International Monetary and Financial Committee

Twentieth Meeting
October 4, 2009

Statement by Amado Boudou
Minister of Economy and Public Finance, Argentina

On behalf of Argentina, Bolivia, Chile, Peru, Paraguay, Uruguay

Statement by the Honorable Amado Boudou
Minister of Economy and Public Finance of Argentina
Speaking on behalf of the Southern Cone Countries of Latin America
International Monetary and Financial Committee Meeting
Istanbul - Turkey, October 4, 2009

I. The Global Economy and Financial Markets—Outlook, Risks and Policy Responses

The world economy is expanding again and overall financial conditions have improved markedly. We therefore remain confident that the worst of this global financial crisis is behind us. The unprecedented fiscal, monetary, and financial actions taken in both developed and developing countries have yielded tangible results. The diversity and broad array of our policy responses, anchored in active public intervention, has been vital. A systemic breakdown of the financial system in industrial countries has been averted; countercyclical fiscal policies have bolstered domestic demand; world trade has resumed, and capital flows are once again flowing, thus helping to stabilize global financial conditions.

We claim, however, that the process of recovery and repair remains incomplete, hinging on continuous public support. Despite the fact that prospects vary significantly across regions and individual countries, we underscore that sustaining strong policy responses, strengthening growth, averting the rise in unemployment and facilitating the flow of credit remains of the essence. Indeed, this full-blown financial crisis has exacted an enormous toll in both human and economic terms. As demand continues to largely depend on fiscal stimuli in advanced countries, we believe that a premature exit from accommodative monetary and fiscal policies could hinder the incipient economic recovery. The overarching risk is that the recovery stalls. Both advanced and developing countries must stand ready to support domestic demand through countercyclical policy actions to limit the risk of a protracted recession. It is therefore much too early to declare victory and thus consistent joint action must still be deployed to revive global growth. This is one of the main points on which we must reach a robust agreement.

Above all, we underscore that developing countries are leading the recovery, faring better than advanced economies and turning around with even greater strength. We are indeed better prepared to cope with the challenges of the post-crisis, as we are projected to gather momentum in 2010. This crisis has therefore brought to the fore a new geopolitical order, in which developing countries have become a new source of global growth. In advanced countries, the crisis has severely damaged potential output through multiple channels: protracted increases in unemployment, structural disruptions in the financial system, and declines in capital formation and productivity levels. In contrast, developing countries that have built up current account surpluses, maintained fiscal room, reduced external debt and strengthened their international reserves position during the booming years, have faced this crisis from a position of strength, having room of maneuver for unprecedented countercyclical actions to support domestic demand. Notably, they have averted domestic banking crises and managed sudden-stops in capital flows without jeopardizing macro stability. This is the result of sound macro policies and better regulated

and supervised financial systems. All in all, advanced countries remain vulnerable to deleveraging in mature markets and potential shocks to growth.

Despite the systemic nature of this global crisis, Asia has become the new locomotive of growth, with positive impacts on developing countries as a whole. Efforts to rebalance its export-led growth toward domestic demand began long before the crisis and the benefits are now becoming clear. With a more gradual approach, away from the calls for a rapid appreciation of their domestic currency and far-reaching pro-market liberalization reforms, China has significantly progressed bringing about a sustained increase in domestic demand and private consumption. It is undisputable that fiscal stimulus has played a key role in sustaining demand, but the solid growth and strong rebound could not have been feasible without the ongoing rebalancing. Going forward, avoiding overinvestment, stepping up financial reforms to boost domestic spending, and strengthening social safety nets will cement a robust and inclusive growth.

Latin America has plainly benefited from these new sources of global demand and promising prospects are becoming apparent. Timely and well-targeted countercyclical policy actions, more balanced and inward-looking development strategies, sustained employment and strengthened social protection, increased investment in both tradable and non-tradable sectors, export diversification, rising commodity prices rooted in the turnaround in global economic activity, higher costs of energy and increased biofuel usage, the depreciation of the dollar in real effective terms going forward that will boost competitiveness gains, commodity prices, and greater South-South cooperation, all contribute to a positive outlook for our region. Our banking system is sound and well capitalized and capitals are flowing again. Overall, we are confident that Latin America will soon gather momentum and swiftly resume a sustained growth path.

The true challenge moving forward will be to reduce global development imbalances. Our individual and collective efforts must focus on strengthening development strategies that limit inequalities within and between countries. This crisis highlights the fact that the world growth model was not only unsustainable, but also inequitable. The external imbalances concealed sharp development asymmetries. If the gap between countries widens even further as a result of varying capacities to respond to the crisis, global imbalances and inequalities will intensify. There will be no sustainable future growth unless we rebalance global demand. Greater social inclusion and better income distribution will be key factors in attaining this goal. Far more is at stake than merely increasing domestic consumption in China and/or helping deficit countries to rebalance saving and investment demand while increasing exports. Global imbalances are a symptom, not the source of this crisis. We must avoid viewing global imbalances through the prism of exchange rate adjustments. Greater demand is needed in Africa, Latin America, and Asia, rooted in a more equitable development process, if the world economy is to resume a sustainable growth path. It is now openly acknowledged that advanced countries cannot overcome this crisis alone. There can be no doubt that the contribution of the developing world is vital but this will require a new era of multilateral cooperation and commitment.

Expanding the scope of development financing and avoiding protectionism in response to this crisis are two essential preconditions for sustaining economic growth. First, as developing countries will face large financing gaps, it is crucial to broaden development financing on flexible terms. The International Financial Institutions (IFIs)—including the IMF—must provide timely and adequate support to facilitate this economic transition. Second, developed countries must avoid protectionist measures in trade, finance, investment and labor services. We remain concerned about large domestic and export subsidies included in countercyclical financial packages. Inward-looking solutions and protectionist responses are not the answer. Its impact for developing countries is particularly acute and will derail the prospects of a sustainable recovery. Meeting the real development goals of the Doha Round, while protecting the legitimate rights and aspirations of the developing world in trade and production terms, would be a major step in the right direction. The principle of special and differential treatment for developing countries has yet to be put into practice.

At the same time, greater attention should be paid to the human dimension of this crisis in order to boost the global economy. Two priorities stand out: to protect employment so as to revive demand; and the moral imperative to adequately address the urgent needs of low-income countries.

Unemployment, underemployment, labor instability, and wage deflation are the greatest obstacles to growth. A key policy lesson must be drawn: fiscal packages must now focus on employment and social protection. The International Labour Organization (ILO) states that over 40 million people will lose their jobs this year and that this trend will rise further in 2010, particularly in the advanced countries. To sustain growth in the short term and to ensure an orderly transition from public stimuli to private demand, countercyclical measures must focus more on protecting employment and strengthening social safety nets. So far, emphasis has been placed on bailing out the financial system. The situation has now been stabilized and the banking sector is once again enjoying large profits, but credit flows remain constrained and the real economy has lagged behind. Public concern toward what is perceived as a bail-out for those responsible for the crisis is fueled by the rally in financial markets, still led by past corporate governance practices that pursue excessive risk taking and short-term gains. Thus, the likely shifting of the burden of the financial crisis from capital to labor and the middle classes will only make the crisis worse. We therefore support the Global Pact for Employment proposed by the ILO and we ask that the IFIs pay particular attention to assessing the impact of their policy recommendations on this topic.

Similarly, it remains a moral imperative to give a better and more rapid response to the needs of low-income countries. The long-term consequences of this crisis on poverty, hunger, and malnutrition are undeniable. Approximately 90 million people have been thrown into extreme poverty, with a major negative impact on the poorest countries. The Millennium Development Goals will not be met. The international community and particularly advanced countries—where the crisis originated—must offer greater financial assistance to meet the development needs of the most vulnerable. It is our belief that more needs to be done to support in this regard.

Likewise, greater efforts are required to ensure that the financial system that is emerging from this crisis will be safer. The excesses that led to this crisis still need to be tackled. The too big-to-fail-bank problem has been a critical feature of this global financial crisis. We claim, however, that these problems are now even worse than before the crisis. Part of the profits that the banking sector is now witnessing has come from mergers and acquisitions. Indeed, for some financial conglomerates that have received government financial assistance, assets have increased and have taken over the activities of other banks. In a nutshell, what is emerging is a slightly better capitalised financial sector, but one even more concentrated and benefiting from explicit state guarantees. The need to timely address this issue is undisputable in order to overhaul of financial-industry compensations and strengthen consumer protection. We underscore that stricter oversight of systemically important institutions is important, but will not suffice. We need to limit the size of these institutions and discourage them from growing excessively.

The crisis has created a New World Order under which the role of governments and of multilateral actions has taken on a new meaning. The free market economy paradigm has come to an end, not without immense social and economic consequences for generations to come. This crisis was rooted in the tectonic plates of modern capitalism and globalization, and has derailed the engine of world growth based on consumer excesses, debt, and financial speculation. In the quest for a world economy that is socially and environmentally sustainable, we believe it is essential to make great strides in order to achieve broad and effective regulation of financial markets, to pursue the reform and democratization of IFIs, and to design global agreements to make them more compatible with our development strategies.

Successful efforts to overcome this crisis will rest on coordinated actions and genuine international cooperation. We firmly believe in active, concerted and effective multilateral responses, not in declarations. From the onset of this crisis, our Constituency has underscored the need for a Global Accord for Sustainable Development. We remain convinced that we need to move further in that direction. We particularly value the strategic role of the G20 in promoting concerted and effective actions in the area of regulation, reforms, and countercyclical response measures. Adequate representation of developing countries has been vital to better meet global needs. The era of the G8 as the international Steering Committee is over. This in turn will continue to pave the way for broader concerted action and could prove to be a "bridge" toward more representative and universal representation.

To conclude, the world economy still remains at a critical crossroads. The recovery could prove to be uneven and dependent on policy support. The risks of inaction, complacency or failure to implement deeper and more fundamental reforms are real and could bring with them systemic risks. All countries, albeit with varying responsibilities, must work together to limit the risks of a sluggish, jobless and credit-constrained recovery. Without far-reaching reforms in multiple areas (regulation, financing for development, governance structure of IFIs), the current efforts could fall short of what is needed.

II. The IMF's Post-Crisis Role—A Critical Reform Agenda Lies Ahead

Democratizing the IMF and further reforming its lending and surveillance mandates are indivisible and critical tasks. Today more than ever, we stress that unless the Fund makes further efforts to have a more legitimate basis, its authority and credibility to carry out its mission will be impaired. Broader political backing and enhanced legitimacy will be critical to rebuild the Fund's credibility and strengthen its cooperative nature. We recognize that progress has been made, but claim that more needs to be done in light of the scale and magnitude of this global crisis. We particularly underscore that significant resources have been deployed to support a broad array of countries, while the approval of a general allocation of Special Drawing Rights (SDRs) has been key to avoid the risk of systemic contagion. Nevertheless, the post-crisis challenges are without precedent and in the absence of strategic reforms to the IMF's mandate, functions and governance structure, the collective promises to prevent the recurrence of systemic crises—*never again*—will remain unfulfilled.

To tackle the challenges ahead, the international community must act quickly to provide broad-based contingent financing against shocks. To effectively rebuild the global financial architecture in the post-crisis, the Fund needs to strengthen its crisis-prevention role through a multilateral insurance-type facility available for the vast majority of countries. This crisis has already shown that the global financial system is fragile and unstable, where financial instability in one country can echo around the world, halting economic growth. In a globalized world of capital account instability and free capital flows, developing countries have learned the lesson well from recurrent past crises: the accumulation of current account surpluses and international reserves effectively protect our economies against global shocks. Self-insurance mechanisms through reserve accumulation have been and will continue to be an essential macroeconomic tool. However, this crisis has shown that the provision of liquidity through swap lines has played a key role in containing panic and contagion risks. Notably, half of the Fund's total loanable resources recently provided have been precautionary and allocated through the new Flexible Credit Line to only three countries. Thus, more needs to be done, as this crisis has highlighted the need for very large liquidity buffers to deal with fast and hard-hitting capital market shocks.

Indeed, successful rebalancing to sustain global growth will hinge on innovative actions toward broader financing for development. We need to release both domestic and multilateral resources to close the development and financing gap in the developing world. Multilateral development banks should strengthen financial assistance for countercyclical measures and development purposes. The IMF should review its financial instruments and make them attractive to a wider range of countries, limiting policy conditionality. In a nutshell, the Fund must ensure that it offers credible financing alternatives. A new precautionary facility should be introduced to provide large-scale, longer-term contingent financing which would be available quickly and with certainty. Access to this facility should be based on objective and transparent eligibility criteria. The global benefits would be twofold. From the bilateral perspective, it would avoid excessive accumulation of precautionary foreign exchange reserves, thereby freeing up domestic resources for domestic development. From the multilateral perspective, it would help to rebalance global demand and reduce external imbalances through an orderly readjustment of

exchange rate parities, thus preventing a deeper recession or a resumption of global imbalances. **We therefore support a new approach to contingent financing at the Fund, backed by adequate resources.**

Similarly, we call on the Fund to mobilize SDR resources to support the Fund's lending to the poorest countries with adequate concessionality. Indeed, concessional financing must be expanded for low-income countries by facilitating a voluntary redistribution of the recently approved general SDR allocation. We claim that mobilizing such resources in favor of vulnerable countries will ensure a more efficient and equitable distribution of its benefits. Seeking an active contribution from donor countries to increase the concessional resource envelope or using the windfall profits from the sale of gold are two options that must be further pursued. However, they will likely take time. The most immediate resources are available from the SDR issuance, since the countries that issue reserve currency do not need to increase their liquidity positions. Reflecting country specific circumstances, it is essential to move forward in this regard and to offer supplementary resources to assist low-income countries by significantly increasing their access level to the available revamped facilities. We also call on the Fund to further adapt its lending instruments to these countries' specific needs, by providing emergency budget support and smoothing the impact of aid volatility and aid shocks.

We also underscore that new and ongoing Fund-supported programs should not contain unwarranted procyclical conditionalities. Countries must have the necessary flexibility to implement countercyclical measures and to pursue tailored responses to the crisis. Policy conditionality has proved to be inappropriate in a world loomed by risks of global contagion. We remain concerned regarding the Fund's asymmetric response to this crisis, which was not of the making of developing countries. While experiences at country level have varied significantly, in almost all Fund-supported programs the depth of contraction has been unprecedented, well beyond initial assumptions and projections. In different Program reviews, we have witnessed the same problems: a wider fiscal gap driven by a sharp contraction in revenues—despite unprecedented fiscal restraint—and a very swift current account adjustment exclusively driven by dramatic import compression. Eloquently, both mirrored global contagion and procyclical policy adjustments that created political and social instability. Moreover, the Fund's policy advice has been unequal among groups of countries, allowing advanced economies to borrow and spend their way out of recession while promoting procyclical adjustment in those countries under the Fund's financial assistance. "Double standards" and geopolitical reasons, still reign in the way the Fund does businesses. This must be a unique opportunity to progress with greater reforms, removing conditionality and moving away from the Fund's traditional role as arbiter of "good versus bad" policies over legitimate and sovereign policy decisions at country level. Thus, further revamping the Fund's traditional lending framework remains critical.

Equally, we restate that the Fund's surveillance function must be further reformed. The IMF's surveillance has remained incomplete and weak, mainly because the building blocks of effective surveillance of systemically important advanced countries were lacking while there was neither an agreement nor a means to force the necessary cooperative actions. Thus, surveillance failed to anticipate and provide policy recommendations to guard against

the scale and ultimate impact of the crisis. Vulnerabilities have arisen and mounted in advanced countries, not in developing countries. Financial liberalization and deregulation, the oversized banking sector, the accumulation of bubbles in real and financial assets, the imbalance between savings and investment, and the burgeoning short-term indebtedness in systemically-important advanced countries have generated the worst global crisis in the last 75 years.

Bolder steps must be taken to strengthen the IMF's surveillance with an emphasis on macro-financial stability and attainment of strong and sustainable growth of all members. We underscore the importance of evenhanded and more effective surveillance of systemically important advanced countries and financial markets. The Fund must also ensure that policy responses do not derail growth in developing countries, which currently represent the only source of economic dynamism. Developing countries have not only coped with the impact of the crisis but also with the imbalances promoted by the massive stimulus and bail-out measures introduced in advanced countries in response to their crises**.**

This crisis also brings to the fore a critical aspect of the Fund's bilateral and multilateral surveillance: its cooperative nature. Policy surveillance will only be effective if its members voluntarily adhere to the mutually-developed rules and are in agreement on the smooth functioning of the global economy. New forms of engagement should be considered. Assessing the consistency of such policies in a regional and multilateral context would enable remedial actions to be identified to support global growth. Undoubtedly, the Fund would have to be recognized by all countries as a neutral, even-handed and credible institution. The need for fundamental reforms in its governance structure is undisputable. We are also convinced that emphasis should be placed on reforming this function through a review of the 2007 Decision with due regard to its operational guidance to the staff, strengthening regional and multilateral surveillance offering cross-country perspectives.

In the same way, we underscore that there will be no "new IMF" without a more representative and democratic governance structure. To achieve this goal, the voice and representation of developing countries, including the poorest, must be significantly increased. The Fund will not succeed in its endeavors unless all its members regard it as *their* institution, furthering *their* common interests and *their* strategic goals. Correcting the unfair distribution of quotas and voting power is the most important and urgent governance issue that needs to be tackled.

A realignment of quota share from advanced to developing countries to achieve parity in voting power is a central goal for the next quota review. The G20 Leaders have agreed to increase the quota share of dynamic emerging markets and developing countries by at least 5 percent. This shift must come to under-represented countries using the current quota formula as a basis to work from. We believe that this is a significant step in the right direction. It is worth noting that in the past 33 years the quota share of developing countries has decreased, even after the quota reform of 2008. Indeed, in 1976 the developing countries held 33.2 percent of the Fund's quotas; now they have 32.1 percent and once the 2008 reform comes into effect this will rise to 32.4 percent. Advanced countries have reduced their quota

share in that period from 65.4 percent to 60.5 percent, but the realignment mostly benefited transition economies even at the expense of other developing countries. Latin America and Africa have lost quota share (from 9.6 percent to 7.6 percent and from 6.7 to 4.9 percent, respectively), while Asia's share will rise from 10.2 percent to 12.6 percent once the 2008 reform package takes effect. Meanwhile, developing countries account for 47 percent of World GDP measured in purchasing power parity terms and this proportion will most likely increase in the future in view of the imbalances in industrial economies. Thus, we call on stronger political commitment to shift 7 percent of aggregate quota shares from developed to developing countries.

Going forward, we claim that it is imperative to revisit the quota formula addressing its present deficiencies and bias against developing countries. We agreed to work on the basis of the current formula and in 2008 we also agreed to revisit the formula before using it again. Behind that "compromise solution" was a broad recognition that the way to measure our relative weight in the world economy was flawed. Significant shortcomings, particularly with regard to openness and variability, were explicitly recognized. Indeed, the inclusion of openness in gross value leads to a double counting of cross-border flows and magnifies the resulting measure of economic size already captured in GDP figures. Moreover, intra-currency union flows create an upward bias in gross trade figures exacerbated as the share of this trade in global values has substantially increased over time. Similarly, the current measure of variability does not capture the potential need for Fund resources. Critically, advanced countries account for 60.9 percent of potential demand and their share in openness (66.4 percent) is also to the detriment of developing countries. We also underscore that PPP-GDP must have a greater weight in the quota formula to capture the dynamism of developing countries' contribution to growth. We claim that the redistribution of quotas must not be at the expense of other developing countries using an unreformed quota formula.

To cement fundamental changes in the Fund's governance structure and mandate, the next quota review must at least double the size of the overall quotas. The Fund must remain a quota-based Institution. The temporary increase in resources has boosted the IMF's capacity to meet the financing needs of countries in the wake of the crisis. To help member countries deal with the volatility of international capital flows and global shocks through contingent financing, the Fund must have sufficient permanent resources to reassure members and markets that will be providing credible alternatives. We also claim that there will be greater scope to achieve a shift in shares that keep pace with global economic developments and the competing demands for further representation from developing countries as a whole. Thus, we support a combination of equiproportional increases that favors developing countries to protect their quota share coupled with selective increases using a reformed quota formula.

Finally, reducing the Fund's democratic deficit goes beyond quota realignment. We are in favor of instituting a double majority system as a core democratic voting principle for certain strategic decisions, we support an open selection of Management without predetermined geographic bias, as well as greater academic and geographical diversity of the staff; a strengthened Independent Evaluation Office with capacity to assess current financial programs and the evenhandedness of surveillance of key systemically important countries;

the introduction of a strong accountability framework to assess the performance of both Management and the Executive Board; the strengthening of the International Monetary and Finance Committee based on consensus decisions. All in all, we believe the future of the IMF will depend on its ability to reform itself in order to gain the political support and legitimacy needed to meet the challenges of the new world order.

III. Economic Outlook for the Countries of our Constituency

Argentina has successfully overcome the worst of this international crisis and is very well placed to resume a sustainable growth path going forward. Despite the systemic nature of this global crisis, we expect to end 2009 with modest growth (0.5 percent) due to the rebound in the level of activity in the second half of the year from an increase in consumption, and growth is projected to be at least 2.5 percent for 2010.

The crisis has revealed the resilience, strength and advantages of our macroeconomic policy framework instituted since 2003. If Argentina had not had an economic framework based on a competitive exchange rate and built on strong fiscal and external surpluses coupled with by robust financial buffers and sheer reduction in public external debt, this international crisis would have devastated our country. Indeed, our growth is anchored in robust social and productive basis and generates its own internal resources of financing, boosting domestic demand through higher wages and a strengthened social safety net. The economy has slowed down given the slump in trade, the contraction in private investment, and the drop in commodity prices, but we have applied countercyclical policies which have cushioned the negative effects on employment, consumption, and the level of activity. The role of the government has been crucial in sustaining domestic demand, increasing public investment in infrastructure and energy. Active labor policies aimed at protecting jobs and prevent wage deflation, and active financing and incomes policies were deployed to support the real economy while protecting the most vulnerable members of the population. The banking and financial system is sound and well-capitalized, with very low levels of both non-performing loans and dollarization which substantially reduce exchange rate risks. International reserves continue to be at high levels and the managed floating exchange rate policy, together with active monetary policy, has been very effective in promoting macroeconomic stability against a backdrop of high international volatility.

Argentina is exhibiting a broad array of strengths. These include a significant volume of international reserves (US$45,100 million, excluding SDR allocations, equivalent to almost 10 months of imports); a significant trade surplus (US$14,127 million in 2009) which will continue into the future and will represent a unique source of liquidity in foreign currency for the country; a competitive multilateral exchange rate which helps to support our domestic production; a solvent fiscal position which is sustainable over the long term (with a projected primary surplus of 1.36 percent of GDP for 2009 and 2.29 percent for 2010), thereby enabling the government to regularly meet its public debt commitments in a year of major international disbursements; a sustained level of economic activity and domestic consumption, with specific problems in certain sectors, which are, however, not at all widespread; a steady level of employment supported by active labor and income policies; and a financial system with high liquidity and no solvency problems. All this, combined with

significant improvements in agricultural output after the worst drought in recent years, and the clear upturn in international commodity prices, places Argentina in a position of strength going forward.

The core of our strategy has been to support a continued robust and inclusive growth. A key priority has been and will continue to be to boost domestic demand and ensure employment and social protection. Real direct investment of the public sector increased at an annual rate of 82.4 percent during the first half of this year, with a sharp rise in investment in infrastructure. Two thermal power stations were opened, housing improvements were made under the FONAVI (National Housing Fund) Federal Housing Program, the National 700 Schools Program was continued (Programa Nacional '700 Escuelas'), and the Drinking and Waste Water Expansion Program (Plan de Expansión de Agua Potable y Cloacas) was developed. The Productive Recovery Program (Programa de Recuperación Productiva – REPRO) which aims to help distressed enterprises and to support the level of employment was also implemented. To protect the most vulnerable members of the population, a rise in the minimum variable basic wage (*salario mínimo, vital y móvil*) to Arg$1,500 a month as of January 2010 has been approved. Another highlight is the significant improvement in the coverage and benefits provided by the social security system, which now covers 5.5 million beneficiaries, with a sharp increase in the average pension (*haber medio*). Expenditure on social security in 2008 was 6.2 percent of GDP, compared with 5.3 percent in 2002. Alongside this, various stimulus measures were launched to boost consumer credit and investment, combined with incentive and financing policies for small and medium-sized enterprises and corporate working capital in general.

Counter-cyclical monetary and financial policies implemented by the Central Bank have also played a key role in ensuring macro-financial stability. For the first time in decades, the Central Bank has built liquidity networks in national and foreign currency, allowing the monetary-financial system to act as a shock absorber of this crisis. The developed scheme includes four fundamental pillars: (i) robust monetary policy which ensures the equilibrium between supply and demand in the money market; (ii) counter-cyclical policies, including the accumulation of International Reserves to buttress liquidity needs; (iii) a managed floating exchange rate regime and (iv) a well-regulated and supervised financial system, allowing the monetary and financial system to mitigate shocks to the real economy. In addition, the scheme does not have inconsistencies which threaten its sustainability. Therefore, the Central Bank has firmly reacted to normalize money demand and stabilize foreign exchange markets. The crisis has brought to the fore the ability of the Central Bank to act as a lender of last resort. Hence, both banking deposits and credits have been raised, while interest rates remain stable.

To strengthen the benefits of our macroeconomic policy framework, bolstering a sustained and inclusive growth, solid productivity gains and even high levels of investment, Argentina is moving toward re-entering the international financial markets. The success of recent domestic debt refinancing has allowed significant fiscal savings and substantially reduced financing needs going forward. Country risk has significantly decreased in connection with the strong demand for local bonds, while stock market indices are recording unprecedented gains. The Central Bank of the Argentine

Republic continues to take advantage of the improved domestic and external climate to purchase dollars on the foreign exchange market and further strengthen international reserves. Against this background, firm measures are being taken in both the official and the private sectors to build on the achievements of our economic model. We firmly believe that 2010, the year of our Bicentenary, will open up renewed opportunities for a sustainable growth rooted on robust social and economic bases.

Bolivia will continue to follow its model for state-led economic development. The government strategy aims to reach sustained growth with a more equal income distribution, relying partly on the nationalized sectors (hydrocarbons and telecommunications) and a significant expansion of public investment. The authorities are confident that the growth rate for 2009 will be above 4 percent, surpassing the IMF's projections, as the economy is being stimulated decisively, seeking job creation to further reduce poverty. The macroeconomic policy has managed to partially isolate the country from the international effects of the crisis, providing confidence about economic stability. The Bolivian economy has rebounded during the second quarter of 2009 reaching 3.1 percent growth from 2.1 percent during the first three months of the year, even though relevant commodity prices for Bolivia are recuperating slowly. The prospects for 2010 have now significantly increased.

The Bolivian government plans to use public spending as an economic boost amid adverse external conditions which have affected fiscal revenue. Fortunately, the significant surplus achieved in the past three years is allowing the authorities room to retain the level of public spending and maintain social programs, which are crucial for protecting the poor from the damaging effects of the international financial crisis. Bolivia expects its fiscal revenue to average a still-strong 44 percent of GDP in 2009, and total spending is forecast to average around 45 percent of GDP, similar to 2008. The government has planned public investment to reach US$ 1.8 billion in 2009 (around 9.8 percent of GDP), largely financed by fiscal savings. Public investment will be even greater given that the state oil company has started to implement a billion-dollar investment, financed by a loan from the Central Bank of Bolivia. Public hydrocarbons investment will spill over into 2010 and an increase in private investment is also envisaged.

Monetary policy in Bolivia is moderately expanding to facilitate a countercyclical approach, while carefully monitoring inflation, which is projected to be around 3 percent by the end of 2009. The Central Bank will continue to use the crawling peg regime for the exchange rate, maintaining it around its equilibrium level in real terms. The exchange rate policy is supported by a very strong level of international reserves (around 50 percent of GDP) and a declining domestic inflation. At the same time, this policy is promoting the de-dollarisation of banking deposits and anchoring inflation expectations.

Bolivia's current-account surplus of 2009 will be smaller but still positive, as demand and prices for natural gas exports remain subdued. On the other hand, metal prices and exports are showing a positive recovery, and the prospects for international trade are encouraging, as global economy is rebounding. In the same vein, remittances to Bolivia are projected to recover by the end of 2009 and further still in 2010. As a result, international reserves are continuing to grow, which is a positive sign vis-à-vis the trend of the balance of payments.

In **Chile**, output contracted 3.3 percent in the first half of 2009, as a continuation of the sharp slump of the last quarter of 2008, as a result of the large impact on expectations and confidence due to the drastic worsening of the global scenario by the end of last year. The global downturn also implied falls in the value of exports stemming from marked reductions in export prices. Thus, inventory accumulation, house sales, and imports of durables have all fallen sharply. The tightening of credit conditions and postponements of investment projects have affected industrial output and construction (although this sector has been less affected by the crisis than in previous episodes), while lower oil prices and improved hydrological conditions have provided some cost relief in terms of energy costs. In line with these developments, unemployment has risen slightly above 10 percent due mostly to a significant contraction in employment until earlier this year.

In light of these developments, the Central Bank of Chile (BCCh) has lowered the output growth forecasts for 2009 and a contraction of between –2.0 and –1.5 is expected for 2009. This downward revision shows the materialization of downside risks previously assessed, due to a more significant impact of the global recession. In the baseline scenario, however, the growth forecast for 2010 lies between 4.5 and 5.5, as growth appeared to resume in the second half of 2009 in response to the significant monetary and fiscal stimuli already underway and the recovery in confidence. The recent evolution of several indicators point to a recovery in consumption and investment, trade flows, the stock market, as well as increases in commodity prices. As a result, the negative consequences of the uncertainty of end 2008 on confidence of consumers and businesses are gradually fading. The main downside risks going forward are related to the possibility of a renewed weakening of global growth, with an impact on emerging economies, commodity prices and a protracted situation of global uncertainty.

Over most of 2008, annual CPI inflation increased steadily, reaching a peak of 9.9 percent in October. However, the marked and synchronized downturn in the world economy during the fourth quarter triggered a significant shift in the inflation path towards a rapid and steady decline. As a result, inflation decelerated rapidly in the first eight months of 2009 as annual CPI inflation reached –1.0 percent in August. Given that the output gap is expected to remain negative for some time, CPI inflation is expected to remain below the target range in the second half of 2009, converging back to 3 percent by 2010. In line with these developments, the BCCh revised downward its inflation forecast to –0.8 percent for year-on-year inflation by end December 2009, and to 1.7 percent for average inflation in 2009.

The change in the expected path for inflation warranted a shift in monetary policy towards a significant easing of the monetary policy stance. Therefore, since January of 2009, the BCCh has aggressively lowered the monetary policy interest rate, slashing the policy rate by a cumulative 775 basis points, bringing it to a level of 0.5 percent in July 2009. Such aggressive monetary stimulus is unprecedented under the existing inflation targeting framework in terms of both the speed of adjustment and the level of the policy rates. It also reflects the authorities' view that a sizeable monetary stimulus was needed to secure the attainment of the inflation target over the policy horizon. In its Monetary Policy Meeting in July, the BCCh also noted that the level of 0.5 percent for the monetary policy rate should be considered the lower bound for the policy rate, and highlighted that given the inflation

forecast and the need to maintain monetary stimulus for some time, the policy rate will remain at this lower bound for an extended period of time. In the current baseline scenario the monetary stimulus should start to be withdrawn by the second quarter of next year. In order to reinforce recent monetary policy decisions, and to align the prices of financial assets with the current monetary policy stance, the BCCh has implemented a term liquidity facility, (Facilidad de Liquidez a Plazo, FLAP), providing funding to banks at the current policy rate for terms of 90 and 180 days. The BCCh has noted that these measures will remain in place as long as needed, and that these complementary measures need to be coherent with the overall stance of monetary policy.

In terms of fiscal policy, given the significant change in the macroeconomic conditions in the fourth quarter of 2008, the government implemented decisive countercyclical policy responses under the structural budget rule on three fronts: a Fiscal Stimulus Plan to support economic activity and employment; a Pro-Credit Plan to secure the flow of credit to businesses and individuals in the lower phase of the economic cycle; and the Pro-employment Employment Accord to mitigate the impact of the cycle on employment. These measures reflect a diversified fiscal policy response that focused on temporary measures to provide the largest impact on demand in the short term. The Fiscal Stimulus Plan was announced in early January, with a size equivalent to 2.8 percent of GDP (USD 4 billion) with the purpose of supporting economic activity and employment. The plan included direct transfers to families and individuals, an increase in public investment of up to USD 700 million, recapitalization of Codelco by USD 1 billion to support its investment plan, tax reductions and other incentives for private investment, strengthening small and medium-sized enterprise (SME) access to funding, and measures to protect employment. Such increase in spending stems from larger structural income, derived from the exchange depreciation relative to the level envisaged originally in the budget and from a reduction in the structural surplus target on a temporary basis from 0.5 percent of GDP to 0 percent of GDP.

The Pro-Credit Plan was announced in March 2009. It included 20 measures to stimulate the provision of credit by banks as well as non-banking financial institutions, to promote competition in the financial system, and to widen the scope of available funding alternatives. The pro-credit plan involves three broad dimensions: support to micro-entrepreneurs; measures to facilitate access to bank funding, and measures to facilitate access to non-bank funding. The overall impact of the pro-credit plan was to generate an additional USD 3.6 billion in new credit to the private sector, which complements the previous government initiatives including a USD 500 million capital injection to Banco Estado, the state-owned bank, to spur lending to SMEs by up to USD 2.6 billion, and also to increase the Small Enterprise Guarantee Fund by USD 130 million, to a total of USD 200 million.

The Pro-Employment Accord is a tri-partite temporary agreement between employers, employees and the government which translates into six specific measures that would benefit a total of 130,000 workers. This program benefits the employers as it increases the productivity of its employees, alleviates the cost of firing and the adjustment cost once the recovery is in place, and also the employees, as the increase in their human capital allows for better expectations in terms of wages and better skills to improve the prospects of finding employment. All the measures included in the Accord were approved by Congress in record

time. Additional measures include increased transfers to four million low-income households, bringing forward the benefits of the Pension Reform, the establishment of an insurance plan to cover the mortgage payments of those families whose heads of household loses his or her job, and the expansion of the New Millennium Scholarship Program. All of these measures implied an additional government spending of USD 330 million in 2009.

Given the size and scope of the countercyclical fiscal policy measures, public expenditure is expected to grow 14.5 percent in real terms. This represents an increase with respect to what was initially projected in the Budget Law (5.7 percent). Therefore, a fiscal deficit of 4.1 percent of GDP is projected for 2009. This is 1.2 percentage points higher than what was projected in January. The difference in the projection arises from 0.2 percent of GDP of increased spending and 1.0 percent of GDP of lower revenues. Such deficit is the natural outcome of the decisive countercyclical fiscal policy, whose very own definition is to incur deficits during years of contraction of the global economy and to accumulate surpluses in booming years. In the first semester of 2009, the fiscal deficit attained was equivalent to 2.6 percent of GDP, which is in line with the expected 4.1 percent for the year. Having saved the surpluses derived from the windfall gains in the price of copper of previous years, the Sovereign Wealth Funds have provided plenty of fiscal room for the government to implement countercyclical fiscal policy under current circumstances, as funding of the fiscal stimulus plan will come from the Economic and Social Stabilization Fund. Therefore, the government announced that it would withdraw an equivalent of USD 8 billion from the ESSF and, in order to conduct the foreign exchange operation, the Ministry of Finance instructed the BCCh, as a Fiscal Agent, to conduct a program of competitive bids for the sale of USD on a daily basis since March 2009. The government has also announced that as part of its financing strategy for 2009, it will issue USD 1.7 billion in the 5-year and 10-year domestic bond markets.

Moving to structural reforms, the government will send a bill to reform capital markets (Capital Markets III – MKIII) to Congress, with the aim to improve the overall competitiveness of the Chilean financial system to make Chile a financial services exporting country and to promote market access for SMEs by improving the channels and financial instruments through which they can access capital markets. The agenda promotes foreign investor participation in domestic markets, the use of the CLP as a fully internationally traded currency, and increases the depth and liquidity of domestic financial markets by improving information and increasing the supply of securities available.

After five consecutive years of strong economic performance, the **Paraguayan** economy is expected to contract in 2009, mainly due to lower agricultural output as a consequence of adverse climatic conditions and the global economic crisis. GDP contracted by 4.2 percent in the first half of 2009. However, there are emerging signs of recovery for 2010, with GDP growing at 4 percent. This projection is based on a rebound in export commodity prices, good prospects for agricultural production, and a general improvement of the global economy. Certain signs of improvement, such as declining interest rates (specifically for corporate loans) and the economic impulse of several infrastructure projects implemented by the government, are already present.

The implementation of appropriate counter cyclical policies while securing the hard-earned macroeconomic stability was the authorities' main focus to address the economic downturn. The weak domestic demand was helped by the fiscal stimulus driven by the effective implementation of the 2009 budget in the context of the Economic Recovery Plan. Recent data shows an upturn in private consumption, specifically in the second quarter, following the government trend in expenditures. Central and local government expenditures have increased since August 2009, and are expected to continue to grow throughout next year. Public investment and well-targeted social programs are the focal points of the draft 2010 budget sent to Congress. Despite the projected budget deficit of 1.5 percent of GDP, fiscal policy seeks a balanced income and spending flows to reassure a sustainable mid-term fiscal position.

The Central Bank has continued with monetary policies focused on maintaining price stability and avoiding a stall in credit supply by providing adequate liquidity to financial institutions. The 12-month growth rate of inflation reached 1.6 percent in August and it is projected to end the year between 2.5 and 3 percent, close to the lower limit of the Central Bank referential range. The banking system remains healthy and stable, supported by quantitative easing measures issued by the monetary authorities and the strengthening of prudential regulations and supervisory practices. The main financial indicators show a continued expansion of credits and deposits, although at a lower rate than last year's figures, with a reduced ratio of non-performing loans and increased profitability.

The external position is outstanding, with international reserves amounting to $3.5 billion, equivalent to 5 months of imports. This record level was reached after recent increases coming from the general SDR allocation and loan disbursements from the World Bank and the Inter-American Development Bank, providing the country a firm standing to confront possible external shocks. The flexible exchange rate contributed to a smooth appreciation of the *guaraní* currency resulting from increased foreign exchange inflows.

Regarding the structural reform agenda, there was significant progress in budget implementation and tax revenue administration. Moreover, the authorities are striving for an ambitious public investment program to overcome shortcomings in infrastructure. The government has recently sent a draft law to strengthen the financial position of the Central Bank to Congress, providing the resources to better implement its monetary policy. These steps are only a sample of the Paraguayan authorities' commitment to pursue further reforms to reach a more sustainable economic growth with the final objective to reduce poverty and inequalities.

The **Peruvian** economy grew 0.3 percent in the first half of 2009, even though real exports and domestic demand decreased by 2.8 and 3.2 percent respectively, due to a deteriorating international environment. However, employment and consumption have not decreased and the financial system remains healthy. As in other economies, deceleration in domestic demand has mainly been the result of a drop in investment associated with a large inventory drawdown.

After the collapse of Lehman Brothers, monetary policy aimed at preserving adequate liquidity and avoiding a credit crunch. Since February 2009, the Central Bank has reduced its policy rate by 525 points, thus creating more favorable monetary and credit conditions. Complementary measures, such as reducing reserve requirements and introducing new monetary injection instruments, have successfully supported the loosening of liquidity conditions. At the same time, the government implemented fiscal stimulus measures to ease the impact of the crisis and accelerate public investment. The plan includes improvements in infrastructure, direct stimulus programs, and social protection in support of the most vulnerable segments of the population.

Based on mounting signs of recovery, growth in the second half of 2009 is now forecast at 3.2 percent.

In **Uruguay,** amidst the international crisis, and with a slowdown in its economic activity (bearing in mind the country's average growth rate of about 7 percent between 2004-08), in the second quarter of 2009 Uruguay was already able to exhibit an increase in its real GDP. Considering the year as a whole, this variable will end 2009 with a positive change, which, unfortunately, is not a common outcome around the world under the current global recession. Consistently, investment has continued to show a noteworthy dynamic; unemployment has reached historic low levels; poverty rates have continued to decline; and, although higher than originally expected, especially due to a severe drought, the fiscal deficit is relatively low and fully manageable under the current policies. Furthermore, the financial system has maintained a remarkable soundness, and Uruguay was recently able to issue US$ 500 million bonds in the international markets under very favorable conditions (it is noteworthy that the demand for Uruguayan bonds under this operation was more than five times the cited amount, which, once again, demonstrates investor confidence in the country). Evidently, all the above-referred developments are the result of policies and structural reforms implemented in recent years, as well as critical intangible assets Uruguay has been able to establish in its history, such as the country's solid tradition of honoring commitments and developing sound institutions and governance, among others. Fiscal policies have successfully aimed both to drastically reduce the debt-to-GDP ratio and substantially improve social conditions, goals that are not contradictory but synergetic. Meanwhile, following a few cuts as a response to the eruption of the international crisis, some days ago the Central Bank decided to leave interest rates unchanged, signaling once again the Central Bank's commitment to its overriding objective of maintaining low and stable inflation rates and expectations (which, although close to its upper limit, are already within the authorities' target range). It would be possible to point out many structural reforms undertaken in the last few years, including those regarding the revenue administration, the tax system, the administration of public debt, the autonomy of the Central Bank, the regulation and supervision of the financial sector, the establishment of a bank resolution framework, etc. Nonetheless, perhaps the reform that best reflects the government's highest priorities is the *Plan Ceibal*. This plan, through which one laptop, with internet access, was provided to every child in public schools, along with other related plans that are being developed, constitute critical pillars to boosting knowledge, further inserting Uruguay into the global economy, attaining higher and sustainable growth rates, equalizing opportunities for the whole population, and improving social conditions.