Macroeconomic context. **Latin America: a historic crash**

Pandemic[2]

Latin America has been one of the regions of the world most affected by coronavirus, both in terms of case numbers and mortality. In the countries where institutions belonging to the BBVA Microfinance Foundation (hereinafter our footprint[3]) operate, there were around 3,684,460 recorded cases in 2020.[4] In other words, 23.7% of all cases recorded in Latin America, a proportion of 31,189 cases per million inhabitants.

Although only 1.5% of the world's population lives in this footprint, to December 2020, 4.4% of the world's accumulated COVID-19 infections, and 5.8% of the deaths caused by the illness were concentrated here, equivalent to 20.5% of all the fatalities in Latin America. The data give a ratio of 879 deaths per million inhabitants, similar to the rates in Europe and in the United States.

However, even though the region has better demographics to fight the pandemic —younger populations, lower obesity rates and trained immunity— these advantages did not transfer to lower mortality rates; on the contrary, the weakness of the region's health systems became all too clear.

While in OECD countries there were 506 hospital beds for every 100,000 inhabitants at the beginning of the pandemic, the ratio in the countries in our footprint was 174 beds. This disparity becomes more critical as health problems become more complex. In OECD countries there are 16 ICUs (intensive care units) for every 100,000 inhabitants, compared to 7 per 100,000 in our footprint countries.

Although only 1.5% of the world's population lives in this footprint, to December 2020, 20.5% of COVID deaths in Latin America were concentrated here

OECD countries	Footprint countries
506 hospital **beds**	174 hospital **beds**
16 ICU **beds**	7 ICU **beds**

for every 100,000 inhabitants

Macroeconomic context. Latin America: a historic crash

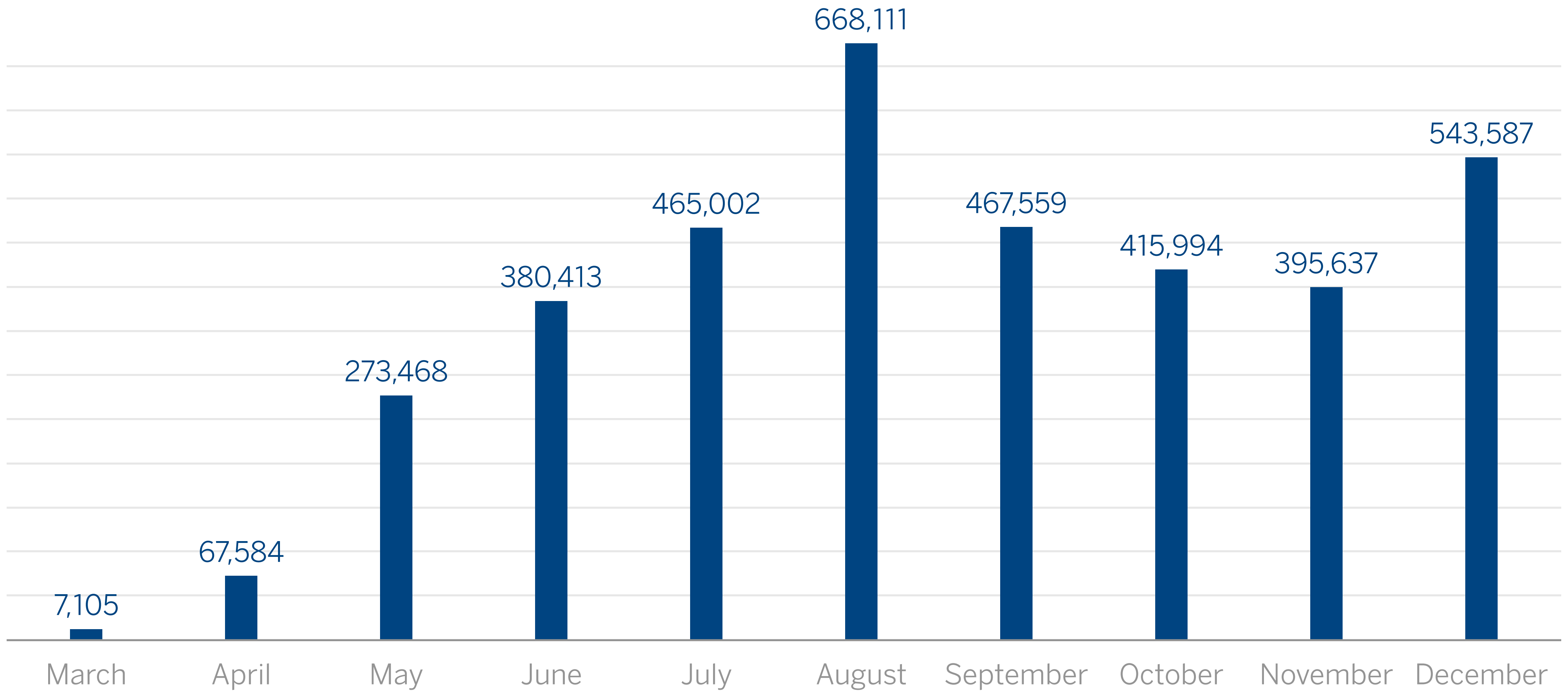
The first confirmed case of COVID-19 in the footprint was recorded on March 1, 2020 in the Dominican Republic; over the next few days others began to be reported in the other countries. As the caseload rose, and following the measures implemented in several European countries and China, restrictions began to be applied, with declarations of States of Emergency, starting with cordons sanitaires around the affected areas which were subsequently extended to entire countries.

In our footprint as a whole, the shutdown of activities and lockdown on people's movements in the second half of March affected around 56% of activities and movements; by April it was 63%. Despite social distancing rules put in place to contain the speed of contagion, and measures designed to reinforce health systems, the latter were put under huge pressure.

Pre-existing conditions of a high degree of informality in the labor market and high demographic density in the areas where most of the vulnerable population live, as well as the lack of a coordinated strategy for diagnostic tests and tracking of positive cases, contributed to the failure to contain the spread of the virus in the first wave and to health systems becoming overwhelmed.

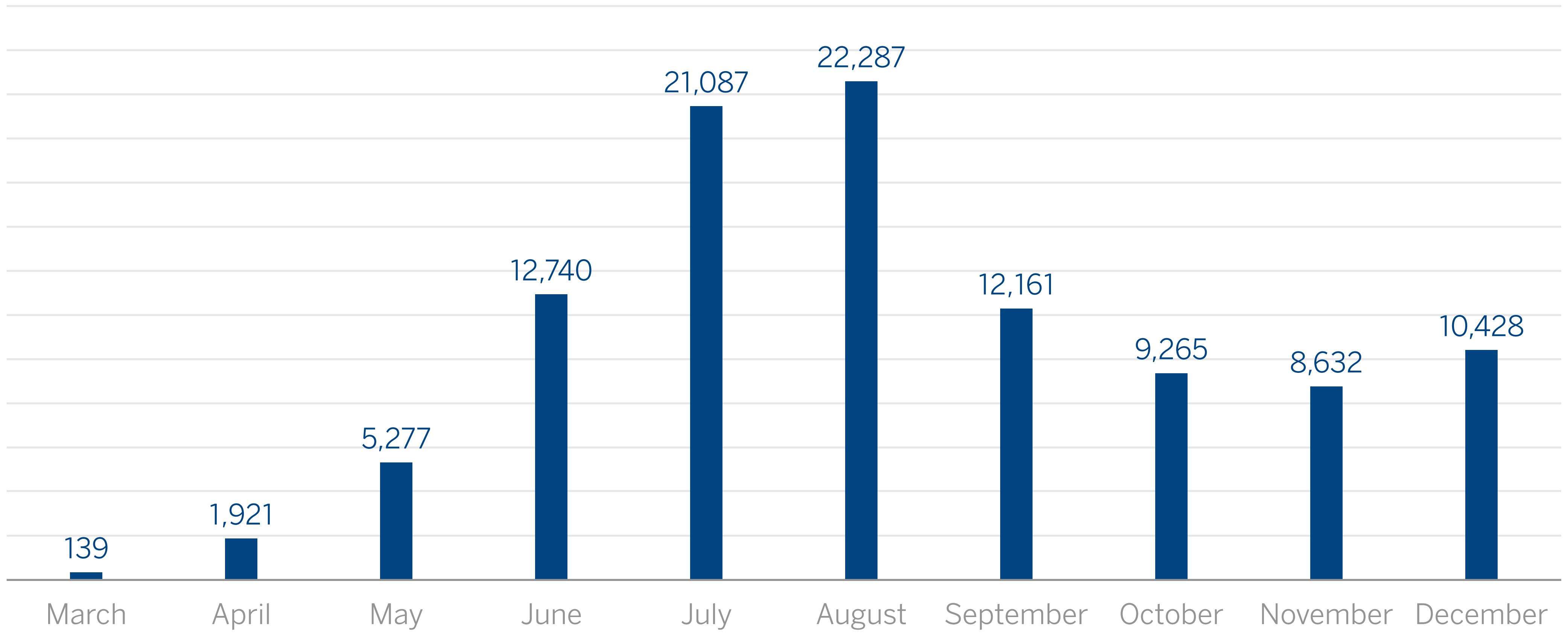
Positive cases by month in the footprint*

2020



Monthly deaths from COVID-19 in our footprint*

2020



* Source: National Health Ministries.

Macroeconomic context. Latin America: a historic crash

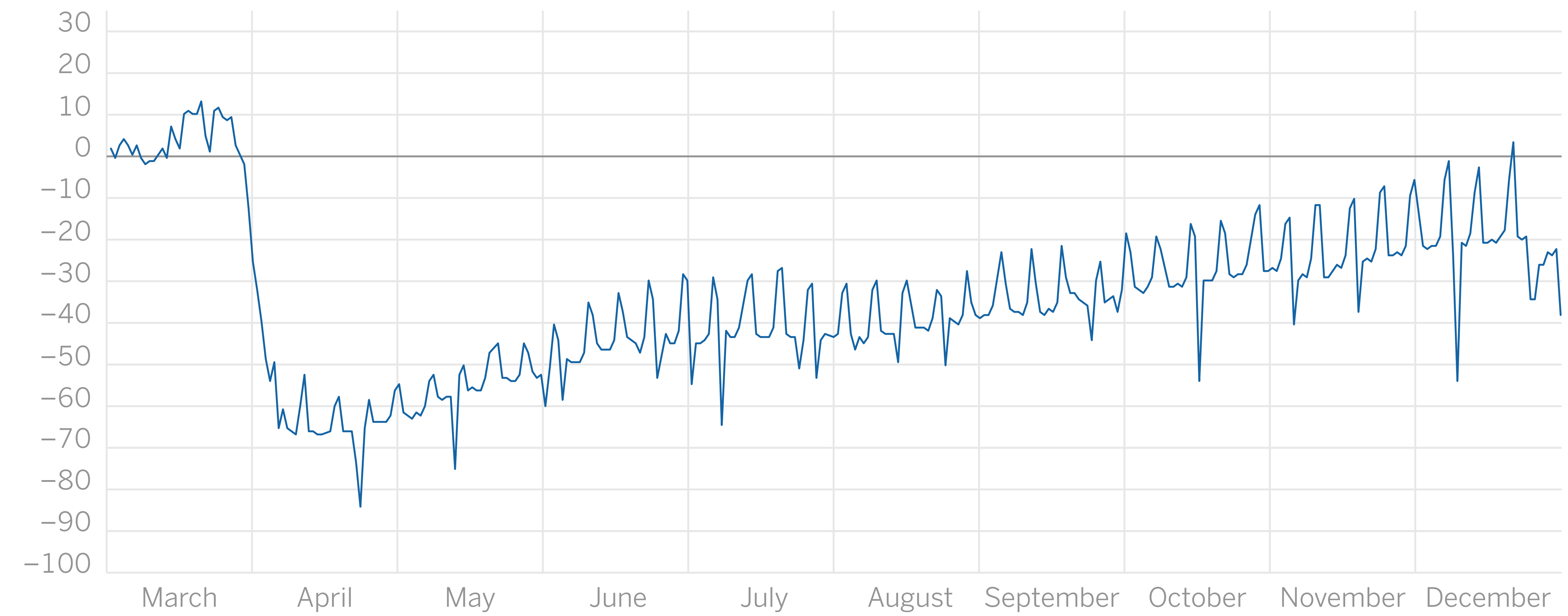
In an initial phase, the economic support measures implemented were too timid for some countries and introduced late in most of them, meaning that the measures to restrict mobility were less effective because of the urgent need to generate income on the part of the population groups mentioned. In this phase, on average, there was 20% more mobility compared to European countries.

Nevertheless, as policies became increasingly more restrictive and control over citizens' actions became more exhaustive, there were two effects: the shutdown of activity and as a result a profound impact on the economy and jobs, both in terms of goods and services production and in demand.

As occurred in other regions, the epidemic has come back in several waves, depending on whether mobility was restricted or not, and on the opening up or restriction of activities.

When the restrictions to mobility are lifted and a good part of the underlying unemployment becomes visible, the informal sector could go back to being the labor market's shock absorber —See *Employment* section

Mobility in the footprint*
2020



Economy[5]

2020 will go down in history as one of the worst years for the economy in a hundred years, one in which the entire region not only suffered an unprecedented health crisis, entailing serious restrictions on mobility, but also the shutting down of economic activity to slow down infections. This affected the normal functioning of productive enterprises, generating a sharp fall in the economy's growth rate, with social and productive impacts that will last in the medium term.

As the pandemic expanded across the region, risk aversion rose sharply on international financial markets, causing investor portfolios to flee to safe-haven assets. Subsequently, this aversion was partly mitigated after the coordinated global response by major central banks to the pandemic.

The region's central banks called in unison for a reduction in interest rates. Some of them accompanied this call with asset-buying measures, credit support and liquidity supply, both in dollars and local currency on national financial markets.

* Source: Google Community Mobility Reports. BBVAMF calculation.

Macroeconomic context. Latin America: a historic crash

To compensate the significant depreciation of the region's currencies at the start of the year, central banks have also adopted measures to stabilize exchange rates.

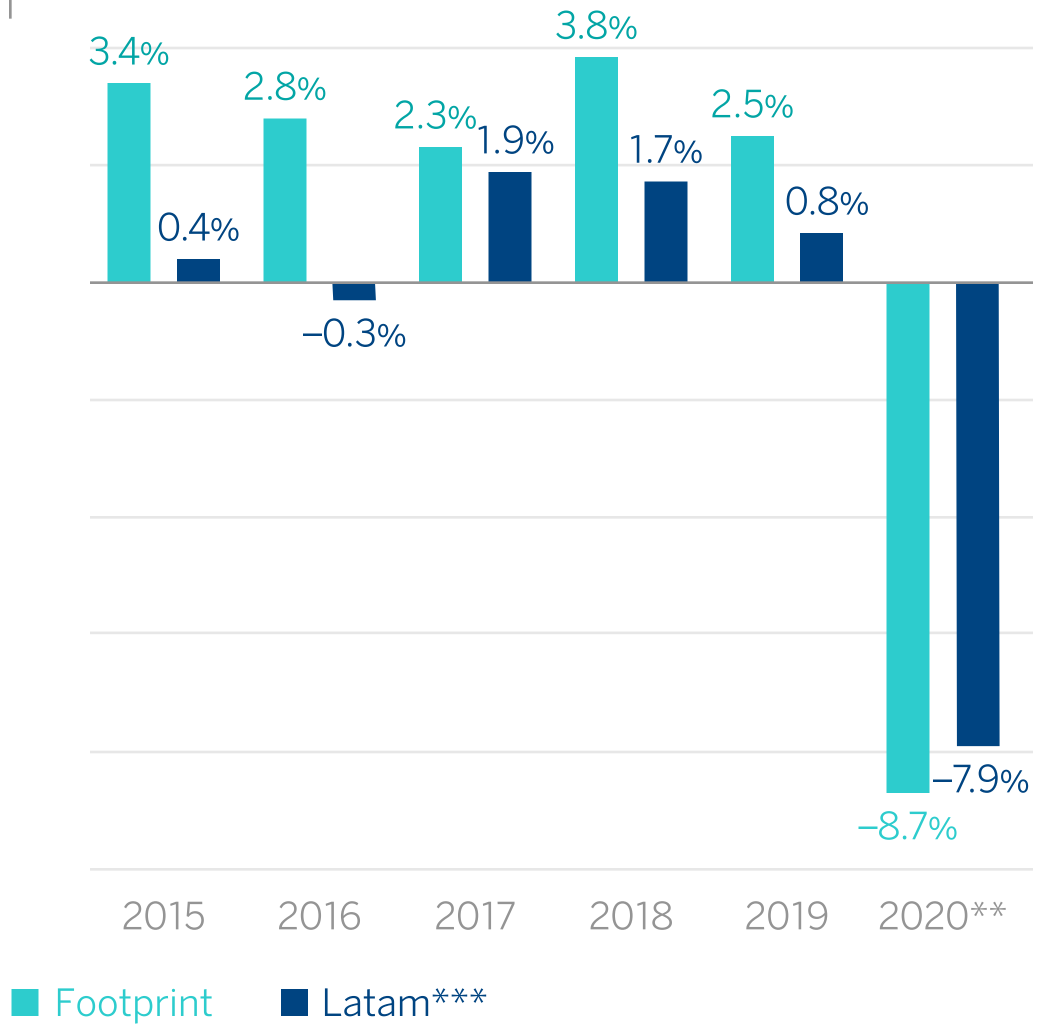
In this framework, the region's GDP[6] fell by 7.9% in the year. The global, synchronized nature of the pandemic and shutdowns of activity, the sharp contraction in international trade and the tightening of financial conditions triggered a collapse across the board of economic activity.

After an extreme contraction in March and April, activity began to recover gradually as lockdowns were eased. As companies and consumers adapted to social distancing habits, major support policies were introduced and global activity began to strengthen, starting to recover in month-on-month terms. This is not a normal recession; to a large extent it has been self-imposed in order to slow the spread of the virus.

The economies in the countries in our footprint were impacted by the same factors as those operating in the rest of the region, with the concomitant fall in activity amounting to 8.7%.[7]

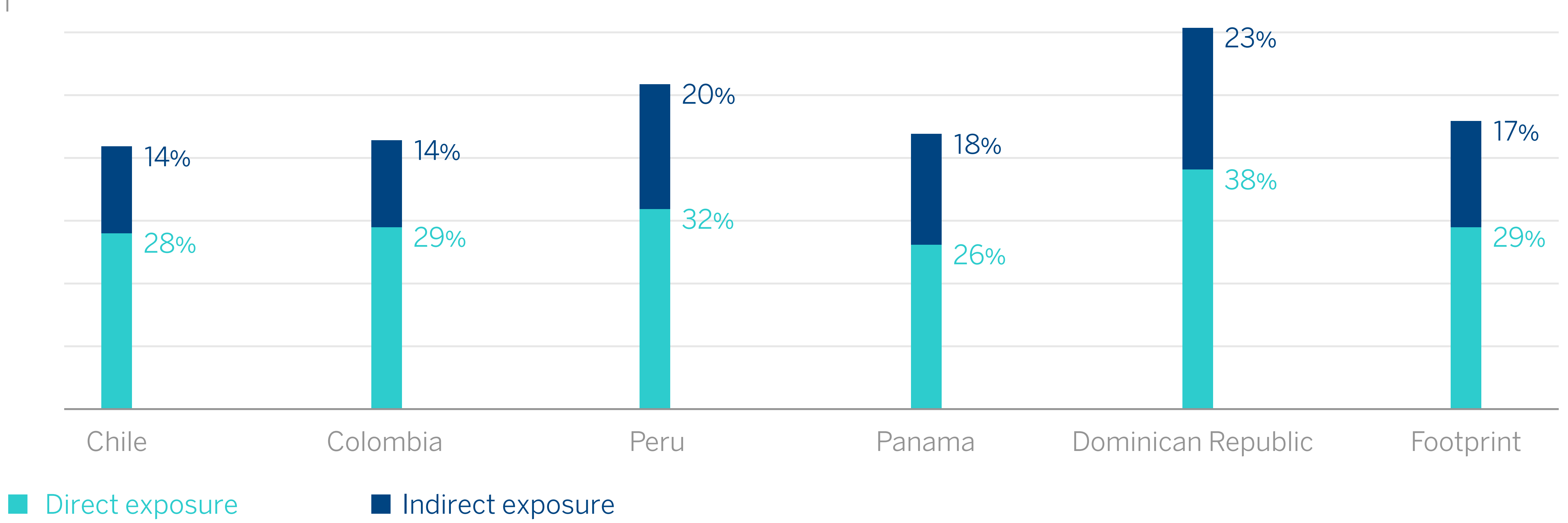
Real GDP growth*

Variation



Weight of sectors with social contact

Exposure by direct contact



The shutdown of activities left a deeper imprint on sectors that have intensive contact, such as wholesale and retail trade, transport and storage, hospitality and restaurant services, education, the arts and entertainment.

In our footprint, average direct industry exposure, because of intensive contact,[8] whether direct or indirect, accounts for 46% of sectors.

Although activity in the last three quarters stood on average 10.9% below the same period the previous year, the quarter-on-quarter momentum showed that recovery was positively correlated with the gradual lifting of health control measures, economic support programs for household incomes and the disbursement of part of the social welfare funds.

* National sources. BBVAMF calculations.
** BBVAMF estimate.
*** Excluding Venezuela.

Macroeconomic context. Latin America: a historic crash

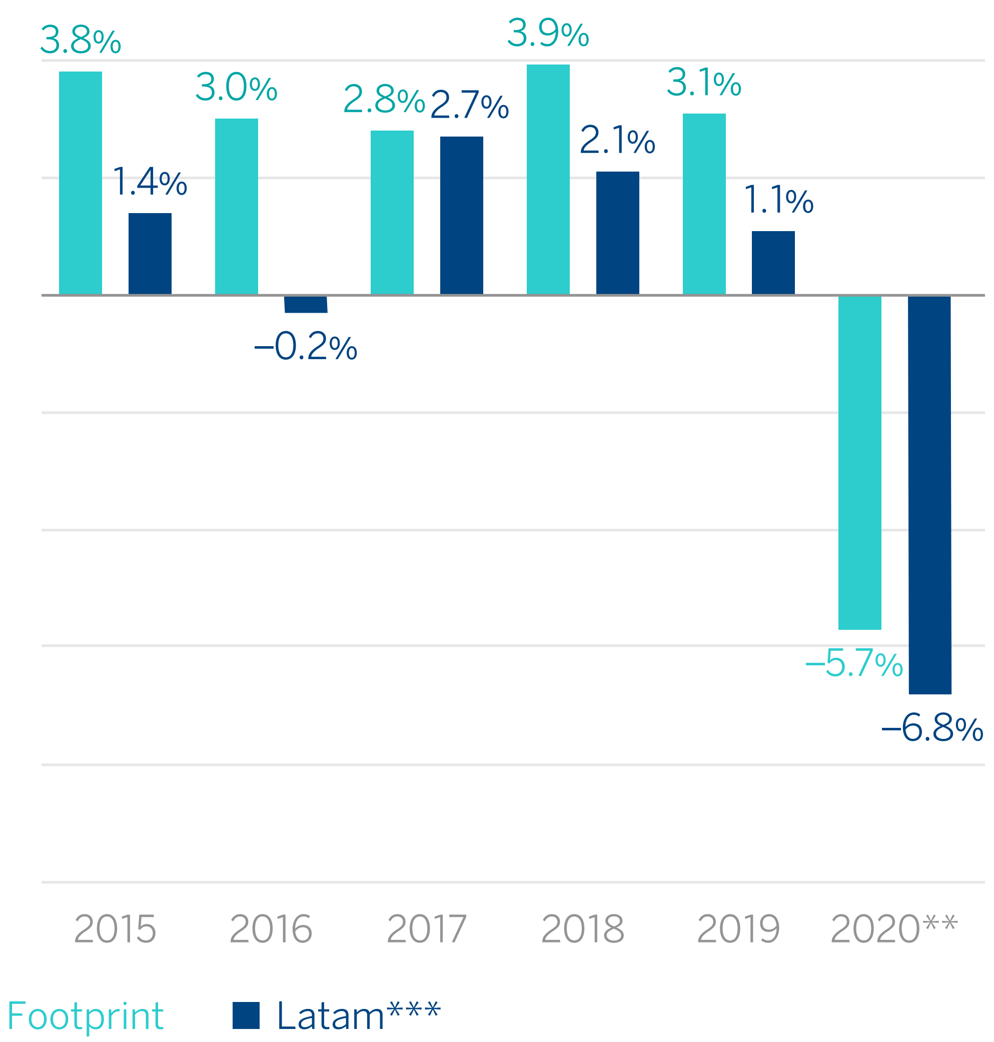
In the second quarter activity shrank, in quarter-on-quarter and seasonally adjusted terms, by 11%, while the third and fourth quarters posted recoveries of 7.5% and 6.1% respectively.

The health crisis also had negative effects on supply, since public health measures entailed the total or partial closure of numerous companies. The outcome was a 10.8% contraction in the trade sector and a 32.3% drop in the restaurant and hospitality industries. Manufacturing, meanwhile, contracted by 12.7% and construction by 17.6%. These last two sectors were affected by the restrictions suffered by supply chains and by mobility difficulties.

Worsening terms of trade,[9] furthermore, have had serious impacts on economies' revenues because of their dependence on exports. The contraction in world demand, particularly in China, one of the largest consumers and importers of commodities, played a major role in the reduction of prices in the first half of the year.

Spending*

Real variation



The collapse of economic activity in 2020 was so great that, at the end of the year, income per person had gone back to where it was 7 years ago

Due to the fall in international demand and the interruption of supply chains, export volumes of goods and services fell by 13%. However, the drop in domestic activity meant that imports fell by 18%, improving the balance of trade.

The collapse of economic activity is so great that, at the end of 2020, per capita GDP in our footprint was similar to that of 2013. In other words, there was a seven-year reverse in income per person, unparalleled in recent history.

Turning to demand, the lack or reduction of workers' incomes, whose circumstances prevented them from working normally, and the rise in unemployment, affected consumption. Private spending shrank by 5.7%. The reduction in enterprises' cash flow, together with the rise in uncertainty, was visible in a sharp reduction in investment, with private investment crashing by 18.2%.

The combination of these two effects caused lower domestic demand, an effect that was partly offset by net exports. Economies' domestic demand, which had already been weak in 2019, contracted significantly, by 10.9%.

* National sources. BBVAMF calculations.

** BBVAMF estimate.

*** Excluding Venezuela.

Macroeconomic context. Latin America: a historic crash

All components of domestic demand fell. Household spending diminished, accounted for by lower spending in goods and services. Investment also fell due to the fall in gross fixed capital formation (GFCF), mainly in construction and other works and, to a lesser degree, in machinery and equipment.

Fiscal and monetary policies played a crucial role in the region's reactivation in the second half of the year. The first was executed by means of transfers, subsidies and guarantees for lending programs. Monetary policy, meanwhile, became very expansionary, with incentives for private credit thanks to a speedy reduction —to historic lows— of benchmark interest rates and to a wide range of guarantee measures and injections of liquidity.

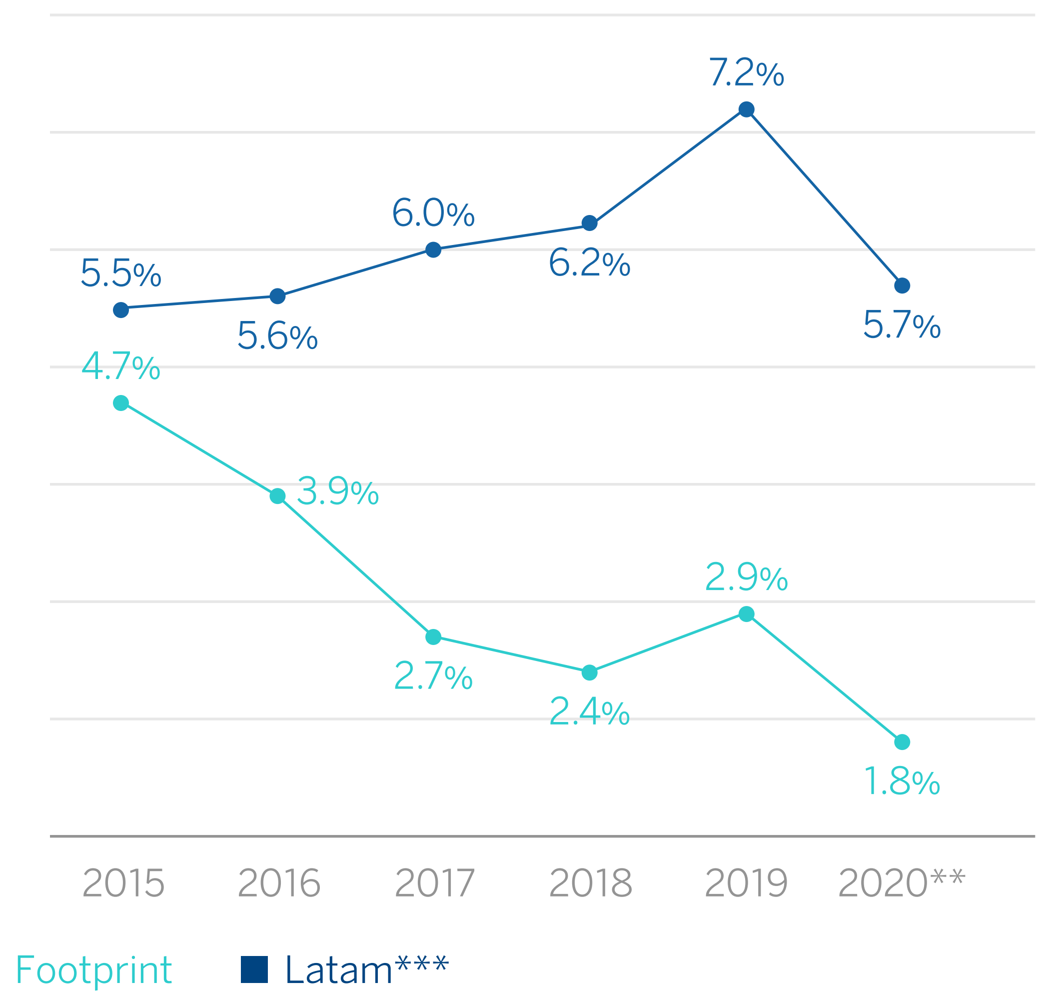
The slump in activity during the year revealed a significant negative output gap.[10] A negative output gap happens when effective output is lower than what the economy is capable of producing at full capacity. Low demand and, in consequence, lower prices, denote idle capacity[11] in the economy.

Given the idle capacity of the economy, inflation fell and, in many countries, posted below the target set for 2020. The wider impact of the deflationary forces associated with depressed activity and with the moderation in commodities prices offset the inflationary pressure of the supply shock and the currency depreciations experienced in the major economies.

Against this backdrop, in 2020, average inflation in Latin America[12] fell by 1.5% from 2019, closing the year at 5.7%. In our footprint, inflation stood at 1.8%, the lowest in our data history, with sharp falls in all countries except for the Dominican Republic, where it rose. As a result, monetary policy rates fell to historic lows in all countries, a consequence of a great deal of slack in the output gap.

In our footprint, inflation fell sharply in all countries apart from the Dominican Republic to an average of 1.8%, the lowest since data collection began

Inflation*
Variation



* National sources. BBVAMF calculations.
** BBVAMF estimate.
*** Excluding Venezuela.

Macroeconomic context. Latin America: a historic crash

Employment[13]

In Latin America the average rate of unemployment rose from 7.9% in 2019 to 11.6% in 2020.[14] This was attenuated by the significant number of people who left the work force, i.e. stopped looking for a job. This has meant that the unemployment rate is actually underestimated, because of the drop in both the participation rates and occupation.

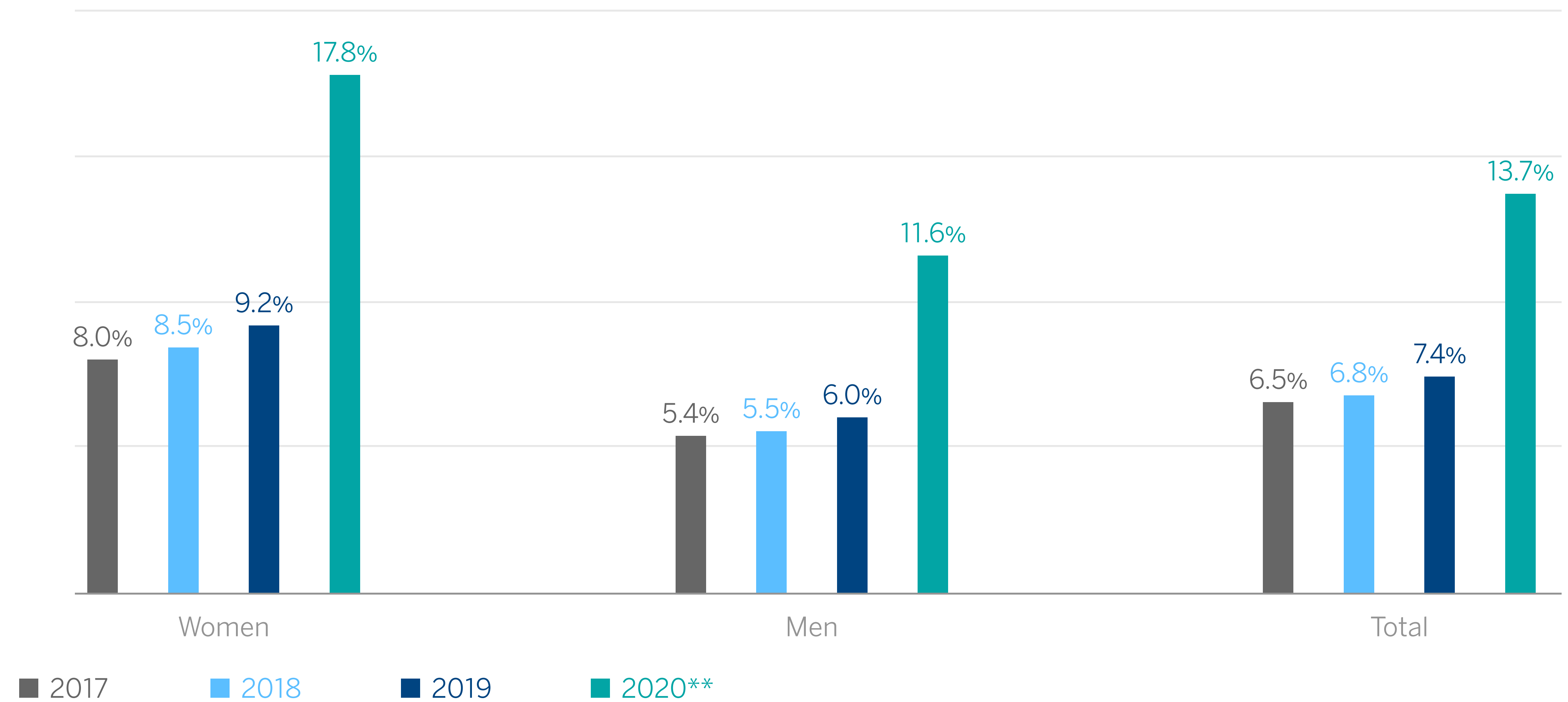
A large number of people chose to become inactive instead of looking for non-existent jobs that the pandemic had eliminated, and this contributed to moderating the effect on the unemployment rate.

The participation rate fell by 5.4%, while occupation was down by 6.1%. This implies that around 12% of jobs in the region were lost, excluding large numbers of people from the labor force.

One factor that has prevented an even greater loss of jobs in the short term has been keeping labor links alive. This was achieved by setting up work furloughs, compensated by some kind of financial provision or subsidy.

Unemployment*

% of labor force



If this group of people leaving the work force had not been furloughed, and if policies designed to support jobs and incomes had not been put in place, the unemployment rate would have been as high as 21.2%.

The same factors were present in our footprint; even so, the unemployment rate rose by 6.3%, posting at 13.7% in 2020. This is the result of impairment in the labor market in all countries, particularly in Panama, Colombia and Peru, and to a lesser degree in the Dominican Republic and Chile.

All countries have shown that they are vulnerable to the shock of COVID-19, due to the small proportion of workers employed in activities which can be done remotely.

If policies designed to support jobs and incomes had not been put in place from the beginning of the pandemic, the unemployment rate would have been as high as 21.2%

* National sources. BBVAMF calculations.
** BBVAMF estimate.

Macroeconomic context. Latin America: a historic crash

At the end of the first semester, 5.4 million more people had become unemployed. Nevertheless, the exit of 4.7 million members of the active population because of the fall in the participation rate, the gradual recovery of activity in the second semester, and the measures adopted to maintain employment, meant that the year closed with 3.5 million newly unemployed, of a total of 7.3 million people without an occupation. If the 2019 participation rate had been maintained, the unemployment rate would have been 22.6% (compared to the actual 11.6%).

The global participation rate fell by 5.3%, dropping from 65.9% to 60.6%. Similarly, there was a gender gap of 23.6% between men and women, with participation at 72.7% and 49.1% respectively, that is, a slight widening of the gap since 2019. Although the reduction in the participation rate has been similar among men and women, in relative terms it has hit women harder because of their previous lower participation rate.

The number of women engaged in jobs that require more personal interaction, such as retail trade, restaurants, caring for people and tourism, is much higher than men, and these jobs lend themselves much less, or not at all, to remote working, so they are more prone to becoming unemployed.

Women's employment in the sectors where there is greater physical contract, and as such a greater risk of catching the virus, is over-represented, accounting for around 65% of women's employment.

Women tend to do more unpaid domestic work than men, a reality which has only intensified during the pandemic. During this period, unpaid care work has increased: children are not at school and need more help in keeping up with their school activities.

This greater dedication to unpaid work explains to a large degree the slow rate of recovery of women's jobs. The situation is particularly acute when the woman is the secondary source of the family's income, because of the high direct costs to households of paying for third parties to look after their children and the difficulties caused by the pandemic in these parties being able to do so, leading to many women staying at home to look after their families.

Women's unemployment posted at 17.8%, while for men it was 11.6%. Although women only account for 43% of employment in our footprint, they have suffered 58% of total job losses.

Sectors with higher physical contact, and thus more affected by social distancing, not only employ a greater proportion of women but in many cases do so in the informal sector, where both the remuneration and qualifications required are lower. Most women in these sectors are self-employed or own microenterprises.

Although women only account for 43% of employment in our footprint, they have suffered 58% of total job losses

Macroeconomic context. Latin America: a historic crash

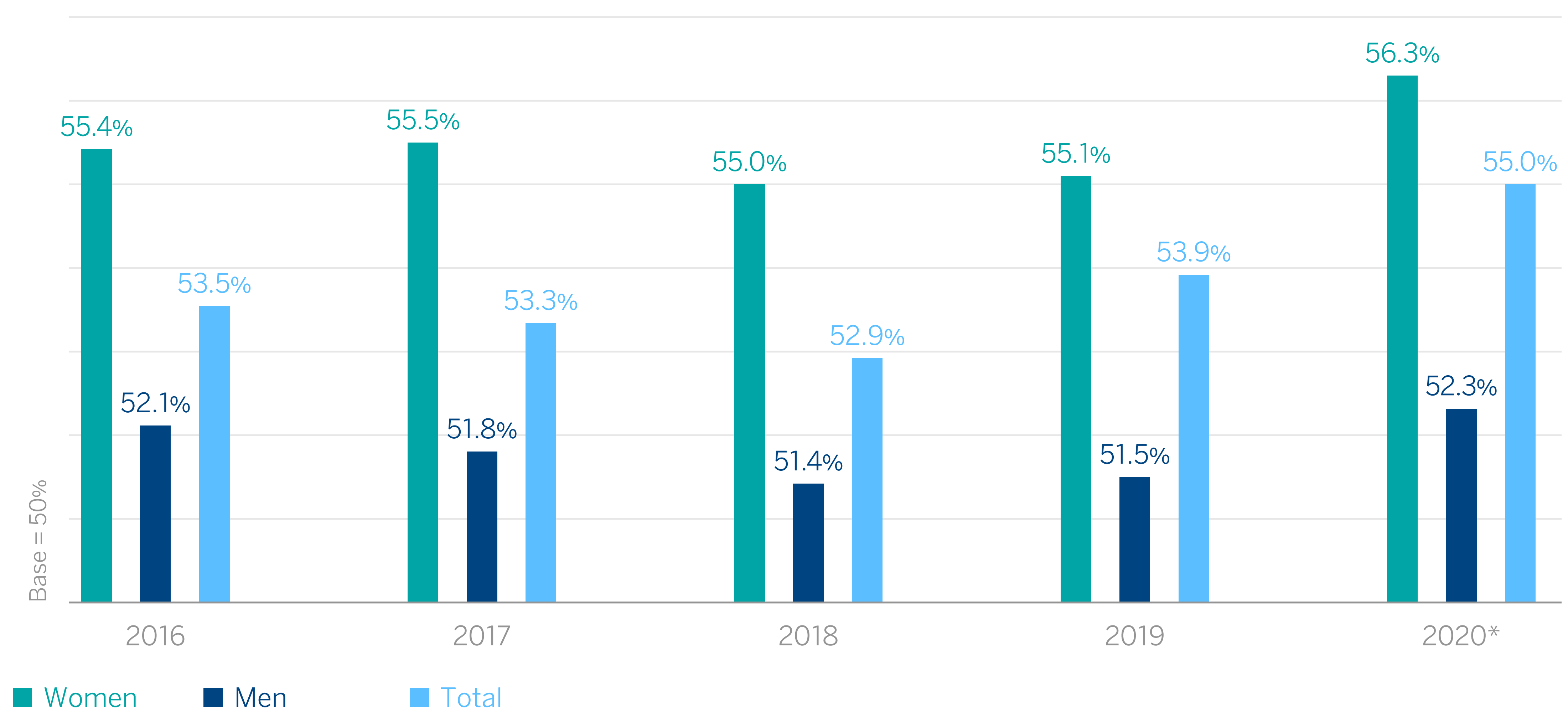
Job losses have been widespread in both the formal and informal sectors. Unlike other crises where informal employment in the event of losing a formal job enabled people to earn some kind of living, on this occasion the physical distancing and mobility restrictions have limited the role of the informal economy as a temporary compensation mechanism.

In the first part of the year the drop in informal employment was even more brusque than in the formal sector, with the resulting fall in the rate of jobs in the informal economy. As the lockdown measures and mobility restrictions began to ease, informal employment began to return and self-employed jobs grew. At year-end, this could be seen in the 1.1% rise in the rate of informality. 52.2% of men's and 56.3% of women's employment was informal in 2020.

When mobility restrictions are lifted and a good part of the unemployment, suppressed until then by job conservation and support policies adopted in 2020, surfaces, the informal sector may return to being the labor market's shock absorber, helping to prevent the increase in unemployment. The labor informality rate will tend to increase in 2021, which will have a negative impact on employment conditions.

Informal employment*

Variation



Unlike other crises, where informal employment facilitated income generation to partially replace formal jobs, on this occasion physical distancing policies and mobility restrictions have limited the role of informal employment as a temporary compensatory mechanism

* BBVAMF estimate.

Macroeconomic context. Latin America: a historic crash

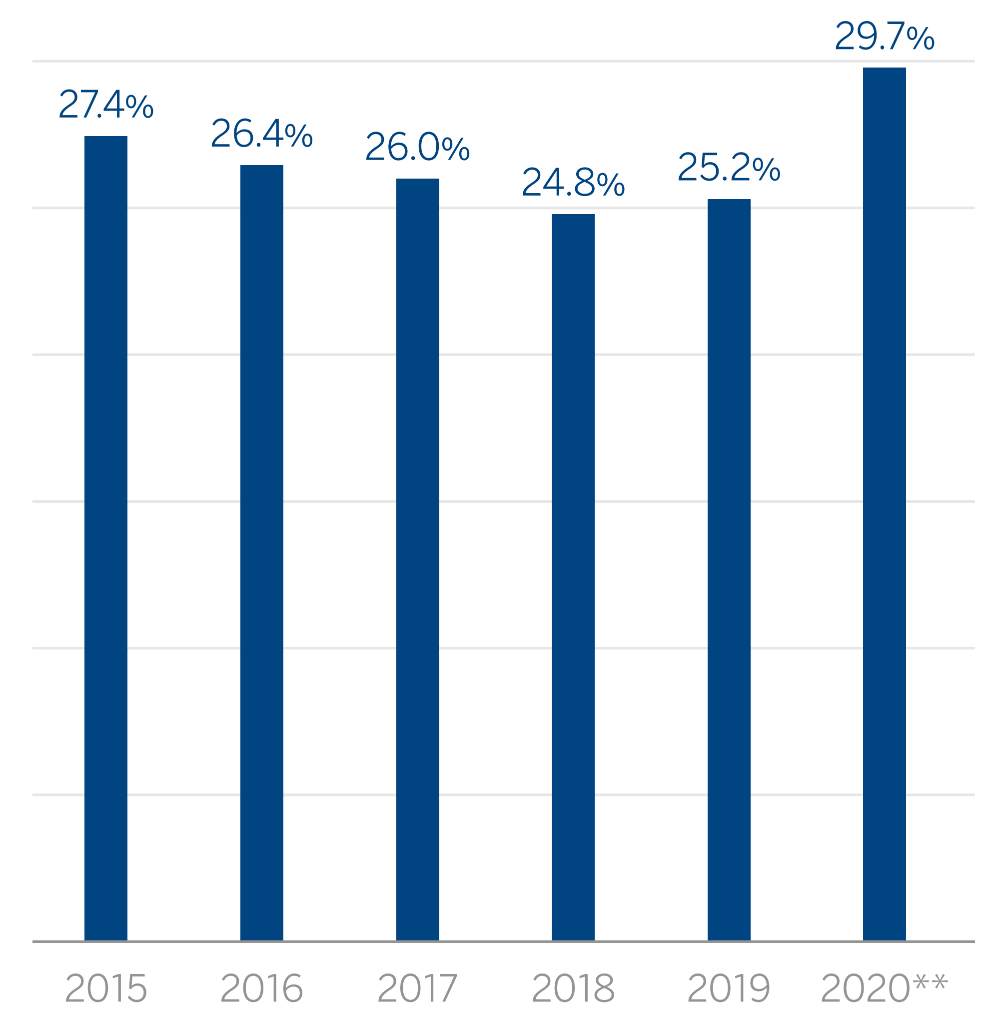
Poverty and inequality[15]

In 2020 monetary poverty in our footprint stood at 29.9%, which implies that around 34.7 million people were in poverty at the end of the year. This represents an increase of 4.5% over 2019, meaning that the ratio has reverted to 2013 levels.

In the last year, around 5.7 million people entered poverty, whereas 4.9 million avoided it in the short term. This is due to a series of measures that were adopted: new transfers, in money or in kind, increased cover, bigger sums in the case of existing monetary transfers and job support policies, among others.

Social spending increased in response to the pandemic, with most of it executed in the second quarter due to the urgent need to protect the income and spending of affected families. This spending represented, on average, 1.75% of GDP in 2020. Without these policies and cash transfers, the proportion of people in poverty would have been 33.9%.

Monetary poverty*
Variation



When quantifying the contributions to the variations in poverty, each component has been broken down based on the variations recorded in household income per capita and the changes in distribution to income per capita.

When these are divided into components, the fall in employment and wage losses from fewer hours worked increased poverty by 8.7% from 2019 because of the income effect. The redistributive effect of the policies adopted to protect wages and of social spending, meanwhile, have reduced this percentage by 4.2%, resulting in a net increase in poverty of 4.5% in 2020.

A further part of the impact is reflected in the composition of poverty. Approximately 8.9% of the population is in extreme poverty, that is, 10.4 million people. Nevertheless, the policies adopted have prevented the shock from being even greater in this segment.

Around 5.7 million people entered poverty over the course of the year, Thanks to mitigating measures adopted, 4.9 million managed to avoid it in the short term

* National sources. BBVAMF calculations.
** BBVAMF estimate.

Macroeconomic context. Latin America: a historic crash

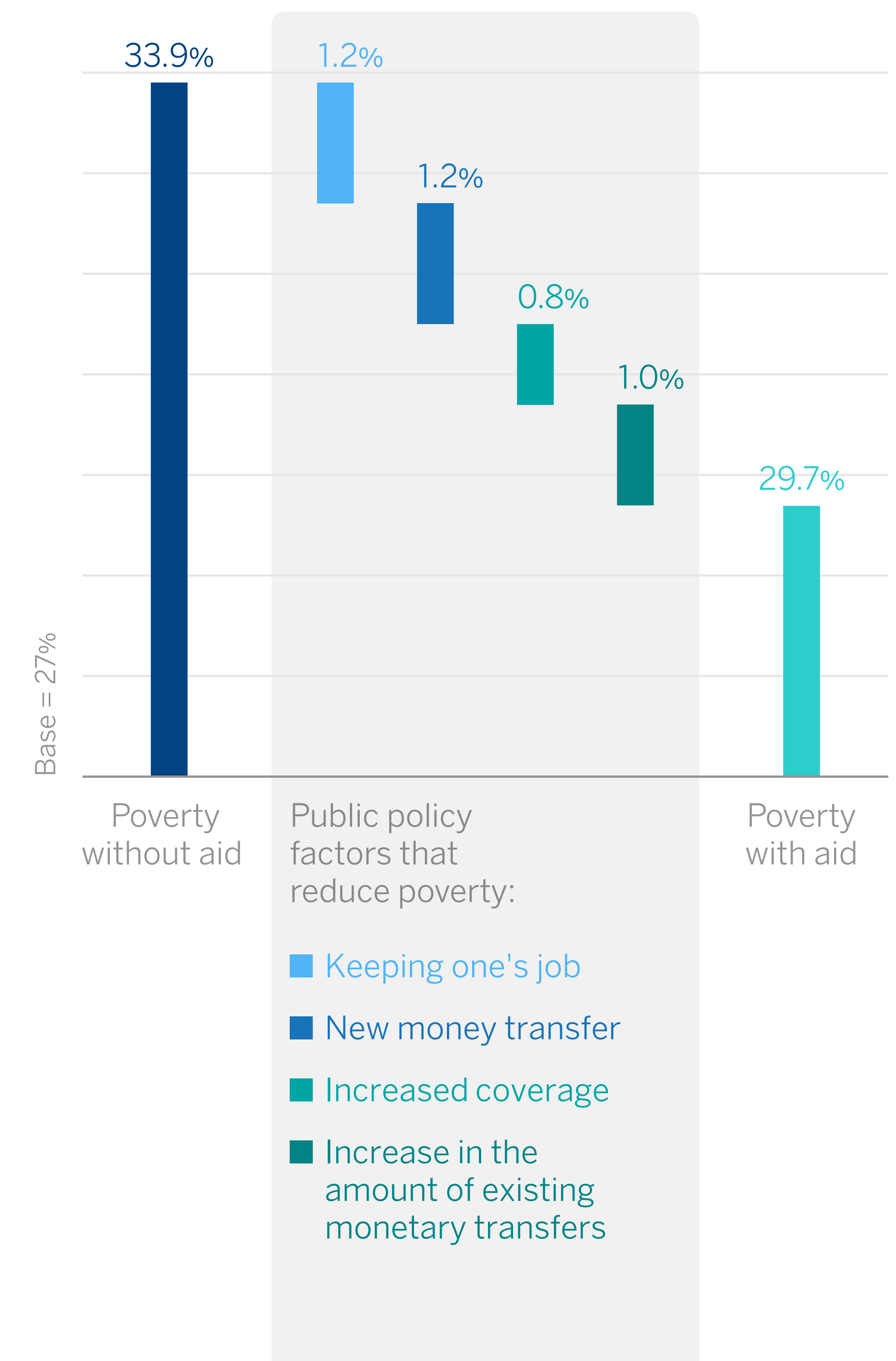
By gender, the greater effect of the pandemic on women is reflected in an unequal impact on poverty. While the 2019 poverty rate was 12.7% higher for women of working age than men of the same segment, this gap widened to 15.8% in 2020; the estimated number of women in poverty in 2020 for every 100 men is 115.8. This gap is even wider in extreme poverty, where the indicator is 119.3 women for every 100 men.

In geographical terms, although the social distancing measures have had a greater impact on urban zones, the poverty gap between rural and urban areas continues to be an important one, with a 16.5% difference between the two, and a poverty rate in rural areas in our footprint of 40.3%.

When we look at the scars the pandemic has left on households, it is helpful to see how the distribution changes. The greatest impact on employment destruction is in the poorest segments, with an even greater loss of income in this segment compared to less poor segments. The gap between both segments is 32%.

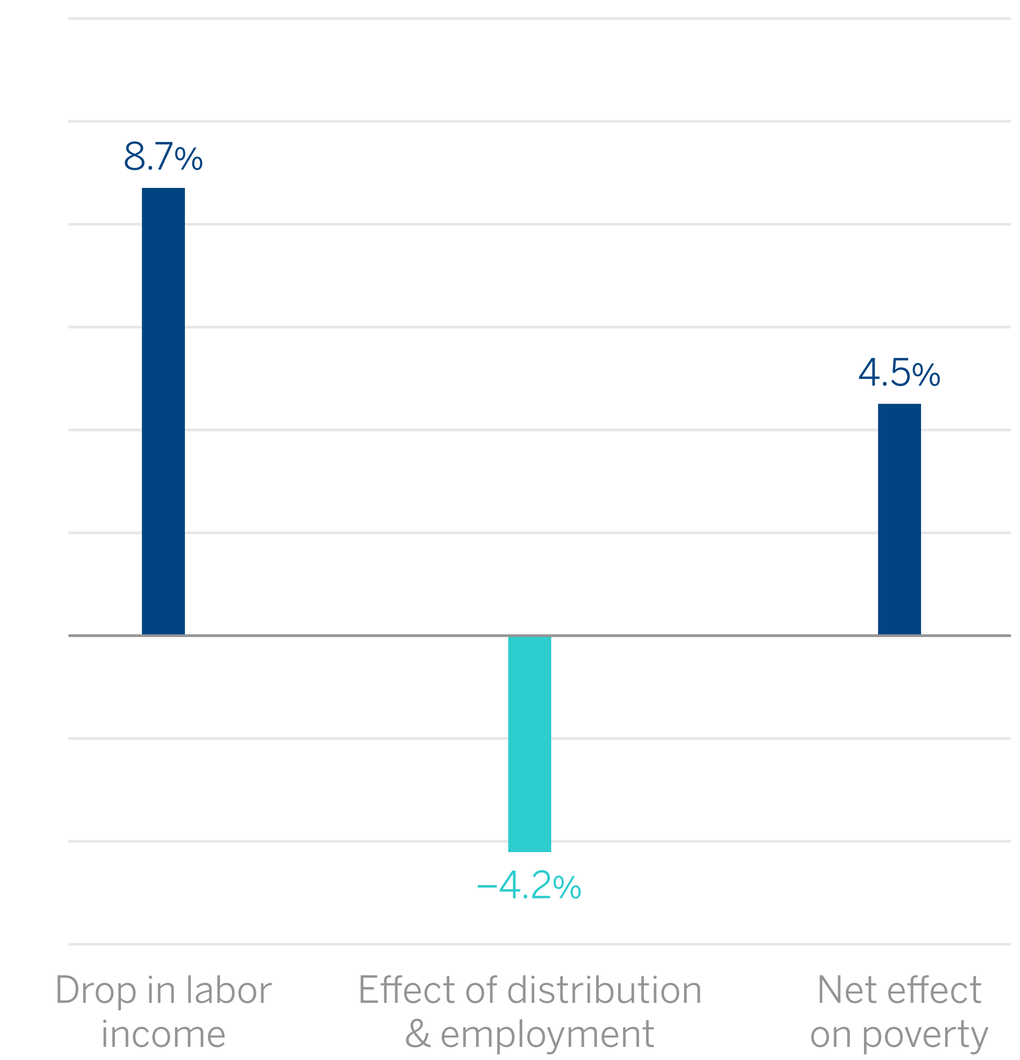
Poverty in the footprint and contribution to poverty reduction

By aid policy in 2020



Variation in poverty

2019-2020



So, we can see that income distribution has become even more unequal: in 2020 the Gini[16] Index went up to 0.503 in our footprint, from 0.478 in 2019.

It is important to point out that this increase in inequality has occurred because the cash transfer programs to mitigate the impairment of household incomes resulting from the pandemic were insufficient to counteract its greater impact on segments with lower incomes.

Rise in inequality in our footprint

Gini Index

0.478
2019

0.503
2020

Macroeconomic context. Latin America: a historic crash

Impact on microenterprises

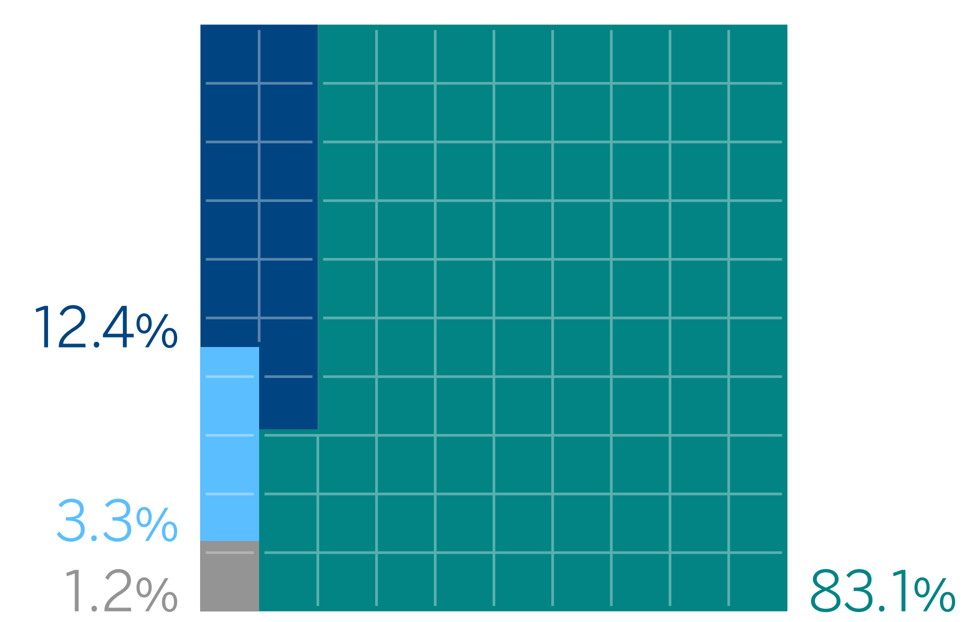
The pandemic has shaken the productive and business structure in our footprint, countries where that business structure is very diverse.

Large corporations make up only 1.2% of all enterprises, concentrated in a few production activities and commodities processing, such as copper, oil and fishing, together with some capital-intensive services, mainly electricity, telecommunications and institutions in the financial system. However, these large companies account for 35.5% of all employment.

Small and medium enterprises make up 15.7% of the total, employing 35.9% of workers, while microenterprises represent 83.1% of all undertakings and 28.6% of employment.

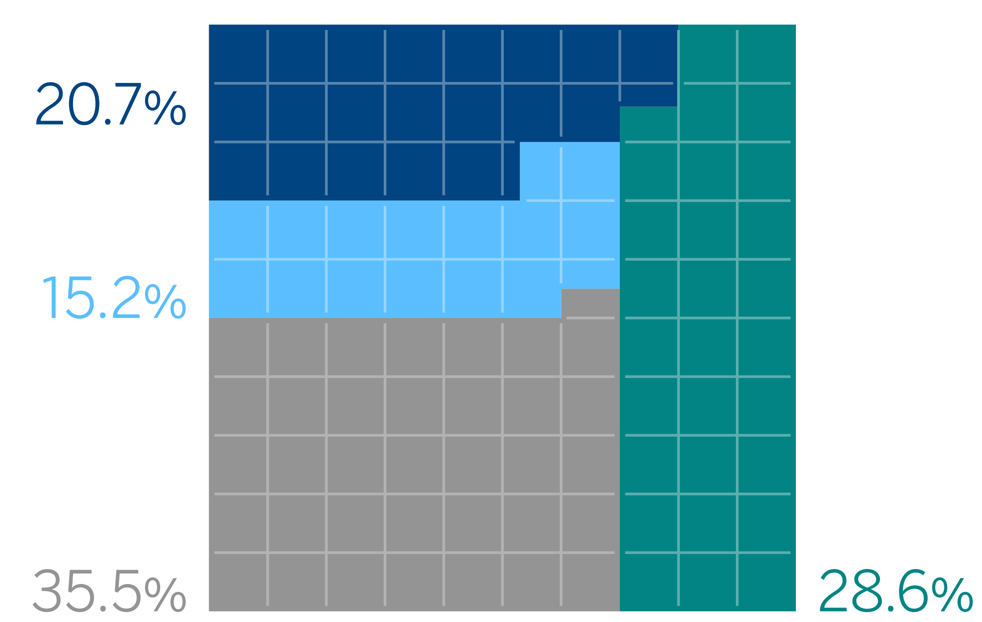
These two categories —SMEs and microenterprises— account for 98.8% of the productive infrastructure and generate 64.7% of the jobs. Microenterprises tend to work in sectors requiring greater physical contact and their productivity is lower than that of large corporations. This means that it is they who have suffered most from the shutdown of activities, experiencing greater difficulties in working remotely and limitations in their capacity to adapt and implement health protection measures.

Structure of enterprise in the footprint



■ Small enterprises ■ Microenterprises
■ Medium-sized enterprises
■ Large corporations

Structure of employment in the footprint



■ Small enterprises ■ Microenterprises
■ Medium-sized enterprises
■ Large corporations

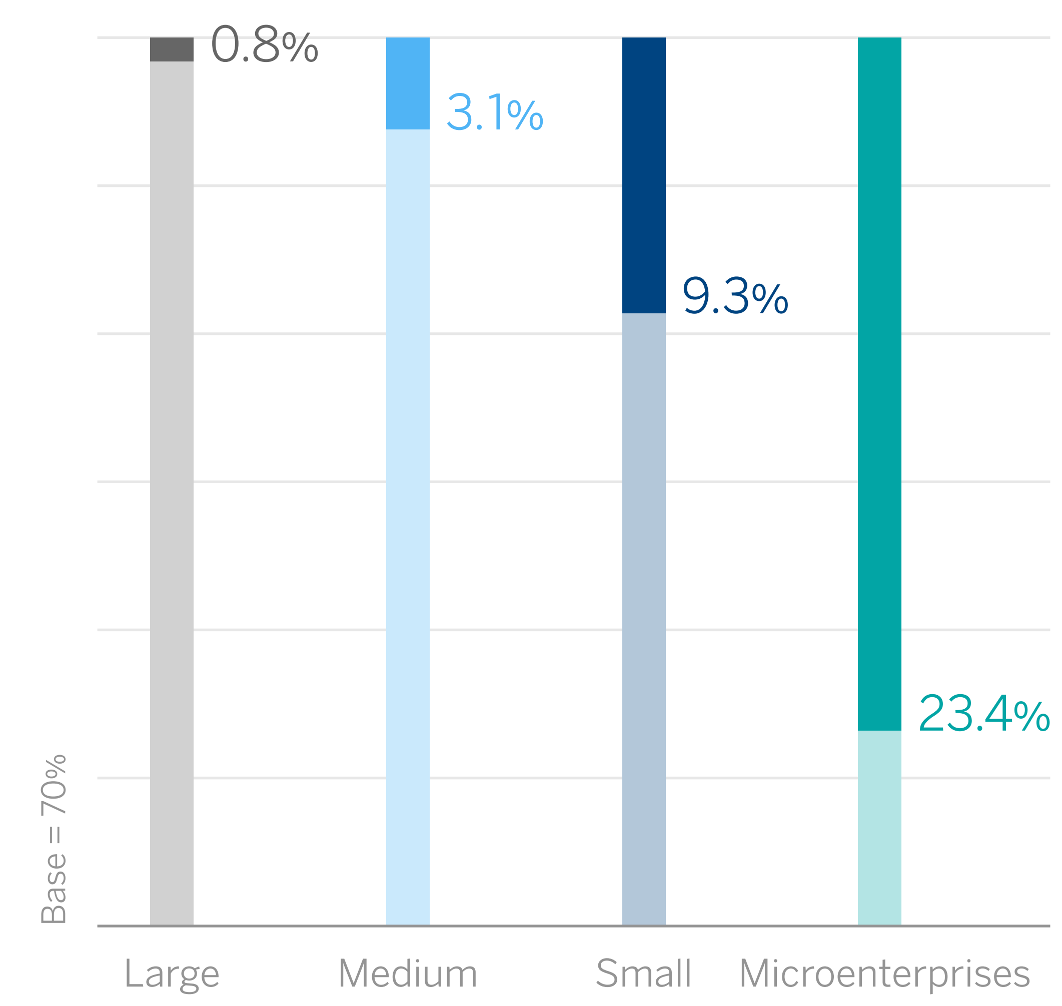
Macroeconomic context. Latin America: a historic crash

All of the foregoing leads to a greater likelihood that they have to stop their operations temporarily or permanently. 23.4% of microenterprises could close for ever as a result of the pandemic, while 12.4% of SMEs might be permanently affected. Meanwhile, large corporations are not greatly affected, because of their nature and industry activity.

Almost all countries announced support measures and special credit facilities to finance working capital to avoid the shutdown of activities and prevent the resulting full impact on jobs. In the case of financing, facilities of different types, payment terms and grace periods have been made available. These programs have been designed to safeguard jobs and as support measures to give companies liquidity and prevent interruptions to the flow of payments.

These policies have succeeded in softening the potential impacts in these different areas. However, most of them last for less than a year. This means that because the pandemic is going on longer than initially expected, the negative impact could deepen, mainly in the segments at the base of the productive structure pyramid.

% of companies that might close due to the crisis



Microenterprises have suffered most, finding it more difficult to work remotely and to adapt and implement health protection measures

Financial Inclusion

It is likely that the pandemic has provided a window of opportunity to go further with financial inclusion. This is despite the impact that it has had on "traditional" financial inclusion due to the effect of shutting down activities and curfews, including closing bank branches and preventing a significant proportion of banking correspondents from executing transactions, in compliance with the restrictions.

According to the BBVAMF Group's own estimates, based on World Bank data,[17] in 2020, financial inclusion grew in the countries in our footprint. 39.5% of adults were excluded from the financial system by not possessing an account or any financial products. However, this ratio has improved by 9.7% since 2017, with 1.4% of that occurring in 2020. What is more, this inclusion has been formalized even more: 98% of those with an account have it in a regulated financial institution.

The widespread use of cashless payment methods to reduce the risk of spreading the virus has created the need to adopt financial services in order to use digital payment systems.

Macroeconomic context. Latin America: a historic crash

This acquired vital significance when channeling the cash which all countries transferred to lower income segments, the poorest 40% of households, who also account for 65% of unbanked adults.

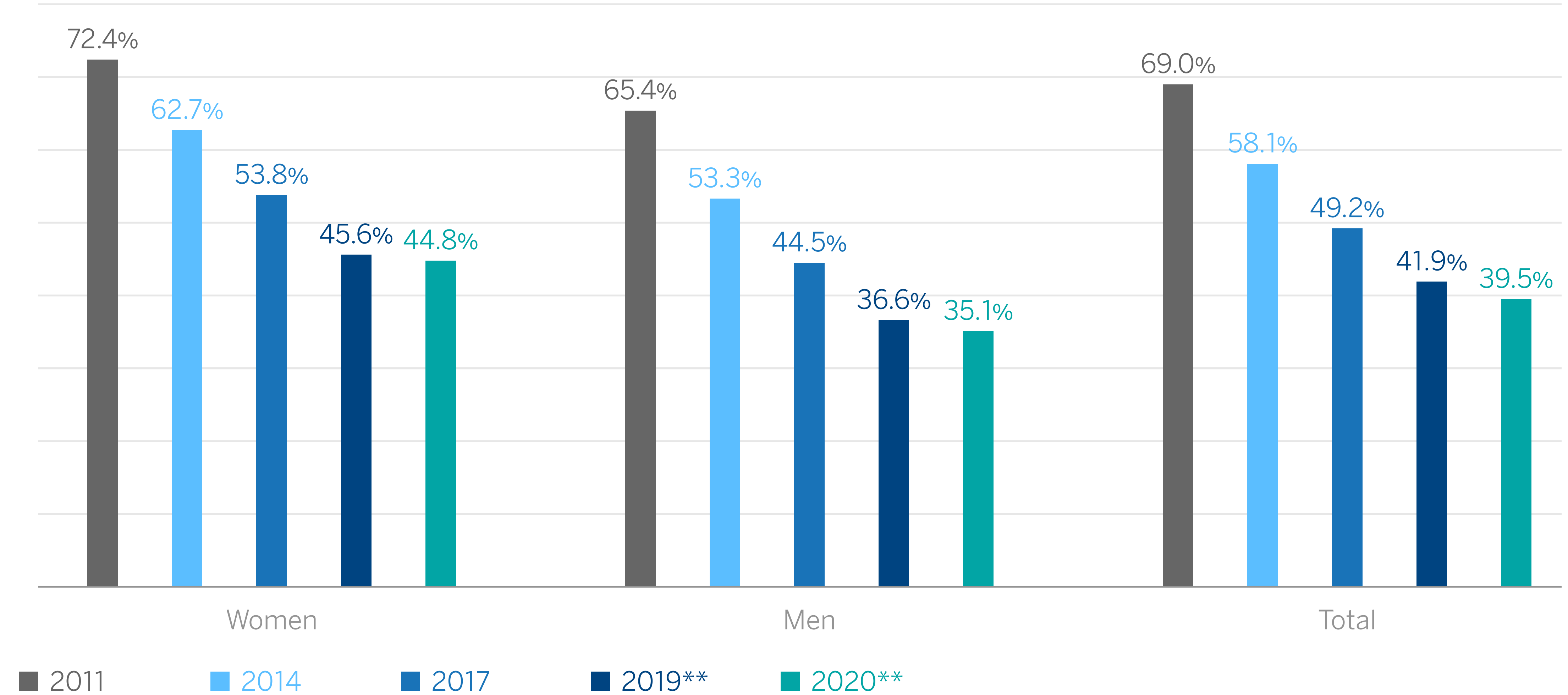
A good part of this segment was included in the financial system for the first time when they opened savings accounts in order to receive these subsidies. The role of the financial system, and microfinance in particular, in helping to route resources to these segments, was crucial.

These policies have also had the effect of governments fast-tracking the development and adoption of digital financial solutions to minimize human interactions and limit the spread of the virus, making regulations more flexible so that bank accounts and mobile accounts can be opened more easily, increasing the number of contactless financial transactions and boosting the take-up of digital payments.

This progress and jump-starts triggered by the pandemic have created the conditions for financial inclusion to move forward faster in the next few years.

Unbanked adults*

% of total +15 years old



It is likely that the pandemic, despite the impact of shutting down activities and curfews, has provided a window of opportunity to go further with financial inclusion

* World Bank Global Findex.

** BBVAMF Research estimate. Calculation BBVAMF.