International Monetary and Financial Committee

Seventeenth Meeting
April 12, 2008

Statement by Martín Lousteau
Minister of Economy and Production, Argentina
On behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

Statement by the Honorable Martín Lousteau
Minister of Economy and Production of Argentina
Speaking on behalf of the Southern Cone Countries of Latin America
International Monetary and Financial Committee Meeting
Washington, D.C., April 12, 2008

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

1. **We meet at a time of unprecedented turmoil in global financial markets and greater uncertainty about economic prospects in advanced countries.** We are facing a combination of a large financial dislocation, a recession in the U.S., coupled with a lagged but protracted deceleration in growth in other advanced economies, and inflationary pressures, mostly but not exclusively, in Emerging Markets.

2. **This financial crisis is rooted in lenient monetary policies and unbridled financial innovation.** Since 2001, liquidity has grown spectacularly, hand-in-hand with an apparently contained inflation. The proven ability of central bankers to target low inflation and the vertiginous financial innovation in the U.S., purportedly explained why markets could absorb so much liquidity without any apparent consequence. With the benefit of hindsight, we now know that three gross assessment errors were contaminating the analysis. First, it was wrong to find comfort in low Consumer Price Inflation (CPI), disregarding asset inflation. Second, if CPI was tamed this was not because central bankers had proven to be effective inflation targeters, so went the argument, but thanks to the massive change in the world's labor endowment that followed the integration into the global economy of China, India, and other emerging markets. Third, financial innovation was indeed recycling liquidity rapidly into the U.S. market, but also concealing risks from investors, borrowers and regulators.

3. **The deflationary pressures brought by the integration of China, India, and other emerging markets into the global supply of products and services seem to be over**. This massive change in the world's labor endowment resulted in low consumption prices and low wages.[1] This first deflationary impulse now seems to be partially offset by rising salaries in China and other emerging economies that are rapidly increasing global aggregate demand. Food and energy supplies cannot cope with the pace of this increase.

4. **This crisis is very distinct and we may need to navigate in uncharted waters**. Against the background of the global current account imbalances, foreigners appear to be increasingly reluctant to finance the U.S. deficit. This time, financial flows were not

---

[1] Immigration, the potential re-location of factories and production facilities and EU enlargement could have also played an important role; see William White, Globalization and the Determinants of Domestic Inflation. BIS Working Paper, No 250, March 2008.

irresponsibly channeled into sovereign borrowers' pockets who ultimately found themselves in a fiscal trap; but into the United States itself. Thus, this is a crisis rooted at the core of the engine of global growth and it is rapidly undermining confidence on the (still) main reserve asset currency.

5. **A significant element in the present turmoil is the re-concentration of credit risk onto banks' balance sheets from off-balance sheet entities they had constructed**. This has amplified the uncertainty about the distribution of losses, the unforeseen linkages between certain types of risks and the size of the exposures to underlying credit problems relative to banks' capital base. As a result, it is likely that more substantial losses may need to be recognized in the near future, exposing a more severe insolvency problem that cannot be resolved by easing monetary conditions.

6. **There is a serious chance of a recession in the U.S. economy.** There was very little growth in the last quarter of 2007 and we may now be close to the zero line of growth. Construction of new homes and property sales are close to 50 percent of their peak and household wealth is seriously contracting. Investment banks and hedge funds are being forced to sell their triple "A" assets to meet their debts and this has prompted the Fed to inject liquidity and to buy time. Recently, the Fed took one more step by extending its lending to investment banks and accepting securitized papers as collateral. This may further undermine confidence in the U.S. dollar and eventually require a tightening of monetary policy. It goes without saying that such a move could worsen the recession. We believe that the situation requires the government's decisive action to prevent unnecessary foreclosures. Public intervention could be a win-win situation for both lenders and borrowers.[2] We support the U.S. Congress' decision to launch additional discretionary fiscal stimulus to curb the strengths of recessionary forces. The more targeted on families with higher marginal consumption propensity, the more effective fiscal stimulus will be.

7. **In the Euro area, growth prospects are deteriorating**. In our view, the risk of recession should not be underplayed. The European downturn could take longer than the U.S. to run its course, but it will probably last longer, particularly if the ECB keeps delaying a relaxation in monetary policy. In fact, borrowing costs for consumers and companies have already jumped as banks ran up losses on investments tied to U.S. mortgages. Further losses in the banking and financial system could soon be disclosed, impairing bank lending, and hitting the European corporate sector in particular. On the one hand, deflation of housing booms could also add to the downside risks. On the other hand, persistent inflation and budget deficits may prevent policy makers from moving aggressively to stall the vicious circle of mounting financial losses and recession. In this context, the constant appreciation of the Euro is a serious threat.

---

[2] We do not agree with those who argue that the sub-prime market crisis is indicating that money was lent to non-credit-worthy families. Rather, what it is indicating is that security originators were luring those families to buy over-priced assets and that the "innovative" financial products in which mortgages were bundled were over-rated and risk was conceived in a labyrinth of financial layers.

8. **Emerging and developing countries look healthy**. This phenomenon is explained by structural macroeconomic changes and a sound institutional and policy environment. Growth in south-south trade flows, together with strong fiscal policies and managed exchange-rate floating policies to avoid over-appreciation of local currencies, were crucial to foster sustainable growth and diversified exports. Naturally, this does not imply that large current account surpluses are desirable for the world economy. It would be a great help if at this juncture countries with large current account surpluses could step-up additional exchange rate flexibility, together with active income distribution policies to boost their domestic consumption.

9. **However, emerging and developing countries are not immune.** Admittedly, the effects of the financial crisis can be transmitted to emerging markets**.** Despite their build up of international reserves and significant lower public debt, integrated financial markets will affect the capacity for emerging market corporations to tap credit and stock markets for financing. On the other hand, a reduction in interest rates in advanced economies may result in more carry-trade into emerging markets, adding pressure on exchange rates, reducing competitiveness and employment.

10. **Raising interest rates will not help to curb food prices.** CPI has increased mostly due to the significant weight of food in emerging and developing countries' consumption baskets. The rise in food prices reflects stronger demand, changes in nutrition habits and bio-fuel developments. In parallel, prices in industrial goods and services have remained relatively contained. In our view, higher food prices are part of a re-alignment of relative prices that does not warrant strengthening monetary policy.

11. **A combination of accommodative monetary policies with strong fiscal policies and prudential capital regulations could suit emerging markets**. In our view, the drop in global demand, following the deceleration of global growth, will in itself prevent the materialization of second-round effects. Moreover, increasing domestic interest rates while the U.S. (and hopefully the ECB) reduces them, will only attract more short-term capital into emerging markets, fuelling liquidity, inflationary pressures, and weakening growth.

A Role for the Fund

12. **Uncoordinated policy responses may not suffice.** We face a vicious circle, where fears of financial collapse, economic recession and inflation retroact. So far we have not seen much coordination in policy responses. Some appear to be more concerned about inflation, while others focus on growth. In the U.S., the Fed has reduced its policy rate by three points while Japan and the EU have left their rates unchanged and some other central banks have had to raise interest rates to hit their inflation targets. The already large difference between U.S. interest rates and those in other countries is having serious consequences on the exchange rate market and poses a serious risk. This may increase short-term capital flows into emerging markets, mounting pressure on their local currencies, increasing liquidity and inflationary pressures and eventually compromising growth in those that are still keeping the global economy afloat.

Moreover, if the U.S. dollar continues to lose ground, the Fed will eventually be forced to raise interest rates, thus sending the global economy into recession.

13. **There is little room for market-driven adjustments.** A better regulatory coverage is necessary, together with better instituted monitor systems to add transparency, discipline and discourage financial institutions from the possibility of discharging from their balance sheets all risk embodied in securities they originate. In addition, Chinese walls should be built between security originators and credit rating agencies to avoid advanced consultations that result in new products tailored for a convenient rating. There is also considerable room for a better articulation of monetary operations lending in greater maturities under more harmonized collaterals.

14. **The Fund and the G-20 should team up to promote consistent policy responses**. Ideally, the Fund could re-convey the multilateral consultation process, albeit with a larger set of participants. However, given that this does not seem to be feasible since there is not sufficient political will for reconvening that process, we believe that the G-20 should take the leadership in this matter and that the Fund is uniquely placed to provide intellectual support. In parallel, the Fund should reinforce its bilateral surveillance on advanced economies and speed-up the creation of a new contingency line as the current differential between interest rates in advanced and emerging markets may enlarge, and this, in turn, could increase short-term capital flows and with them volatility. Finally, the Fund should help to shore up the efforts to conclude the Doha Round successfully. Higher agricultural commodity prices make protection less necessary and create a window of opportunity for bold reductions in tariffs and subsidies. This would lead to win-win results for all trading partners.

II. The IMF Reform Process

15. **After lengthy discussions, we are asked to vote on a reform package that will in itself not redress the Fund's governance structure.** It could only be seen as very modest first step in the right direction as the incoming quota increases will raise the representation of some dynamic emerging market economies. However, it has no credible calculation of members' potential need to borrow and it does not include a clear commitment to purse this reform by periodic quota adjustments de-linked from future liquidity needs.

16. **Without a firm political commitment to capture dynamism as it happens, this reform will be short-lived.** Two thirds of the world economy's growth in the last five years came from emerging and developing countries. Fast growing economies will see their quotas in the Fund eroding rapidly and the text submitted for our approval does not ensure that periodic quota adjustments will be forthcoming.

17. **This reform may freeze status-quo for a long time**. The reform fails to include a work program to revamp the Fund's governance structure. As the Fund is less into the business of lending and more into the business of supervising economies and preserving financial stability,

its governance structure should evolve. In a lending institution, it is reasonable that the more money a member puts into it, the more influence (i.e., votes) it has on its decisions. However, this logic does not bode well in a supervisory and regulatory institution where all members are equal in rights and obligations. The Fund's governance structure is prepared for its lending role, but it is totally unfit for its progressively more important supervisory and regulatory role. We think that it would be appropriate for the Executive Board to use a double majority system (of weighted votes and members) to adopt policy decisions; particularly those that are not strictly related to the use of Fund resources. We will continue to make the case for a meaningful reform of the Fund's governance structure.

18. **Bringing "normal" access from 300 to 500 percent of quotas is both warranted and desirable.** The amount of financing that the Fund is ready to provide to emerging markets and developing countries should be concomitant to their needs. Exceptional access, namely that over 300 percent of quotas, is anything but usual business. In 2003-04, arguably the last period in which the Fund had to provide meaningful assistance to members, approximately 80 percent of financial support was provided on an "exceptional" basis. Needless to say, that "exceptional" access comes at exceptional financial and political costs. This is prompting members to rely more on their capacity to accumulate reserves than in the Fund's ability to provide opportune, affordable and reliable financial support.

19. **Equally important for the legitimacy of the Fund is to put its finance on a sound footing, ensuring that the shortfall will be filled by both income and expenditure measures.** We commend the Managing Director's efforts in this sense. We broadly agree with an expenditure cut of US$ 100 million in the proposed time frame. This shows that the Fund is prepared to live-up to the austerity it has so often preached. However, we caution that cutting country representation in Executive Directors' offices will imperil the capacity of developing countries to participate in the business of the Fund. Poor countries do not have teams of public servants following the Fund's business from capitals, but they very much rely on their representatives at the Board. Undercutting their capacity to be represented in the Fund would go against the interests of a truly multilateral institution. We are hopeful that the Fund will be able to craft a sound and comprehensive package of reforms for congressional approval, as the odds of it being approved by legislators is related to its balanced nature.

20. **Creating a new contingency line would bring double dividends.** On the one hand, it would help emerging markets to be better prepared to face the potential volatility that could hit them in this crisis. On the other hand, it would improve the Fund's finances. Creating an authentic insurance-like facility that could emulate the lender-of-last resort functions of central banks would also help the Fund recover some effectiveness.

III. Outlook for Countries in Our Constituency

21. **Argentina's economy recorded yet another year of exceptional growth.** In 2007 the economy grew by 8.7 percent, accumulating five years of sustained growth. This performance is

noteworthy: it is the first time in more than 100 years of the country's history that the economy has grown for five straight years at an annual rate above 4 percent. GDP is expected to rise again in 2008 by more than 7 percent, despite the international financial crisis, striking the sixth consecutive year of economic expansion.

22. **Increased investment and private consumption are driving growth**. Investment is growing above the general economic activity level, led by higher expenditure in producers' durable equipment. It is at high historical levels —23 percent of GDP at constant prices, mainly financed by domestic savings, hence with reduced exposure to external flow volatility.

23. **Unlike past experiences, strong growth is this time bolstered by current account and fiscal surpluses.** These twin surpluses, together with a consistent and prudent monetary policy are cushioning the economy from external shocks while ensuring that the strong recovery of domestic consumption remains sustainable.

24. **Strong fiscal performance and foreign reserve accumulation have sheltered the economy from financial turbulences.** On the one hand, Argentina's government is forecasting a primary surplus of 3.2 percent of GDP for 2008, but it has the necessary tools to increase that figure depending on the economic developments in the international and domestic spheres. On the other hand, the Central Bank has increased its foreign reserves, which are now over 50 billion US dollars. This has proved to be a very persuasive argument to discourage speculative moves against the currency.

25. **The current account will remain positive for the seventh consecutive year**, mainly sustained by the goods trade balance, which is expected to be in the positive territory, at 3.4 percent of GDP. Exports are expected to hit a new record high in 2008, more than USD 60 billion, and the current account balance is expected to be close to 2 percent of GDP. This is an unprecedented event since, historically, growth in Argentina has come together with current account deficits.

26. **A managed floating regime and a strict compliance with the monetary program have been crucial in buffering volatility, while shoring up competitive gains.** A distinctive feature of the Argentine Economy in the past 35 years has been the presence of sharp and recurrent incidents of economic instability. The managed floating of the exchange rate has helped to overcome the volatility-memory embodied in the Argentinean society, while avoiding a free "exchange risk insurance" as in previous experiences. The Central Bank has also been strictly complying with its quarterly targets for monetary aggregates by pursuing an aggressive sterilization strategy in a context of a strong balance sheet that yields positive results. As a consequence, money supply is consistently growing below the growth of nominal GDP, which shows the prudential bias of our approach.

27. **The public debt stock as a percentage of GDP fell from 140 percent in 2003 to 56 percent at the end of 2007.** Equally important is the lengthening of the maturity of the debt and

the lower interest rate. The government will continue its debt-reduction policy, borrowing in financial markets within a general downtrend in the debt-to-GDP ratio.

28. **The unemployment rate is hovering around one-digit levels (7.5 percent), after having reached 24 percent five years ago.** In parallel, wages have continued to increase due to higher labor demand. The increase in employment, real wage recovery in a context of strong growth in labor productivity, and the government's income policies have made it possible to substantially reduce poverty levels and extreme poverty: from a poverty rate high of 57.5 percent and an extreme poverty high of 27.5 percent during the crisis, the most recent figures from 2007 put the poverty rate at 23.4 percent and the extreme poverty rate at 8.2 percent, respectively. Income distribution indicators also improved. The top-decile to bottom-decile ratio edged down from 32 at the beginning of 2004 to 26 in first quarter of 2007.

29. **Strong commodity prices come at a cost**. Food prices have a heavy weight in the CPI of developing countries, increase inflationary pressures, and have a negative impact on the real income of the most vulnerable population. This has revamped the traditional tension in Argentina's economic history, characterized by the existing dilemma between competitive and equity demands. This also calls for economic authorities to intervene in a responsible way to ensure the protection of every citizen's interest and welfare, especially those of the most vulnerable sectors of the population.

30. **Cementing a sustainable growth process will require increasing the level of investment and productivity.** At this stage, the government is involved in direct dialogue with different sectors of the industry to identify short and medium-term challenges to improve competitiveness. At the same time, it has taken further actions to broaden access for small and medium enterprises to long-term financing under favorable conditions.

31. **Bolivia**'s main economic indicators have continued to show improvement even though real GDP growth for 2007 was slightly lower than in 2006, because of extensive flooding which occurred in March that caused an estimated $500 million in damage. The growth rate in 2008 will also be affected by the severe climate conditions experimented in February and March. The Bolivian authorities have declared the lowlands as national disaster zone and authorized the allocation of 1 percent of the National Public Budget to Prefectures and municipalities to assist the emergency. They also announced that the Ministry of Planning for Development will elaborate a Reconstruction and Rehabilitation National Plan.

32. **The situation regarding balance of payments and international reserves has continued to evolve positively.** Fiscal data for 2007 show that the non-financial public sector accounts remained in surplus although smaller, due to greater public investment for enhancing infrastructure and social expenditure. The only major economic indicator that has recently worsened has been inflation, which rose from 4.3 percent in 2006 to 11.7 percent by the end-2007. This is related to supply shocks as well as imported inflation and expectations. Supply shocks are probably the main inflation drivers since the floods and droughts caused by "El Nino"

notably affected agriculture and, consequently, strong pressure on food prices has emerged. Increasing international food prices also affected domestic inflation in this conjuncture. The surge in expectations played a major role in Bolivia's current inflation rate. This is a very sensitive issue given that Bolivia went through hyperinflation in 1985. Expansion of the country's international reserve holdings along with greater public investment, higher employment, and increased remittances boosted domestic demand. However, the uptick in inflation does not threaten to derail the current economic expansion.

33. **The Central Bank has sought to combat inflation absorbing excess domestic liquidity** arising from strong foreign exchange inflows through open market operations and domestic currency appreciation, while containing increases in commercial lending rates as banking credit to the private sector is slow to pick up.

34. **Fixed investment growth will accelerate further in 2008**, sustained by a recovery in private investments in oil and gas, following higher public investment in infrastructure and an announcement by Petrobras (the Brazilian oil company) that it will resume investments in Bolivia. The Bolivian government will continue to promote the creation of new state-owned companies. Projects include the opening of three new manufacturing companies to produce milk products, sheet glass, and edible vegetable oils. The U.S. House of Representatives agreed on February 15 to extend existing trade benefits for Bolivia for ten months, until end-2008. Extension of the Andean Trade-Promotion and Drug-Eradication Act (ATPDEA), which provides duty-free access to U.S. markets for over 6,000 Bolivian products.

35. **Stronger than previously anticipated economic deceleration in the U.S., will have a small negative impact on Bolivia's export performance**. However, this will be partly offset by firm growth in Brazil, which is Bolivia's main trading partner and will only be moderately affected by the U.S. slowdown.

36. **Progress in reducing poverty has accelerated but there is still much to be done.** In this regard, revenue distribution is an issue. Indeed, much of the economic growth has been in the hydrocarbons sector, which accounts for only about 2 percent of employment. In order for this increased revenue to have more of an impact on poverty, the government would have to use this revenue. As the increase in the fiscal surplus indicates, most of it has not been spent. One reason is that the national government does not control a good part of these revenues, which under current law belong to departmental and municipal authorities. The Bolivian economy has shown considerable progress on most indicators over the past two years. The government has begun a number of initiatives to address the needs of the poor, but other structural changes (including land reform), faster growth, the reduction of regional disparities, and an accelerated diversification of the economy away from hydrocarbons and minerals are the medium-to-long-term development challenges facing the economy.

37. **In Chile, output grew 5.1 percent in 2007, broadly in line with potential output, but with a considerable weakening over the second half of the year**. This result reflected the still

favorable external environment, a more expansionary fiscal policy, and an overall supportive monetary policy. Growth was broadly based, with the communications, construction, and retail sectors exhibiting high growth, in contrast with the contraction of the electric, gas, and water sectors, given the lesser availability of hydrological resources coupled with ongoing restrictions in the imports of natural gas and higher prices of oil. This last issue also affected industrial activity. Domestic demand grew 7.8 percent mostly because of the continued consumption dynamism, as well as improved investment dynamism relative to previous years, as evidenced by the higher investment in machinery and equipment and construction. The still favorable credit conditions and a firmer labor market sustained consumption growth.

38. **Going forward, at the beginning of 2008, output growth was expected to be between 4½ and 5½ percent for this year, with the balance of risks tilted to the downside**. The latter is due to a less favorable external environment stemming from the slowdown in the world economy, the ongoing financial crisis and the uncertainties associated with it, a slower domestic demand due to a less dynamic consumption in a context of lower real income, less favorable credit conditions, and potentially weaker conditions in labor markets. In January, the main downside risks were related to how the credit crisis in financial markets would impact emerging economies, which include the possibility of a recession in the U.S., the persistence of the uncertainties in commodity prices, particularly oil, the possibility of a large correction in the price of copper, and less favorable global financial conditions overall. Prospects for output growth reveal that the downside risks have increased, although domestic demand continues to grow.

39. **During the second half of 2007, inflation exhibited a significant acceleration,** as CPI inflation reached 7.8 percent year-on-year in December 2007, well above the upper limit of the 3 ± 1 percent target. In the first quarter of 2008, annual CPI inflation has continued to rise, reaching 8.1 percent in February, however within expectations. Such increase in inflation resulted from exogenous supply shocks, including a jump in global food prices and unusually cold weather conditions affecting the prices of domestic food items, both of which have proved to be deeper and more persistent than initially anticipated, as well as increases in energy costs and disruptions in energy supply. In line with these developments, core inflation measures and other inflation trend indicators have also remained above the 3 percent target level. However, the growth rate of wages has changed slightly after the increases observed in mid-2007. The exchange rate has appreciated significantly since December of 2007, in part reflecting the weakness of the U.S. dollar, as well as the improved price of copper and the increased interest rate differential with the U.S., due to the aggressive interest rate cuts that the Federal Reserve has conducted in 2008. Even though short-term inflation expectations have increased, medium- and long-term inflation expectations have remained well anchored; this is coherent with the ongoing transitory increase in inflation.

40. **CPI inflation is expected to remain above the upper limit of the target range during 2008**, because of recent increases in oil prices, lagged adjustment in electric tariffs, since some indexed prices will have significant upward adjustments, and due to drought effects on fruit and

vegetable prices. However, the peso appreciation and fiscal measures to reduce the impact of high oil prices on the domestic gasoline prices should mitigate the risk of excessive propagation of supply shocks to underlying price pressures. CPI inflation is expected to gradually move down toward the target range in the second half of 2008, converging to 3 percent in 2009. In line with these developments, and in order to ensure inflation convergence to 3 percent in the policy horizon, the Central Bank has raised the monetary policy interest rate by 125 basis points since mid-2007, bringing it to 6.25 percent in January. In its latest meetings of February and March, interest rates were left unchanged due to the likely disinflationary impact of the significant strengthening of the currency. Moreover, the Central Bank's Board maintains that further changes will be dependent on incoming information and its implications for the inflation forecast.

41. **In the implementation of the structural budget rule and due to continuing high copper prices, in 2007 the Chilean central government posted an overall surplus of 8.8 percent of GDP**, with a real increase of 12.1 percent in revenues, while public expenditure grew 8.3 percent in real terms in the same period. For 2008, the fiscal surplus is expected to reach 4.8 percent of GDP. In order to manage windfall revenues prudently and in consistence with the Fiscal Responsibility Law, the Chilean government has continued saving the surpluses into the Economic and Social Stabilization Fund, which up until January 2008 has accumulated USD14.9 billion equivalent to 9 percent of 2007 GDP. Surpluses have also been saved into the Pension Reserve Fund, with USD 1.5 billion equivalent to 0.9 percent of 2007 GDP. At the same time, the Fiscal Responsibility Law allows the government to use its surplus to recapitalize the Central Bank, and payments totaling USD 736 million were made during 2007. The 2008 Budget –the first constructed under the new structural surplus target of ½ percent of GDP– prioritizes social spending in health, education, innovation, and social housing. It focuses on the execution and quality of public expenditure.

42. In light of the recent increase in oil prices in international markets, **the government has taken measures to alleviate its impact on inflation and the overall level of economic activity**. Thus, in January 2008 the government submitted a bill to Congress destined to provide an additional injection of USD 200 million to the Fuel Prices Stabilization Fund. In March 2008, the government sent another bill to the Congress to reduce the excise tax on gasoline by 25 percent for the next 2 years, until March 2010. Congress approved both measures, and consumer prices reduced significantly in relation to observed prices at the end of 2007. These measures should also help to facilitate the convergence of inflation to its target.

43. In January 2008, **Congress approved the pension system reform according to the original time frame envisaged by the government**. The executive branch is now working on the reform implementation, which includes changes in investment regulation and the creation of the infrastructure needed to pay the benefits approved by the law. With regard to the labor market and social equity issues, in December 2007, President Bachelet announced the creation of a Presidential Advisory Council on Labor and Equity. The objective of this council is to discuss and make policy proposals to contribute to improve equity in the different aspects of the labor

market. The final report and policy recommendations are expected to be concluded in the second quarter of 2008.

44. **Moving to structural reforms, the government has continued working on initiatives aimed to boost competitiveness and investment**, facilitating entrepreneurship, globalizing the domestic financial markets, further enhancing trade integration, improving government effectiveness, fostering innovation and human capital, and addressing the country's expanding energy needs. In March, the government announced that it will issue bonds in the domestic markets up to USD 1.2 billion through the recently created Office of Public Debt. The purpose of this debt issuance is to provide additional liquidity to the local fixed income markets, as well as to establish benchmark securities to foster the development of the domestic financial market. It will be the first time that a 30-year bond is issued by the Chilean Treasury. These issuances are also in line with the government's efforts to improve the competitiveness of the exports sector. By providing funding in local currency, the authorities are avoiding the need to liquidate the U.S. dollar in the local currency markets and in turn, they are alleviating the pressure on the exchange rate. Regarding the improvement of corporate governance of public enterprises –in line with the best international practices–, President Bachelet announced that the government would submit a bill to the Congress on this matter by the first week of April.

45. **The Paraguayan economy is continuing to expand and the growth rate in 2007 reached 6.4 percent of GDP, the highest in 25 years.** As a result, GDP per capita improved by 4.5 percent. Strong exports, improved productivity in the agricultural sector, high commodity prices and the strong performance of the service sector were the main conditions that led the economy to these positive outcomes. Last year, the *guaraní* currency appreciated by more than 10 percent against the U.S. dollar and international reserves have accumulated to record levels, almost 21 percent of GDP. Inflation was 6 percent, significantly less than the 12.5 percent at the end of 2006. Undoubtedly, these results have placed the country in a favorable position to confront possible external shocks as a consequence of the global economic slowdown.

46. **The monetary policy under the Fund-supported program was cautious and very dynamic during 2007**. The Central Bank was committed to construing a predictable monetary policy by increasing short-term interest rates to contain inflationary pressures, but not as much to allow carry-over differentials. For the fifth consecutive year, the fiscal position registered a surplus, indicating that public finances have been consolidated. The financial system continues its pace of restructuring, with well-capitalized banks, expanded operations and improved risk management, revealed by low non-performing loans ratios and high profits. The structural reform agenda for 2008 includes further improving the efficiency and productivity of public enterprises, which requires the adoption of business plans and result-oriented contracts for the five largest companies.

47. **Looking forward, the global economic environment for 2008 is challenging, but the domestic outlook remains positive**. The government is committed to pursuing fiscal and

monetary policies to consolidate macroeconomic gains and to further deepen structural reforms, with the aim to leave a solid economic foundation to the incoming administration.

48. **The Peruvian economy continues to expand vigorously**. Supported by the sound macroeconomic policies implemented over the past several years, Peru grew by a solid 9 percent in 2007. The authorities foresee a somewhat lower increase in 2008, consistent with the deteriorating global outlook, but continuing dynamism in domestic demand and productivity gains would sustain growth. In particular, the investment rate, and thus the country's productive potential, is rising steadily. Peru's strong external position, healthy public finances, and diminishing debt burden provide adequate buffers against exogenous shocks. The government is committed to the economic program under the precautionary Stand-By Arrangement approved in January 2007, which aims at securing the macroeconomic gains achieved so far, implementing an effective poverty alleviation strategy, moving ahead with growth-enhancing reforms, and diminishing financial vulnerabilities. After achieving a significant fiscal surplus of 3.1 percent in 2007, the authorities will seek to address pressing social and infrastructure needs in a way consistent with the targets established in the Fiscal Responsibility Law and with a declining path for the public-debt-to-GDP ratio. In this regard, they will continue to improve the quality of public spending and strengthen the effectiveness of the tax system. The main fiscal reform plans include establishing a framework for Public-Private Partnerships, introducing a Single Treasury Account, using the recently enacted regime for the rationalization of tax incentives to expand the tax base, and pressing forward with poverty reduction on the basis of the government's work to enhance and consolidate social programs.

49. **Concerning monetary policy, in recent months the authorities have faced significant inflationary pressures originated by soaring international fuel and food prices.** Twelve-month inflation in March rose to around 5 percent, above the target of 2 percent plus/minus a 1 percent tolerance margin established in 2007. Consistent with its commitment to price stability, the Central Bank responded by increasing the policy interest rate and banks' reserve requirements. Inflation is thus expected to converge gradually towards the target range by the end of the year. Due to strong fundamentals, booming exports, and increased portfolio movements, the Peruvian sol has been appreciating considerably against the U.S. dollar, around 12 percent in the 12 months to end-March. In this context, interventions in the foreign exchange market have been oriented to smoothing volatility, without committing to any specific exchange rate, and to building reserves. As of February 2008, international reserves were close to five times the short-term debt. In the financial sector, the authorities intend to continue to improve regulation and supervision to limit exchange rate-related risks, and to take steps to further develop capital markets. In order to take full advantage of the U.S.-Peru free-trade agreement approved in December 2007, the government will persist in their efforts to enhance competitiveness and improve the business climate. Finally, in recognition of strong growth, fiscal discipline, and a declining debt burden, early this month Peru was granted an investment grade by a major credit rating agency. The upgrade will further facilitate access to international financing and foster investment, thus reinforcing sustainable growth.

50. **Uruguay is showing an impressive economic performance.** Economic activity is exhibiting a strong and broad-based growth. Private consumption is robust, foreign direct investment —and investment in general— presents unprecedented figures for the country, while exports of goods and services continue to reach record levels, being highly diversified in products and market terms. Obviously, robust activity has been key for Uruguay to attain its lowest unemployment rates in more than a decade.

51. **Nonetheless, economic growth and even a substantial decrease in unemployment would not be enough to achieve the government's ambitious social targets**. These goals are being met with the critical contribution of the successful social policies implemented with the objective of withdrawing people from extreme social conditions, while increasing social expenditures, namely education and health, which undoubtedly have effects on future growth and social development. It is worth underlining that social policies have been undertaken without putting the sound fiscal position at risk. Uruguay's long-standing reputation as a country in which the rule of the law prevails, together with the authorities' debt strategy, have resulted in a significant increase in the maturity of debt and a substantial decrease in its cost. Precisely, the reduction in interest payments, as well as the implementation of critical fiscal reforms, and the accomplishment of efficiency gains stemming from the government's fiscal budget have led to achieving the current fiscal position, whilst leaving a fiscal space for the needed social expenditure.

52. **Meanwhile, as in many countries, imported inflation has pushed up domestic prices, but the authorities' determined fiscal and monetary measures have been able to bring down inflation expectations**, demonstrating once again their strong commitment to a low inflation. In summary, high and sustainable growth, market diversification, a good investment climate, inflation in check, an appropriate level of official reserves, a sound fiscal position, a much more resilient financial system, structural reforms aimed at improving institutions, and transparent and well-targeted social policies constitute the pillars on which the country is based to be fully prepared to withstand the current global economic situation. Looking forward, as noted by the authorities, reinforcing these achievements and policies is key to continue strengthening economic and social stability as a necessary condition for Uruguay's further development.