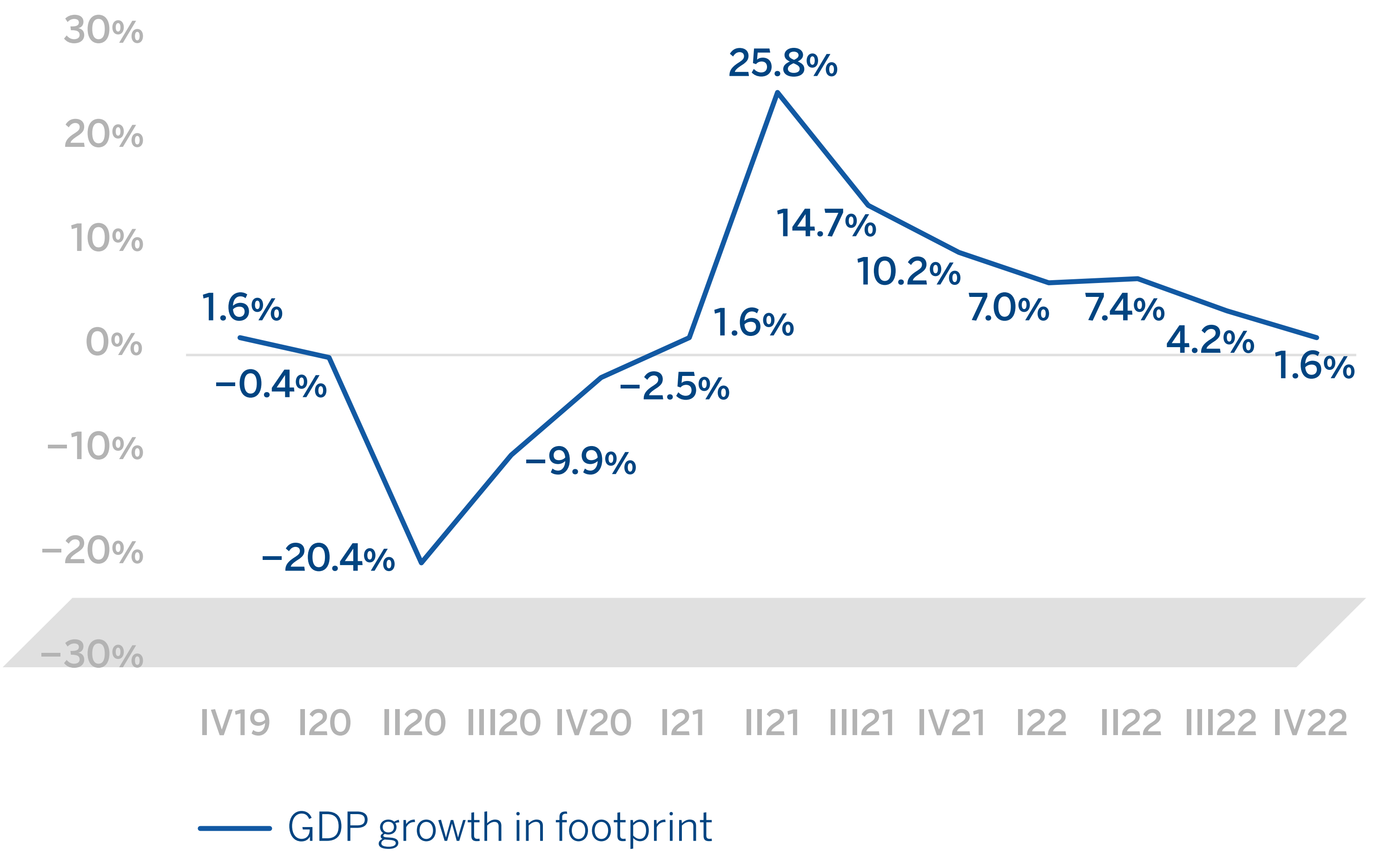
Despite this, activity in each of these countries has continued to normalize, edging towards pre-pandemic levels. This is apparent when we look at changes in growth rates which have gradually slowed since the second quarter of 2021. Growth has gone from 25.8% in that quarter to an estimated 1.6% in the fourth quarter of 2022, back to the figure recorded in the fourth quarter of 2019. Recovery remained steady through the end of 2021 and early 2022. This is mainly due to the fact that people's mobility returned to pre-pandemic habits because of high vaccination levels. Domestic demand was particularly strong in the first half, driven by spending, but slowed in the second.

Throughout 2022, economic activity in our footprint increased by 4.9% from the previous year. The highest growth rates were in Panama (10.8%), Colombia (7.5%) and Dominican Republic (4.9%). Peru (2.7%) and Chile (2.4%) expanded less although they had enjoyed the strongest recoveries in 2021 after Panama's. The strength of spending, which grew by 5.2%, and private investment (8.8%), drove this recovery. These factors were accompanied by very loose monetary and fiscal policies, together with higher exports linked to better prices for raw materials.

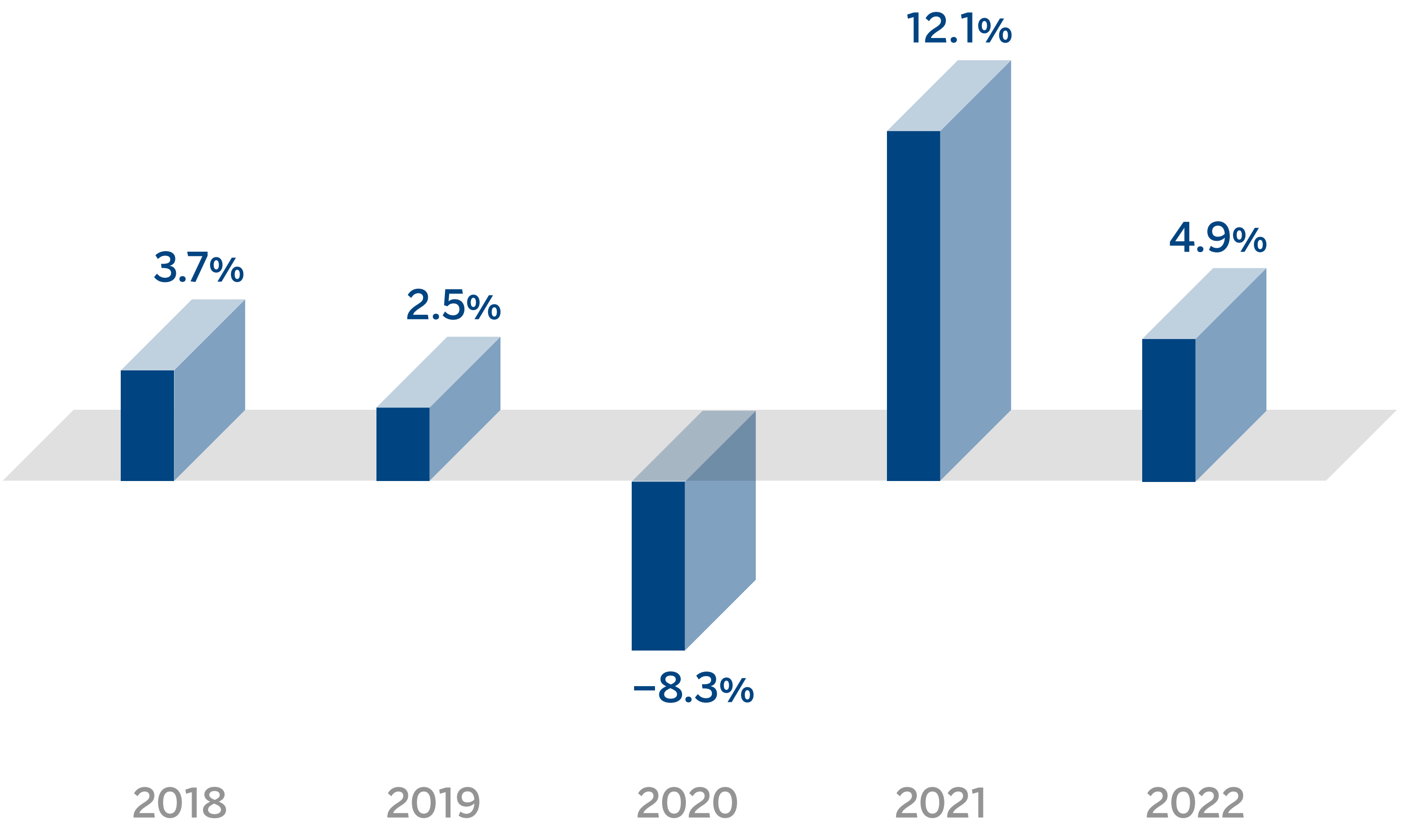
1. National sources. Estimates to end of 2022 by BBVAMF Research.

2. Chile, Colombia, Panama, Peru and Dominican Republic.

1 | Quarterly GDP growth, footprint (var %)



2 | GDP growth in footprint (var %)

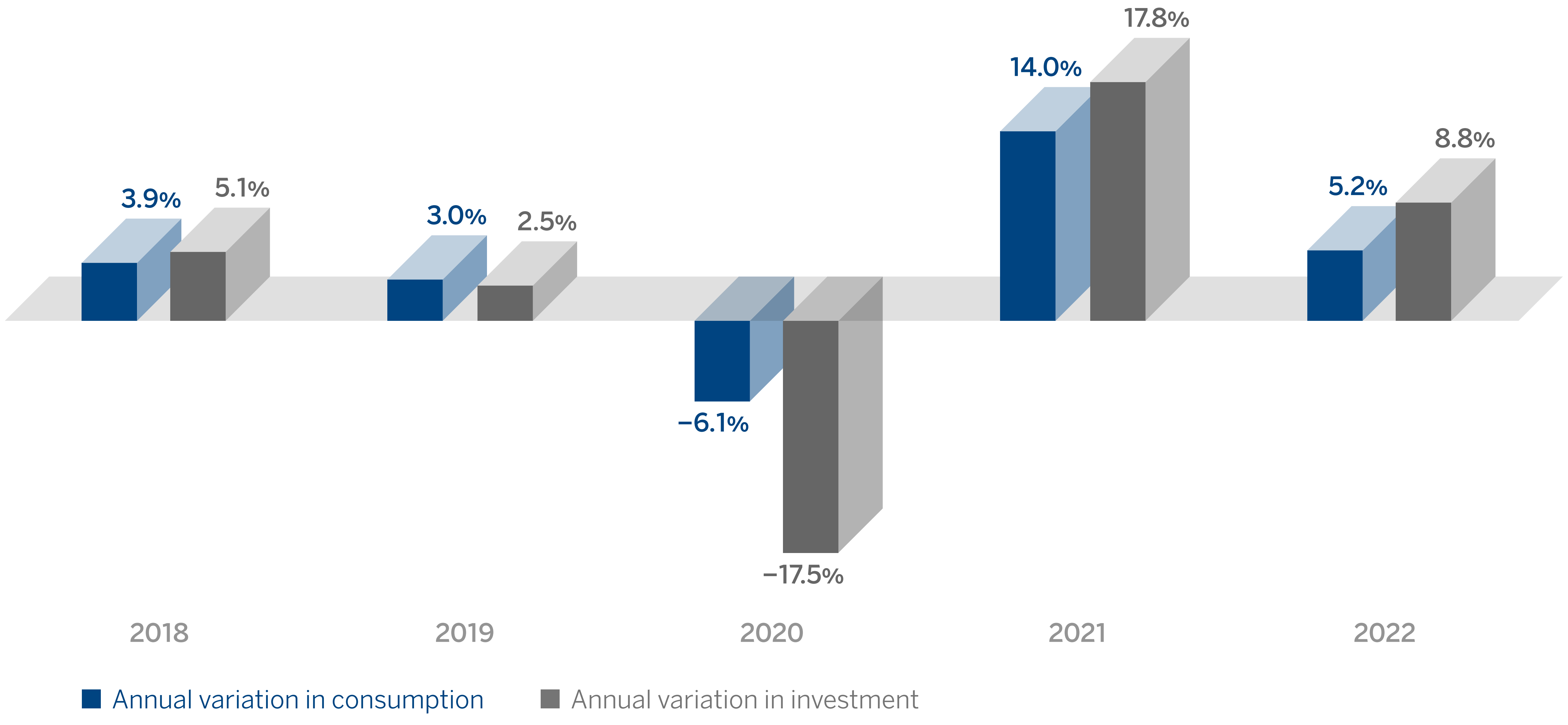


The improvement in the terms of trade[3] and in export volumes meant that the external sector made a greater contribution to growth in most countries, where on the supply side the most buoyant sectors were construction, trade, services, extractive activities and manufacturing.

All countries were impacted by the changes in inflation worldwide and regionally that have been determined by the interaction of supply and demand factors. On the supply side, there were persistent interruptions affecting global supply chains, together with the increase in the prices of primary goods, particularly energy and foodstuffs, linked to the consequences in the raw materials markets of Russia's invasion of Ukraine. These events did not only affect the countries in the footprint, but have been determinants across the world in inflation, which came in at 8.7%, posting at 7.3% in developed countries, while in emerging markets it was 9.8%.

Countries' monetary policies —whether developed or not— have been conditioned by these circumstances, making inflation containment their main goal. The Federal Reserve's actions have been particularly significant: to keep the sharp uptick in prices and pressure on the labor market in check, it suspended its net purchasing of assets in March 2022, started reducing the overall size of its balance sheet in June and raised monetary policy rates by 400 base points, in order to keep long-term inflation expectations anchored.

3 | Growth in domestic demand, footprint (var %)



This in turn had a noticeable impact on funding flows that, in conjunction with certain idiosyncratic factors, translated into greater exchange rate volatility in the countries in our footprint. In view of the situation, the monetary authorities in the five countries reacted speedily, in fact much earlier than other economies. This helped to keep price pressures in check but has not yet managed to anchor long-term inflationary expectations, as inflation in these countries has averaged 10.9% in 2022.

3. Ratio between the index of export prices and the index of import prices. This relationship shows the purchasing power of domestic products sold abroad.

Central banks in the footprint intervened more in the second half of the year, which accounts for the moderation in spending in the second half of the year and lower growth.

In Colombia, inflation remained more anchored, closing the year at 13.1%, despite the Bank of the Republic adjusting its monetary policy rate by 900 base points. In Chile, inflation closed at 12.8%, while its Central Bank adjusted its monetary rate by 750 base points.

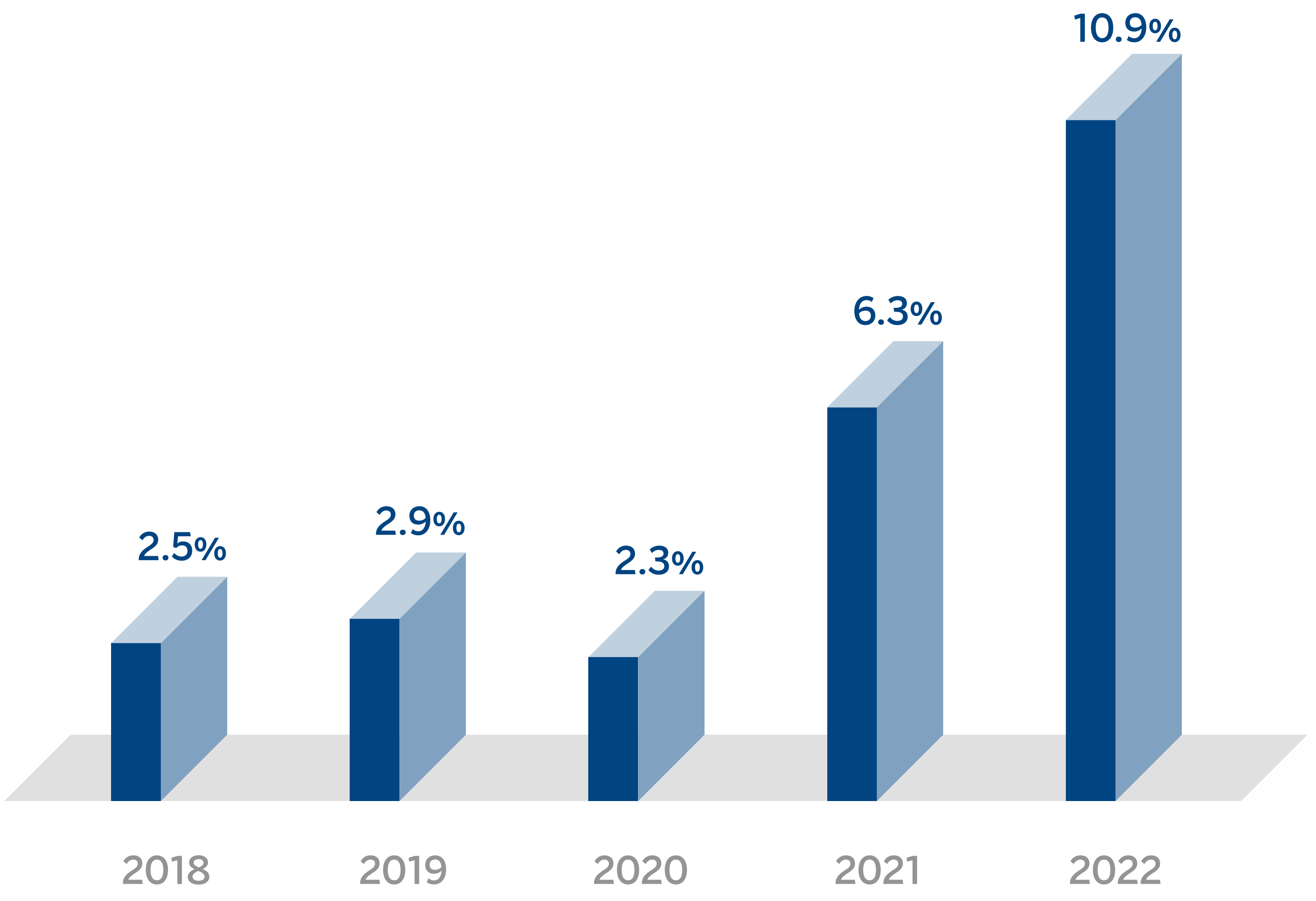
Inflation posted at 8.5% in Peru and the rate was tightened by 500 base points, whereas in Dominican Republic it came in at 7.8% with an adjustment of 500 base points to its monetary policy rate. Panama reported the lowest inflation (2.9%), although this represented a significant uptick from 2021, when it was 1.6%.

Persistently high inflation was the consequence of the elevated private-sector spending of previous years, associated in some countries with policies to withdraw resources from their pension funds, a strongly expansionist fiscal policy and vigorous growth of consumer lending in certain cases, all factors that pushed up prices.

Although inflation has slackened, due to the rise in interest rates on the part of central banks, together with energy and food prices starting to trend downwards, underlying price pressures are proving more long-lasting.

These countries have been exposed to multiple inflationary shocks, including the depreciation of their exchange rates, that have mounted up in the last two years, with the result that the inflationary component of imports has greater weight. Added to the dynamics intrinsic to domestic markets and the indexing mechanisms of some economies, the sum of these factors has meant that the impact of adjusting monetary policy on price dynamics is proving slower than other processes.

4 | Inflation across footprint (var % GDP)



Employment recovers, but of lower quality[4]

The region was hit in 2020 by high infection and mortality rates, as well as a sharp drop in activity. This was reflected in a reduction in working hours equivalent to 36 million full-time equivalent jobs, and 25 million net job losses, 82% of which were people leaving the labor force.[5]

Given that the crisis affected all sectors, the mobility restrictions prevented those leaving the formal job market from moving into informal employment, which had in the past been a key mechanism in job market adjustments. Instead of this, they left the workforce, triggering a drop in the labor participation rate.

Approximately 14% of the people who formed part of the work force in the fourth quarter of 2019 left it. After the pandemic they slowly rejoined the labor market. By the beginning of 2022, around 28 million people were looking for a job and not finding one, and nearly four million had joined the ranks of the unemployed.

The recovery of activity and the return of normal mobility meant that some of these workers were absorbed, bringing the average unemployment rate in the region as a whole down from 10% in 2021 to 9.3% by the end of 2022. However, despite this improvement, there is still a significant scarcity of jobs compared to 2019.

Across the footprint, unemployment fell by 0.8 percentage points, down to 7.7% in 2022. This is the outcome of an improved labor market, especially in Dominican Republic (unemployment down by 2.3%), Panama (–1.4%), Peru (–1.1%) and Colombia (–0.8%). Nevertheless, in Chile unemployment rose by 0.8%, as the work force grew (4.3%) faster than the number of people in work (3.4%).

Like the rest of the region, these countries posted recoveries in their participation rate.[6] During 2022, participation ratios improved on the 2021 figures, going from 64.5% to 65.6%. Despite this increase, participation was still 1.2% below pre-crisis levels.

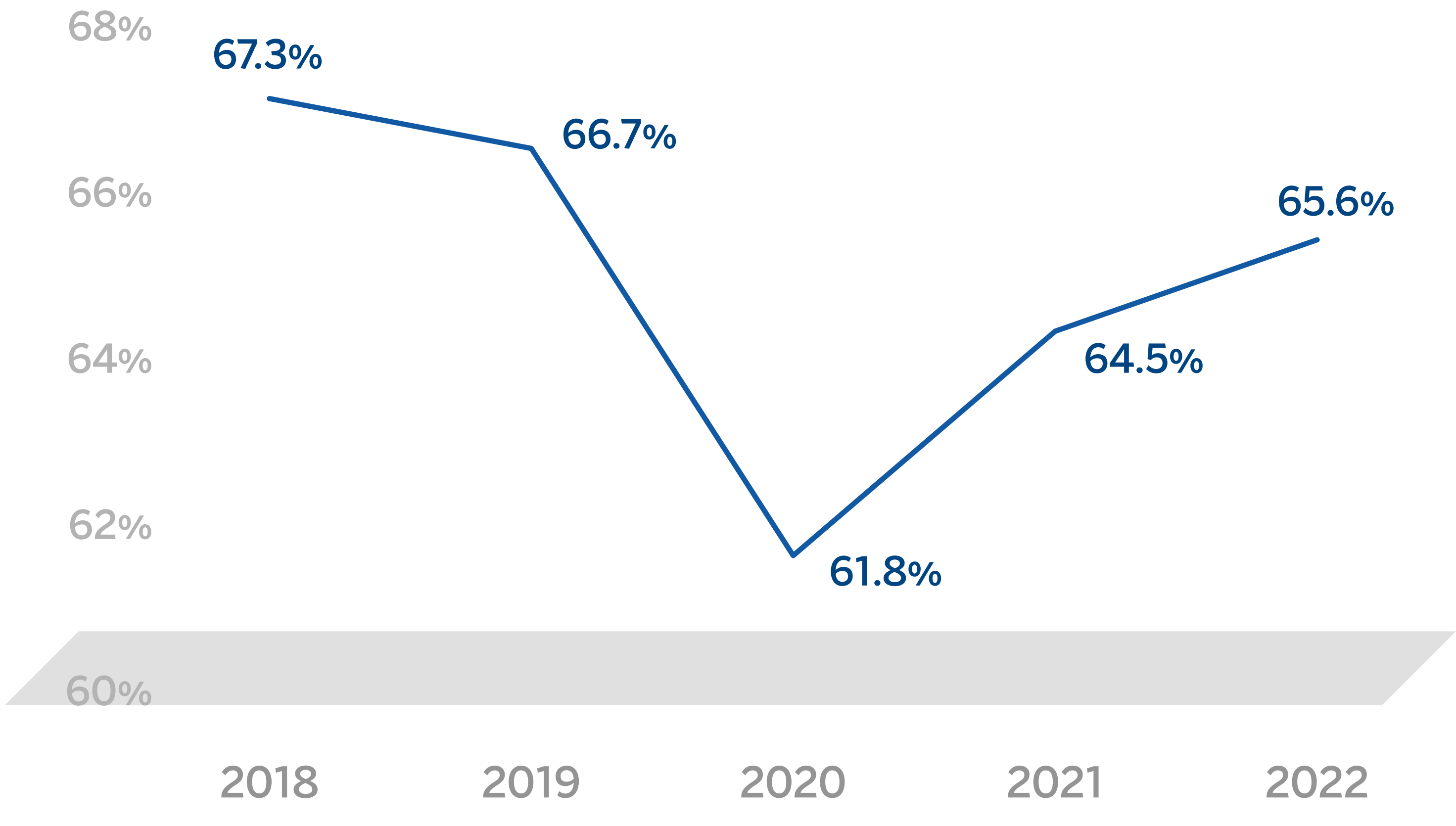
This lower participation could be seen in the more sluggish growth of the active population compared to the adult population as a whole, as many of them chose to stop actively looking for work. 86% of the people pushed into unemployment by the pandemic have returned to the labor market. The ratio would have been 52% if the labor participation rate were the same as it had been in 2019.

4. National sources. Estimates to close of 2022 by BBVAMF Research.

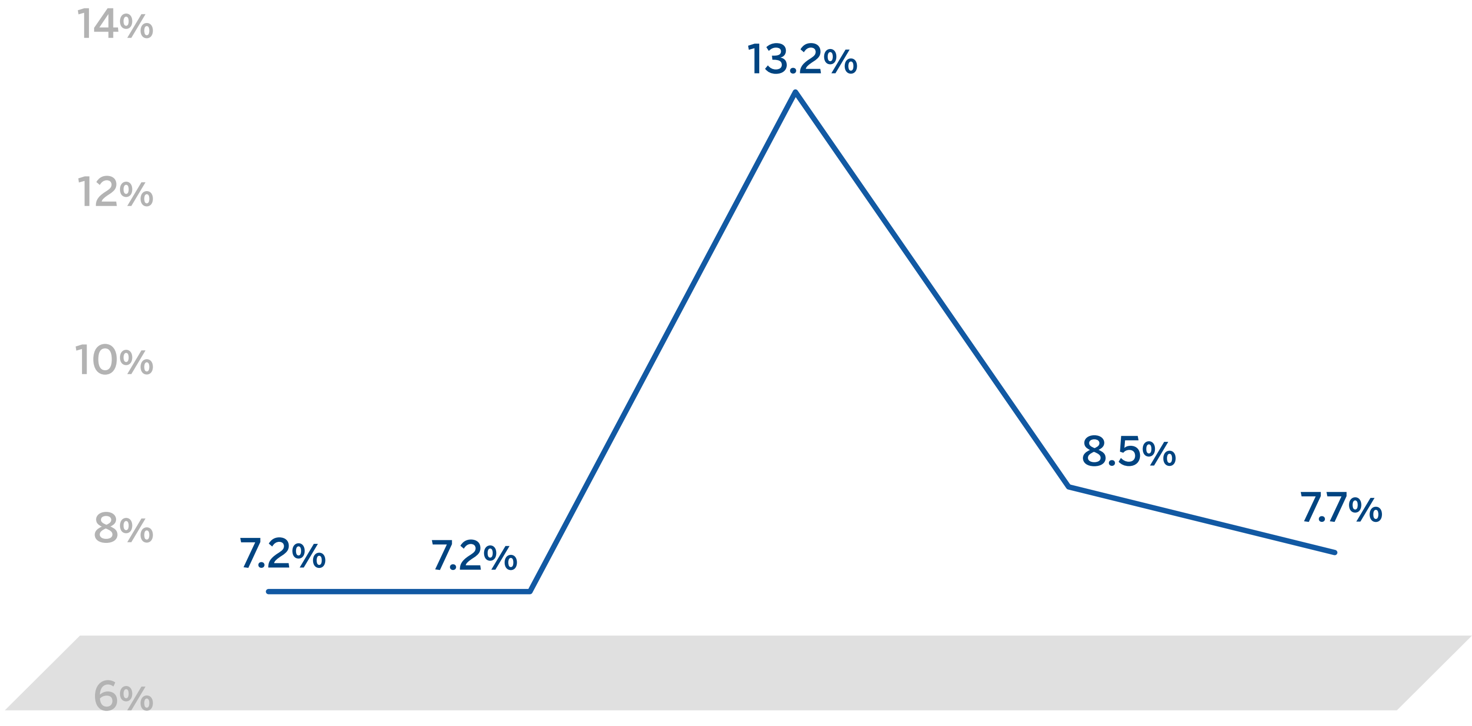
5. International Labour Organization (ILO)

6. Active population participation over working-age population.

5 | Overall participation rate, footprint (var %)



6 | Unemployment rate, footprint (var %)

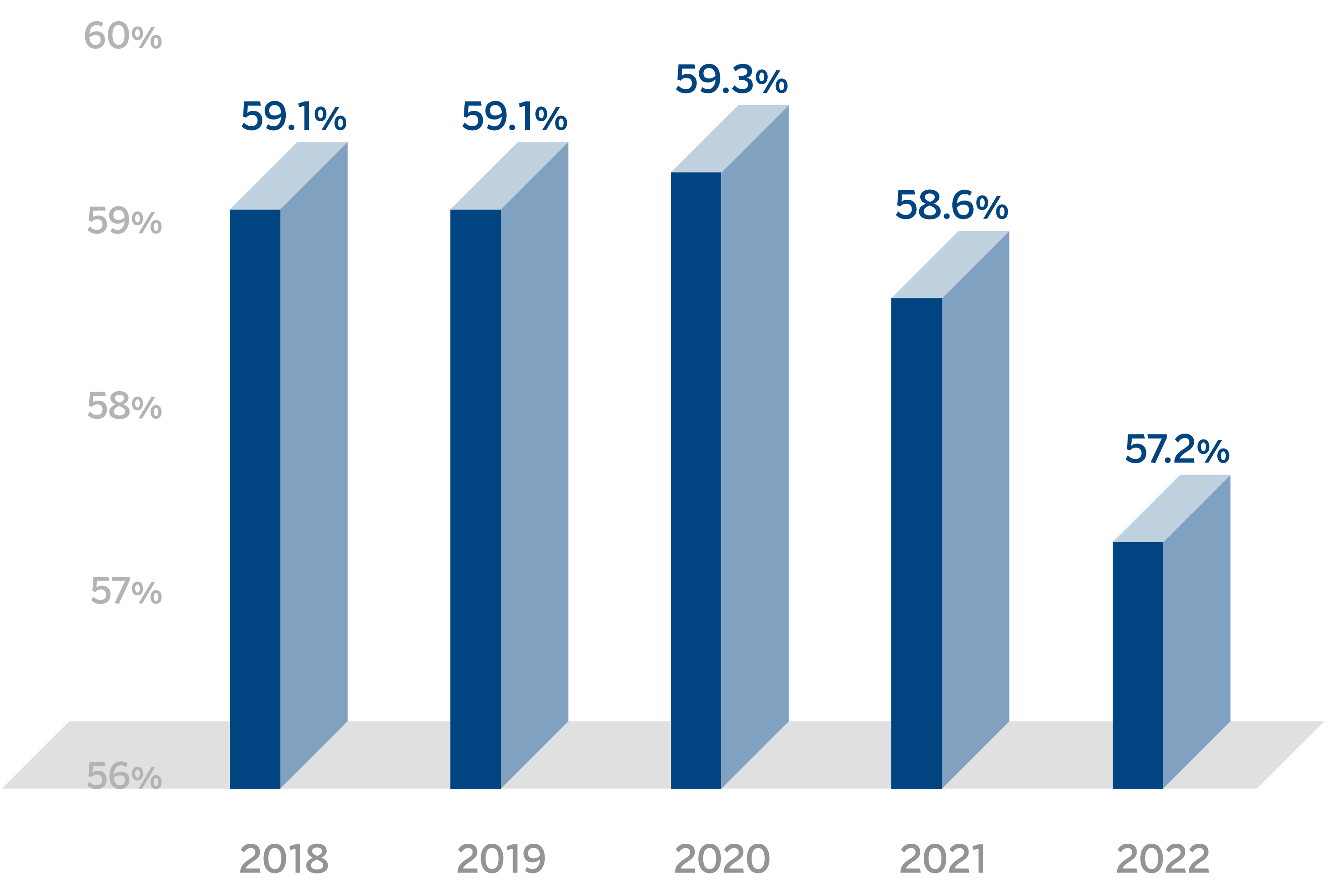


21% of the jobs created in 2022 were informal. Nevertheless, the recovery of 44% of employment can only be accounted for by an expansion in informal jobs since the end of the pandemic. A large part of the job losses were due to mobility restriction policies. Both the formal workers who lost their jobs and those working for themselves left the workforce instead of joining the numbers of the unemployed or working in the informal economy.

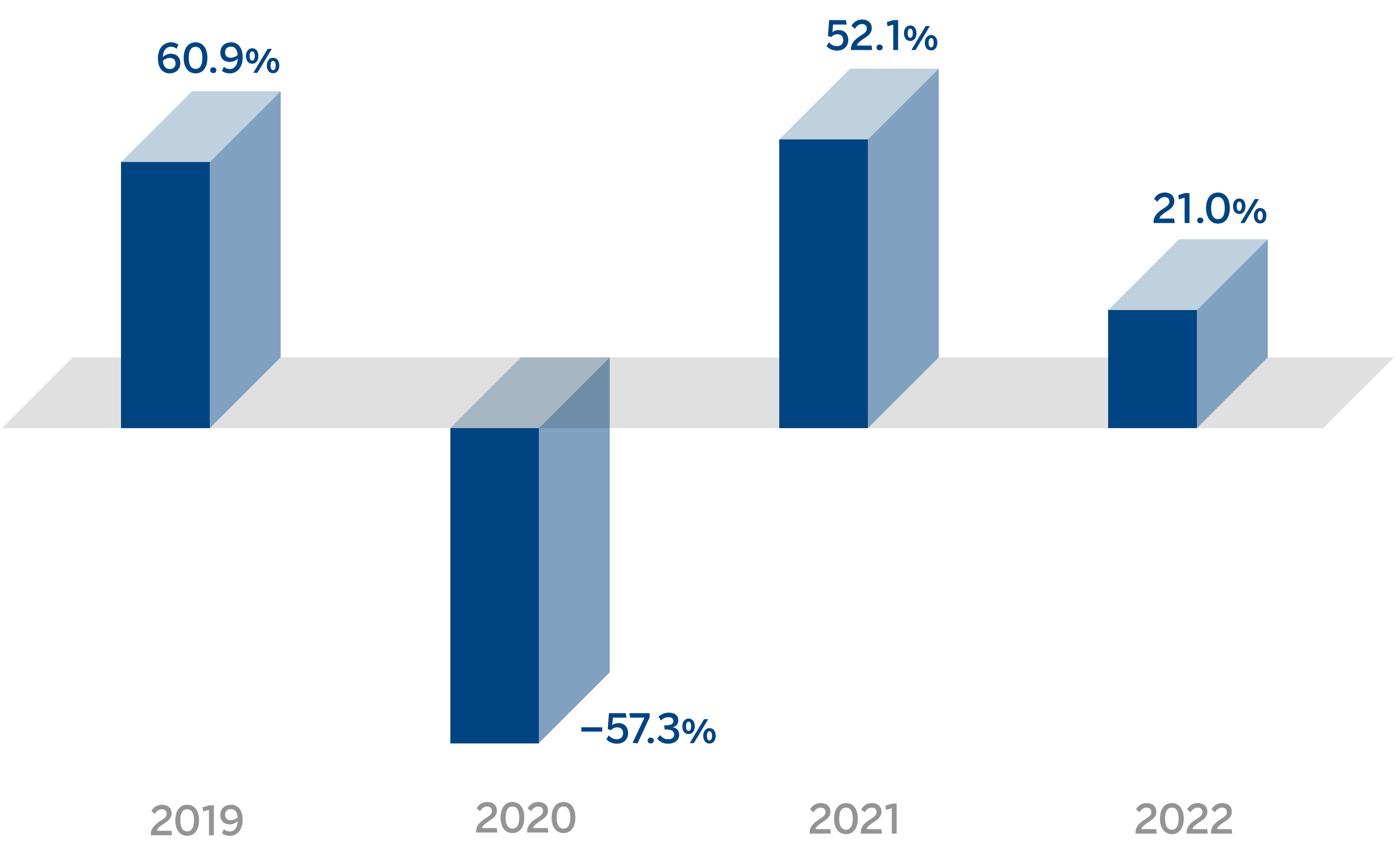
This was all reflected in a 1.9 percentage-point drop in the rate of informal jobs compared to 2019. Around 31.8 million workers (57 of every 100 jobs in the footprint) worked in the informal sector. The disproportionate effect of the pandemic on informal-sector workers in 2020 showed up in a fall in the informal employment rate in some countries during the worst moments of the crisis. This highlights the close links between informal employment and low-income households, generally associated with activities with high social contact.

57% of the job destruction in 2020 was in the informal sector, demonstrating that the policies to protect jobs did not cover this segment. Conversely, 52% of job recovery in 2021 was in this same segment.

7 | % of informal employment, footprint (var %)



8 | Percentage of informal employment in the creation (+) or destruction (–) of total employment, footprint (var %)



The participation rate was not homogeneous by gender, posting a gap of 23.8 percentage points between men and women (73.2% and 49.4% respectively), proof that the pandemic had a harsher impact on the latter. Nevertheless, women are gradually returning to the labor market, with the gap in participation narrowing slightly, by 0.3% since 2021.

This being noted, the difference in participation reflects the difficulties in accessing the labor market still encountered by women, above all in the most vulnerable groups, who face economic disincentives in the lower waged segments.

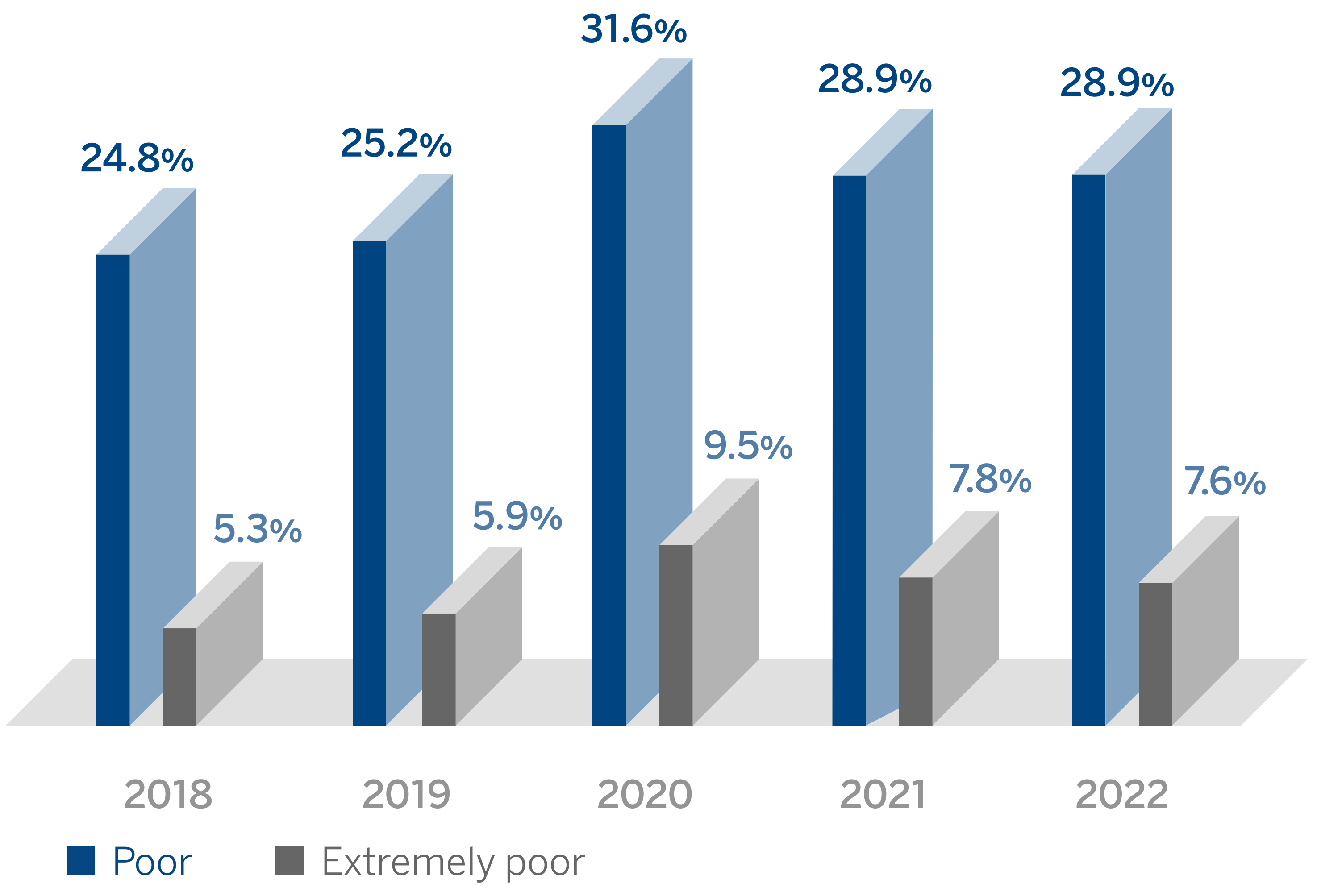
Monetary poverty and inequality

In the last year, around 689,000 people have escaped poverty. But monetary poverty in the footprint in 2022 affected 28.1% of the population, with nearly 33.4 million people finding themselves in these circumstances. 27% of these are in extreme poverty, representing 7.6% of the total population. In other words, around nine million people are not managing to pay for the basic basket of goods from their income.

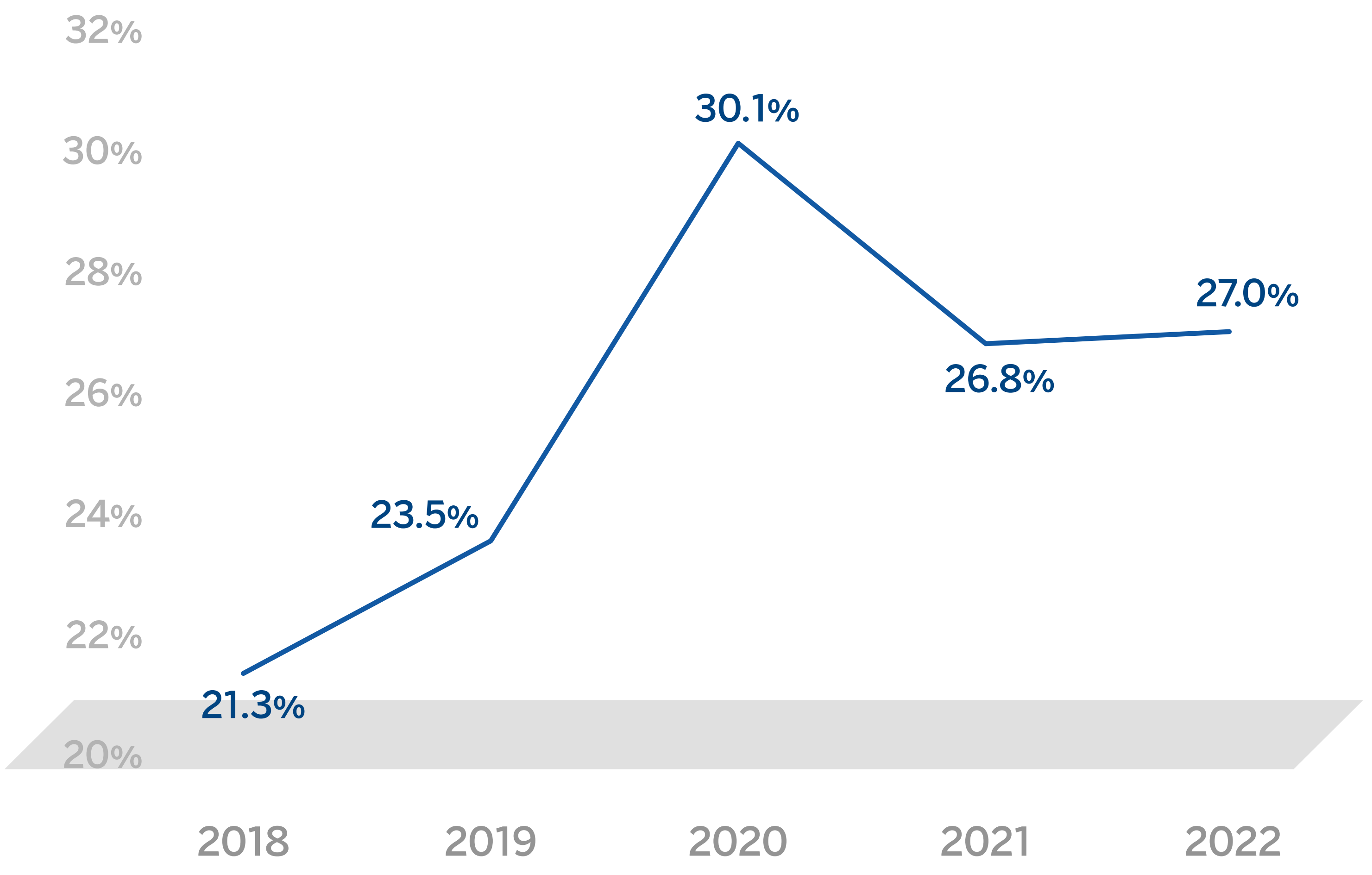
The pandemic changed the dynamics of poverty: around 8.3 million people fell into this bracket as a result, 53% of them into extreme poverty. The combination of the impact on the sectors with most human contact, plus the mobility restrictions, particularly affected the most vulnerable segments and those which, while not in poverty, were most fragile and the most likely to succumb after a shock of this magnitude.

The dynamics of the post-pandemic recovery have enabled 3.4 million people who fell into poverty to escape. However, fully 4.8 million of the newly poor are still in this situation, causing the poverty ratios to worsen, reversing the progress made in the last decade.

9 | Population in poverty, footprint (var %)



10 | Population in extreme poverty, footprint (var %)



Higher inflation, essentially in foodstuffs and energy, has hit the lower-income segments particularly hard, as they had still not recovered from the pandemic's impact on their incomes. This has meant that the number of people in extreme poverty has increased by 3.4 percentage points as a proportion of the total population, compared with pre-pandemic levels.

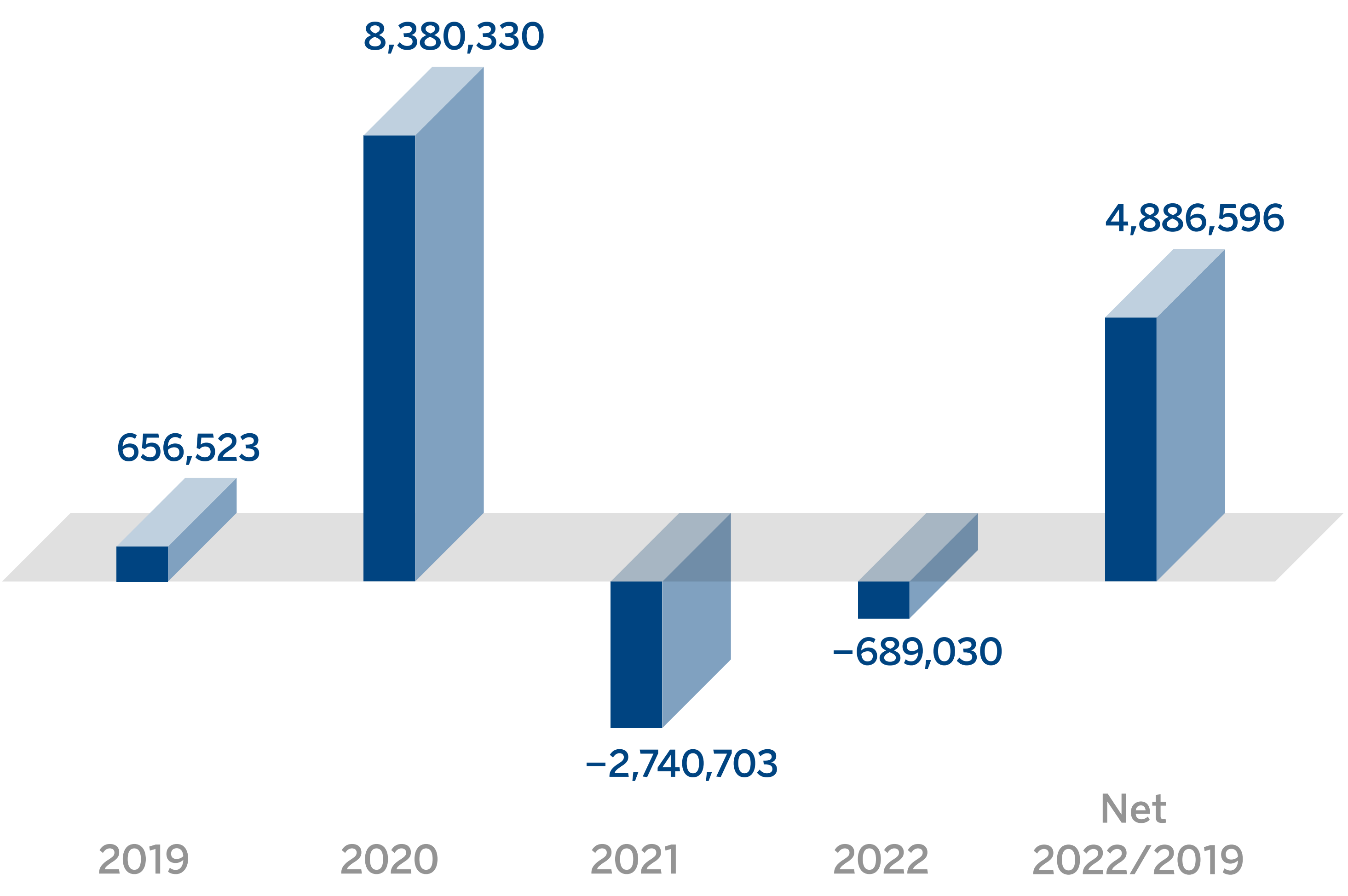
This is important because it has happened despite the large public transfers received by these segments during the pandemic. Many of these are being withdrawn due to fiscal restrictions, which leads us to believe that a structural increase in the segments of poverty may be forming. This situation will tend toward permanence if the extremely poor segment is absorbed by the labor market through informal, lower quality employment.

The most vulnerable segments are those with lower levels of educational attainment, a high proportion of young people and children, and who often live in rural areas.

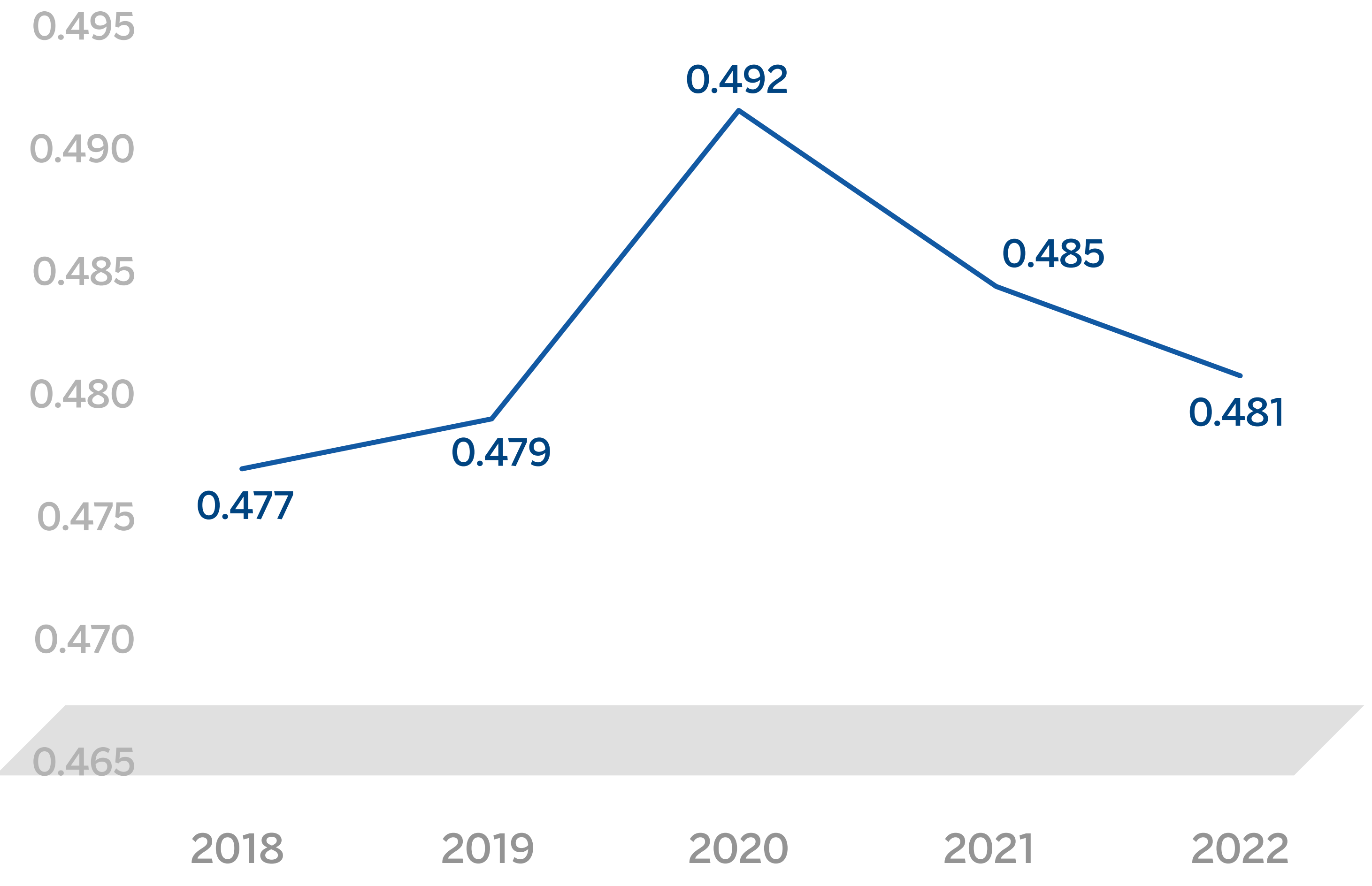
Another characteristic of the pandemic was the reverse in reducing inequalities. While this had been stable since 2017, the impact was not the same for everyone, with the result that equity in income distribution across our footprint —measured using the Gini index[7]— was further impaired, moving from 0.479 in 2019 to 0.492 in 2020.

Although income distribution improved in 2022, as the lower score in the index shows, this improvement has been very slight, with inequality levels recorded at 0.481 in 2022, and thus worse than pre-pandemic levels.

11 | Poverty variation, footprint



12 | Inequality: Gini index, footprint



When we analyze trends across the five countries in our footprint, we see that this index has improved most in Dominican Republic, where there are no relative income drops in any of the income distribution quintiles. In Colombia and Peru the index is basically the same, whereas in Chile and Panama there is an impairment, with impacts that vary between the distribution quintiles.

7. The Gini index scores between 0 (no inequality) and 1 (maximum inequality). BBVAMF Research calculations.

Introduction

Economic realities differ vastly, both between the countries where BBVA Microfinance Foundation (BBVAMF or the Foundation) institutions operate and within them, and these differences are getting bigger. Perspectives of inequality are determined by highly local economic and social factors. Even so, entrepreneurs' performance is strongly correlated with the year's overarching macroeconomic trends, so it is important to put this into context.

Normalization of activity, although with strong inflationary pressure. In 2022, the normalization of the economies where the Foundation's entities operate continued. Average growth of activity was 4.9% up from the year before. Despite this, activity was subject to much uncertainty because of the war between Russia and Ukraine, commercial tension between the United States and China, and strong inflationary pressure. Soaring inflation, which posted at 10.9%, was triggered mainly by the foodstuffs and energy sectors, something which particularly affected lower-income segments that are still suffering the impacts caused by the pandemic.

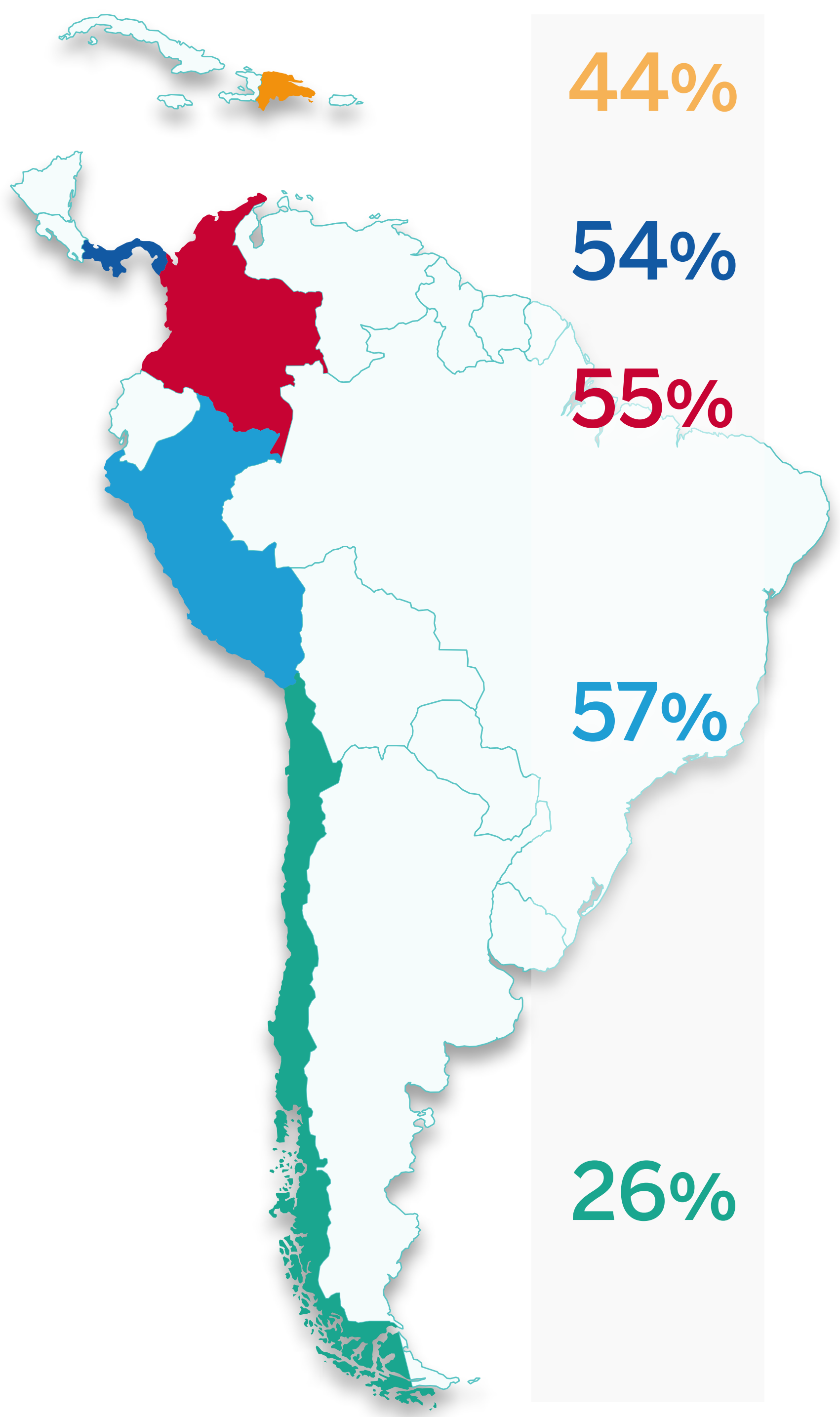
Unemployment fell, although new jobs were of low quality and with a high rate of informality. The average unemployment rate dropped to 9.3% by the end of 2022, but there is still a significant job deficit compared to 2019. In fact, 57% of the jobs in the economies where BBVAMF operates, our footprint, are informal. Informal employment has acted as a buffer but not as a sustainable income solution for many families in vulnerability, as we will see below.

Poverty and inequality rates remain high, with heterogeneity between countries. All these factors have had a direct impact on people's monetary poverty, the numbers for which, while edging down a little, remain higher than pre-pandemic, at 28%. In 2022, around 33 million people found themselves in this situation.

In short, even though income distribution has improved, shown in the fall in the GINI index, this improvement has been painfully slow, with inequality levels remaining at 0.481, above pre-pandemic levels. It is interesting to note how, depending on the country, these trends are very diverse. We can see that in the Dominican Republic the indicator has improved; in Colombia and Peru it has remained practically unchanged, whereas in Chile and Panama it has got worse, showing the uneven impacts between quintiles of income distribution.[2]

1 | National poverty rates & financial exclusion

	National poverty rate	Financial exclusion indicator
Dominican Republic	21.8%	44%
Panama	24.5%	54%
Colombia	38.1%	55%
Peru	27.5%	57%
Chile	11.5%	26%

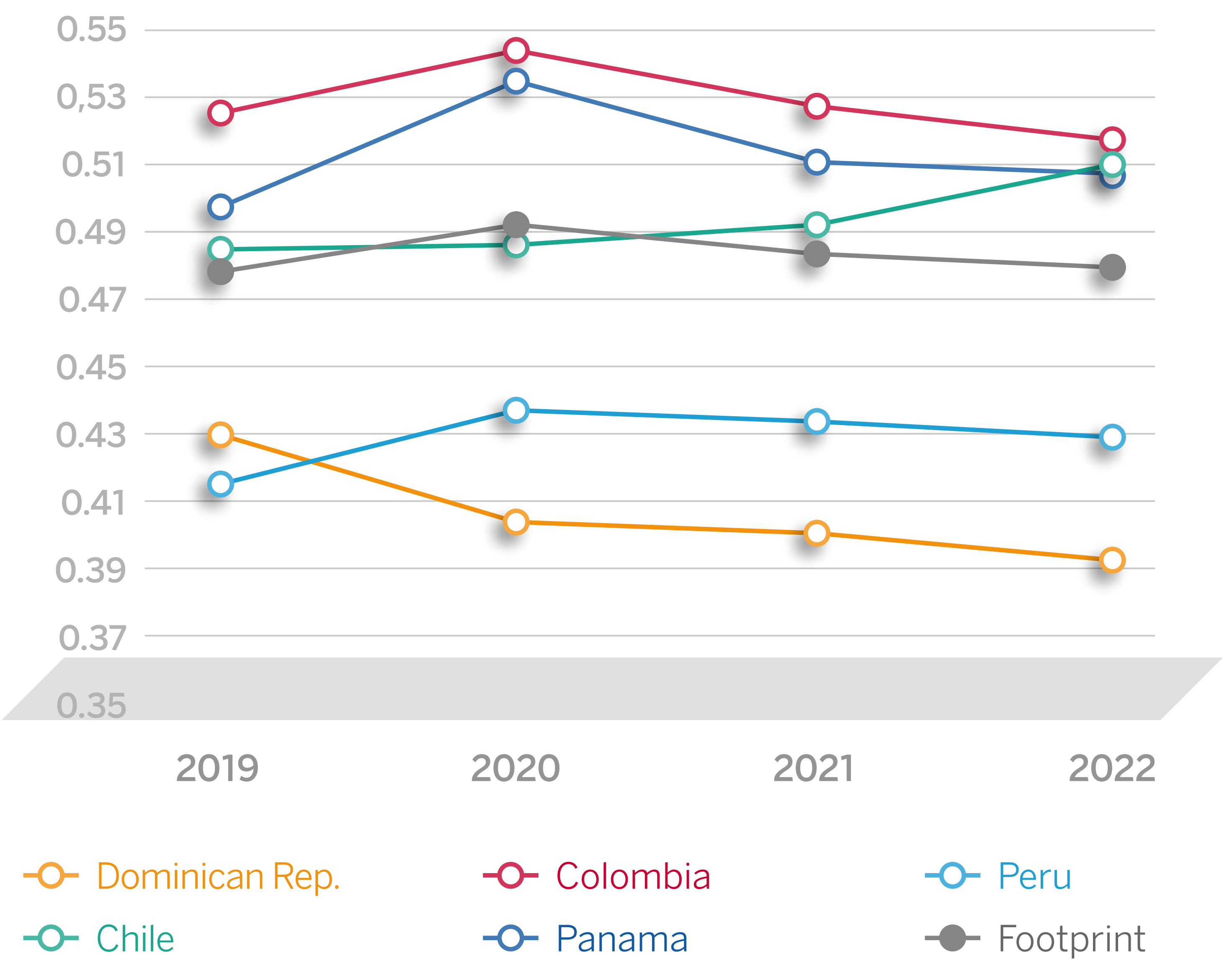


1. The GINI index is the most common measure of inequality. 1 is maximum inequality (one person has all the income and the rest have none) and 0 is maximum equality (everyone has the same income). https://www.worldbank.org/en/topic/poverty/lac-equity-lab1/income-inequality/income-distribution

2. For more details on macroeconomic results, see Macroeconomic Context.

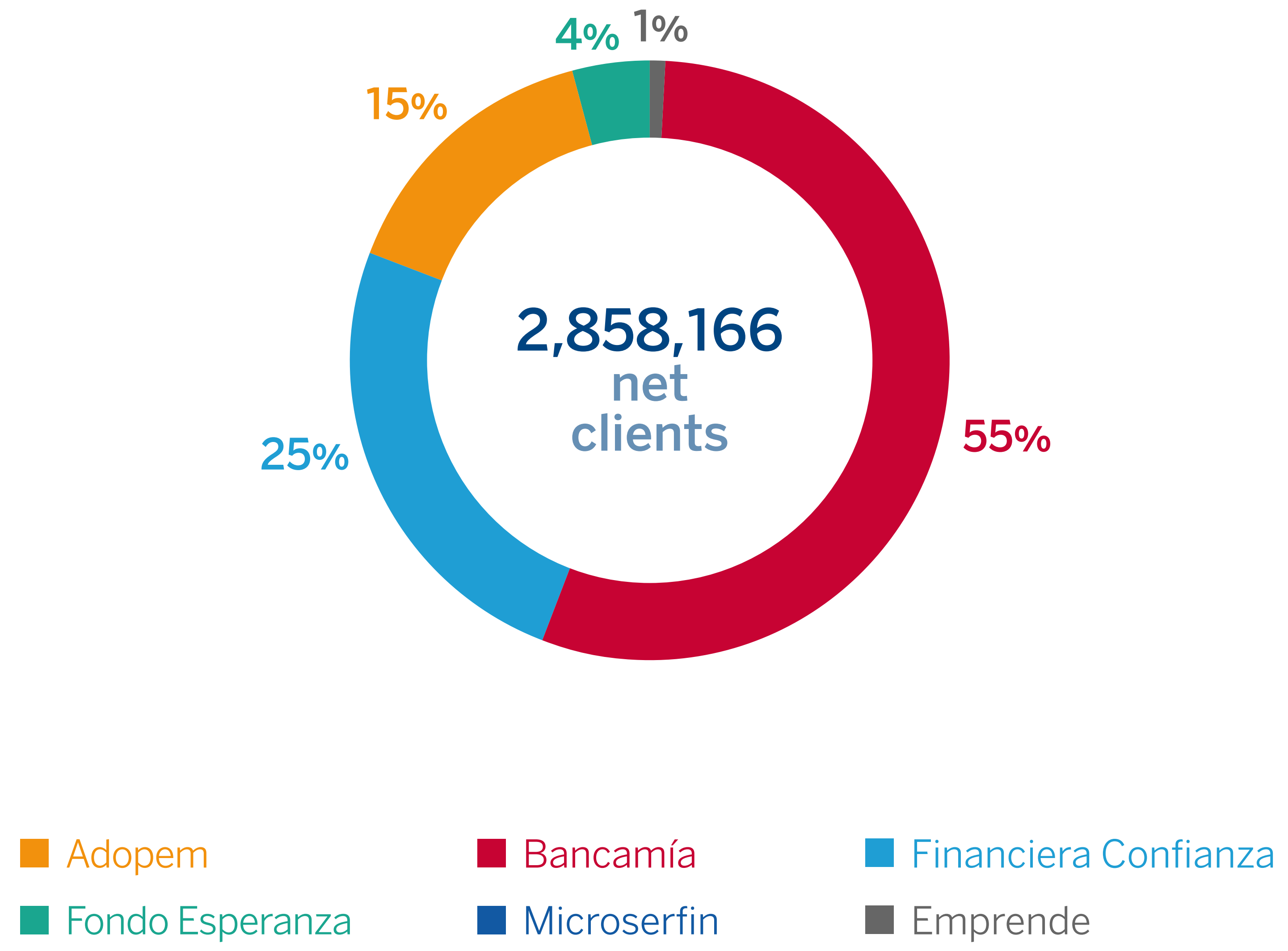
G-**1.** 2022 poverty indices published by each country's statistics bureau. Global Findex Data 2021.

2 | Inequality index (GINI) footprint



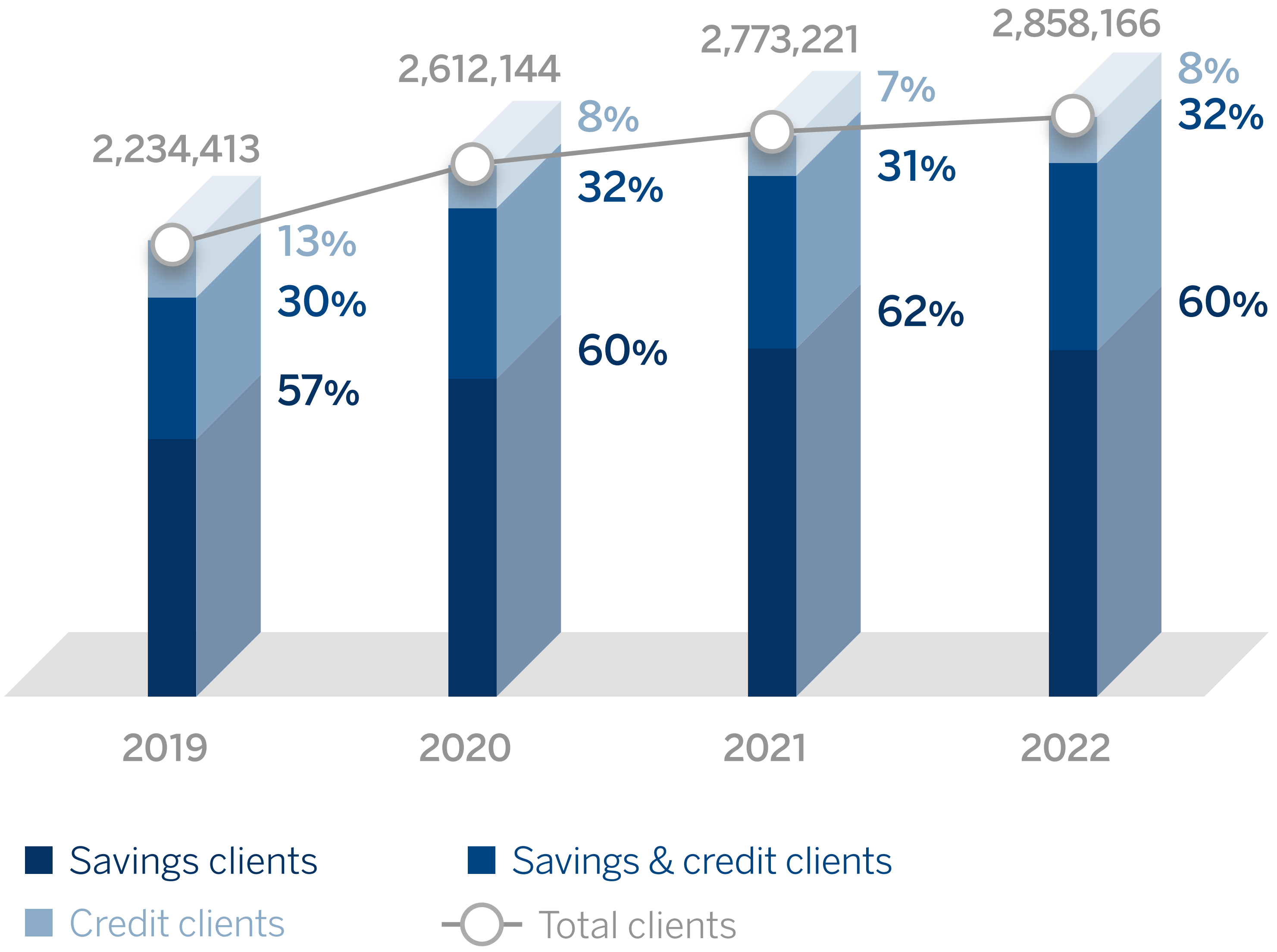
3 | Total clients by country

Total clients at year-end



4 | Clients by product type

Total clients at year-end



Financial inclusion improves, but it is low quality. This contrasts with the significant improvement in this type of inclusion globally and in our footprint. 10% of the global unbanked, 140 million adults, live in Latin America. Of this number, 35 million are in our footprint.[3] In other words, 37% of the population in our footprint countries has no access to a bank account. Even so, appropriate use of accounts is far from widespread, as the percentage of inactive accounts among adults varies from 1% in Chile to 13% in Dominican Republic. The group with the highest proportion of inactive accounts are those with lower educational levels and those who are not in the labor market, with the exception of Dominican Republic, where it is women in general who are most likely not to use their accounts.[4]

The Group's entities have continued supporting the most vulnerable segments. In this context, during 2022, the six institutions that form part of the BBVA Microfinance Foundation Group (BBVAMF Group or BBVAMFG) have stood by 2.8 million low-income people, making financial products and services (loans, savings accounts, remittances, etc.) available to them, together with training to leverage their economic and personal progress. BBVAMFG's mission is to stay with its target segment for whom the Group was set up, and not leave it: entrepreneurs who are excluded from the traditional financial system, those who are overlooked and in vulnerability.

3. The countries in which BBVAMF operates are Colombia, Peru, Dominican Republic, Chile, and Panama.

4. All financial inclusion data are taken from the Global Findex Database 2021, World Bank Group.

G-**3.** Clients current at 12.31.2022. Bancamía, Financiera Confianza & Banco Adopem are regulated institutions, licensed to market savings products.

G-**4.** Clients current at 12.31.2022.