



**International Monetary and
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**Statement by Jose De Gregorio
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Chile**

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

Statement by the Honorable José De Gregorio
Governor of the Central Bank of Chile
Speaking on behalf of the Southern Cone Countries of Latin America
International Monetary and Financial Committee Meeting
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I. The Global Economy and Financial Markets—Outlook, Risks and Policy Responses

Up to now, the global recovery has been better than expected, but still far from self-sustaining. Highly accommodative monetary and fiscal policies in response to the deep downturn have been instrumental in securing the recovery, even though economic activity has been picking up unevenly across countries and regions, and near-term risks remain generally tilted to the downside.

Risks to global financial stability have eased relative to the recent past, but global financial stability remains elusive. There has effectively been a shift in the source of vulnerabilities, from concerns about the balance sheets of private financial institutions toward concerns over the sustainability of sovereigns' balance sheets. Therefore, there is a clear need for credible fiscal consolidation plans, prudent debt management, coupled with structural reforms designed to avert an adverse feedback to the banking systems and another round of financial turmoil.

Moreover, the momentum for implementing much needed financial sector reforms should not be lost in the flurry of the short term upswing in economic and financial conditions. Communication and dialogue are needed so that the several initiatives currently underway for the implementation of new capital and liquidity regulation and improvements in the resolution of failed institutions move swiftly and consistently. At the same time, the international community should be ready to promote mechanisms that reduce the systemic risks arising from the settlement of derivatives and revise the regulatory structure so as to mitigate perverse conflicts of interest in the financial industry. Central banks are likely to increase their role in several of these areas, in which case they should be given clear and proper legal instruments and mandate. Transparency and accountability should remain at the core of the conduct of these central bank policies.

It is evident that macroeconomic policy coordination, between fiscal and monetary authorities and across advanced and emerging economies, will be critical going forward. In major advanced economies, the timing and magnitude of the unwinding of monetary policy accommodation must be gauged carefully. The timing for the phasing out of exceptional credit, liability insurance and liquidity facilities as well as for the resolution of the fiscal fragilities inherited from the crisis will need to be considered. In emerging economies, particularly those showing most buoyancy, the challenge is to maintain the hard-won achievement of price stability, thus shifting monetary and fiscal stimulus to a more neutral stance, while avoiding the buildup of financial fragilities arising from excessive capital inflows, such as asset price bubbles and excessive appreciation of the currencies. Exchange rate flexibility is part of the policy mix, but it must be consistent with long-term trends in real

exchange rates in each specific economy. Other complementary measures that directly affect the inflows of capital should be carefully designed, limiting implementation costs and avoiding new distortions. In the past, in many circumstances, capital controls were used as substitutes for sound macroeconomic policies, leading to weaknesses in the external and fiscal position of those economies. It should also be recognized that their effectiveness is severely impaired in economies with a high degree of international financial integration.

II. The Role of the IMF— Future Mandate and Governance Reforms

It is against this backdrop of lingering macroeconomic risks, financial and banking reform initiatives, and the challenge of international policy coordination, that the current and future role of the Fund must be considered. The Fund should remain a quota-based institution, so as to be a relevant counterpart in all the issues under discussion. The Fund is in a unique position to improve the understanding of macro-financial linkages, filling data gaps, tracking cross-border exposures and improving the traction of policy recommendations. However, to avoid duplicity of efforts between the IMF and other relevant counterparties, a clear and effective relationship between the Fund and the FSB is called for.

We welcome in general the progress attained so far in terms of reviewing the areas of surveillance and lending instruments, and look forward to further progress on the issue of the functioning of the international monetary system. However, none of these ongoing efforts will be fruitful if the future mandate is not coupled with clear improvements in the governance structure that can increase the Fund's legitimacy. These issues will be considered below.

Cooperation and collective action is needed to ensure that global financial tensions do not stump economic recovery, and thus we welcome the role the Fund is playing in the G-20 Mutual Assessment Process. In our view, this process provides the basis of a framework for evaluating the global consistency of monetary, fiscal and exchange-rate policies implemented in different economic areas. This is no easy task, but, unavoidably, it is at the core of what could be a multilateral surveillance process. We believe, however, that given that the IMFC and the Fund are fully global institutions, they should be important fora for considering these global policy concerns. We welcome the fact that the IMFC is being informed of the MAP, and we look forward to its progress. A decision on multilateral surveillance could be the way to establish a formal framework under which the Fund's advice is provided to the G20.

Financial sector surveillance has to be a permanent element of the Fund's surveillance mandate, and the FSAP should be the vehicle to do it. The current crisis has also proven that surveillance of the financial sector is of utmost importance, given the interlinkages and cross-border exposures of the financial systems in different countries. Therefore, the Fund should move ahead in obtaining adequate data to assess spillovers through global financial networks and their implications for macro-financial stability. Such efforts should result in the availability of timely data on debt, derivatives, foreign exchange market exposures, and cross-border bank exposures, with adequate aggregation so as to protect confidentiality. Access to more financial data should facilitate the use of FSAPs and their updates as the right

vehicle to conduct financial sector surveillance, and the proposal to make the FSAP stability module a mandatory part of surveillance for members with systemically important financial systems is warranted.

The proposals to reform the lending role of the Fund are still at an early stage and we look forward for further work on these matters in the near future. Regarding its future financing role, and given the significant increase in resources available to the Fund, we welcome the staff's preliminary proposals for broadening and diversifying the available lending instruments through improved access to the FCL, the creation of Precautionary Credit Lines and Multi-country Swap Lines.

However, we must bear in mind that the availability of new Fund lending facilities will not necessarily trigger changes in exchange rate and reserve policies of member countries. On the one hand, exchange rate policies are broader in scope and objectives. On the other hand, the avoidance of real exchange rate overvaluation as a crisis prevention mechanism is an important dimension that is not necessarily dealt with FCL-type instruments. Indeed, it could be the case that these instruments actually incite the buildup of asset or exchange rate bubbles, due to moral hazard arguments. In this regard, reserve accumulation does not only play the role of self-insurance, but also of limiting excessive exchange rate volatility in exceptional circumstances. Therefore, when the costs of reserve accumulation are compared to cheaper insurance provided by precautionary facilities, a full assessment of the macro effects of both alternatives should be thoroughly taken into account.

We welcome the Fund's progress in implementing reforms to lending facilities and financing for low-income countries. We warmly support future debt relief initiatives to low-income member countries hit by catastrophic natural disasters. On Governance Reform, the 14th Review of the Quota has to be concluded within the envisaged deadline. Although the current quota formula is a basis to work from, we believe changes in the quota should not compromise meeting the deadline. As has been the case in the past, future quota reviews should revisit the definition of the variables and their weights so that the quota formula enhances its credibility as a rules-based criterion for future revisions of voting shares.

In any case, the proposed shift in quota shares will prove to be a challenge. We see the spirit of the October 2009 IMFC proposal as implying that the share of dynamic EMDCs should be increased by at least 5 percent as a group, with the larger shifts to the most underrepresented dynamic EMDCs. Ad-hoc increases could be a way to implement the proportionality criterion we already mentioned. Dynamism of an economy is hard to define, but we believe it should be understood as significant growth prospects and performance over time, which is not properly captured in the current quota formula. Moreover, the size of the Fund should be reviewed so as to update quota resources in line with recent developments in the world economy, so we support a significant increase in the Fund's quota resources by at least doubling them. An increase in the size of the Fund in addition to the expanded NAB would, in our view, send a clear signal that the Fund has adequate resources to support its members under a broad range of scenarios.

We strongly endorse proposals to modernize the Fund's Governance Structure and this aspect should move swiftly. Reform should move toward an improved accountability framework for the IMFC so that the political and technical decisions underlying the Fund's work are strengthened. Enhancing the legitimacy and representativeness of the IMFC is naturally in line with increased accountability. One of the key reforms to support the Fund's legitimacy relies on the need to have in place a process for the selection of the Managing Director that is open, transparent, and merit-based, without considerations of nationality or gender.

Further and more innovative governance reforms could be explored in the future. For a long time the international community has discussed how to make central banks more effective in pursuing macroeconomic stability and how to improve the governance of corporations. Both areas offer lessons for the reform of the IMF governance. Central banks ought to be independent from political influences, while governors of central banks as well as directors of corporations should represent the interests of all the countries and all shareholders, respectively. In contrast, executive directors at the IMF represent the interests of particular constituencies. The Board should become in the medium to long term, more independent and accountable, and representative of all members of the Fund. A first step towards these goals would be to move to an all-elected board.

We reiterate that as the IMF is a global institution, it should strengthen its role as a major forum for discussing macroeconomic and financial stability, and for this reason it is necessary to improve governance to increase its legitimacy and effectiveness.

III. Economic Outlook for the Countries of our Constituency

Argentina has come out stronger from this global financial crisis and clear positive economic prospects lie ahead. Notwithstanding the worst global economic crisis in recent memory, the severe drought that upset our country in 2009—which negatively affected 32 percent of agricultural exports in terms of quantity—and the impact of H1N1 flu, Argentina ended 2009 with modest positive growth (0.9 percent). We expect a very dynamic economic performance in 2010 fueled by domestic demand and improved external conditions, with growth rate in the range of 3.5 to 5 percent tilted to the upside.

We have started the crisis from a position of strength and successfully weathered multiple external shocks through timely and forceful policy responses. This is indeed the result of our sound macroeconomic policy framework implemented since 2003, based on a socially inclusive development strategy capable of generating its own internal resources of financing through continuous external and fiscal surpluses. This has laid solid foundations for sustainable growth, protecting our economy from a past pattern of repeated boom –and–boost pattern that depended on increased flows of external financing that proved to be unsustainable. A sound macroeconomic financing of domestic consumption and investment has been coupled with an unprecedented dis-indebtedness process in tandem with a robust international reserve accumulation. Accordingly, in a manner without parallel in our recent economic history, we have successfully deployed strong countercyclical policy actions that have safeguarded domestic demand, bolstered employment, and protected the most vulnerable members of our population.

Indeed, sizable countercyclical policies pursued since end-2008 have effectively strengthened domestic demand, employment, and social equity. Fiscal stimulus will continue throughout 2010 in accordance to our development strategy and in line with our G-20 commitments. The package of fiscal measures reached 4.7 percent of GDP in 2009, a historically unprecedented level designed to stifle successive external shocks. With a sound and well-functioning domestic banking system, the entire stimulus was channeled into the productive sector, protecting employment and stepping up poverty reduction efforts. We succeeded. Public investment played a central role, with a 46 percent increase in 2009 focused on the provision of economic and social infrastructure. The Federal Solidarity Fund (*Fondo Federal Solidario*), established through the collection of 30 percent on exports of soy complex, has been intended to build schools, homes, drinking water processing plants, and drinking water networks. In addition, significant improvements were made to FONAVI (National Housing Fund); 1,000 new schools were built, and the Drinking Water and Sewerage Expansion Plan was continued. Regarding energy infrastructure, two thermal power stations came on-stream; the Atucha II Nuclear Power Plant is being completed; tenders were opened in the bidding proceedings for the Condor Cliff—La Barrancosa hydropower complex which will generate over 1,700 MW, or 10 percent of the electric power generated in 2009; and Patagonia joined the national interconnected electric grid. The Productive Recovery Program (*Programa de Recuperación Productiva (REPRO)*) got under way; the purpose of REPRO is to help distressed enterprises by providing direct support to different industries in an effort to maintain employment levels and preserve jobs. All in all,

this global financial crisis has brought to the fore something Argentina has already learnt throughout its history: the crucial role played by public intervention –role of the State- in developing a sustained and inclusive economic cycle. We firmly believe that increased employment is the best policy for building continuous social cohesion. Accordingly, the government has launched a number of programs to boost credit for investment and consumption, combined with incentives and financing policies for SMEs, in addition to working capital in general. This is the ‘internal debt’ that the government is committed to fulfill.

In the context of this global crisis, we have launched the Universal Child Allowance Program, strengthened other social programs as well as the Social Security System as key components of Argentina’s social safety net. We envisage these actions as key steps for fostering a more inclusive society and enhancing distributional fairness. The Universal Child Allowance Program is having an unprecedented direct and wide-ranging impact on poverty levels. It benefits workers in the informal sector, the unemployed, and workers in domestic service who have children younger than 18 years of age, providing coverage for 3.5 million vulnerable children. This is a carefully targeted program for social protection, conditional to continuous access to health and education services. The government has budgeted 8 billion pesos (USD 2.05 billion) under this program. Likewise, the social security system has also increased its coverage (6.5 million beneficiaries) and the government has consistently advocated a policy of pension mobility to ensure its increased purchasing power. Social insurance spending thus reached 7.37 percent of GDP in 2009, compared with 5.3 percent of GDP in 2002. Social spending on non-contributory pensions, food security, and households has also been increased. Expenditure on education has risen by over 30 percent to turn out at 6 percent of GDP in line with the Education Law. President Fernández de Kirchner recently announced a program to distribute laptops for secondary school students, which will also have a major beneficial impact on public education. Finally, health spending has also been raised in an effort to prevent H1N1 flu and dengue fever.

In the last seven years, Argentina has accomplished an unprecedented structural transformation that is here to stay. 2010 is the year of our Bicentennial anniversary and we can proudly celebrate that we have cemented our economic independence as never before in our recent history. We have been able to freely determine our own policies and define the path of our future founded on strong economic and social basis. We have therefore transcended our own past. We have overcome this external crisis and strengthened our policy framework focused on broad-based productive and socially inclusive development, fostering regional integration, ensuring solvent, liquid and well-regulated banking system, and completing a substantial debt reduction supported by sizable international reserves. As an undisputable outcome, we have consistently recorded sustainable growth and improved social indicators. Certainly, we have learnt the harsh lessons from our own crisis in 2001. We know that if we had followed the recommendations traditionally made by IFIs—which have favored opening our economies, foreign indebtedness, financial liberalization and ‘unbeatable’ market-oriented reforms-the outcome would have been totally different and today we would have been embroiled in a fresh economic, social, and political crisis. Therefore, we celebrate today our well gained economic independence.

Reinforcing Argentina's dis-indebtedness process reigns in our policy agenda. Building on the progress made since 2003, the government has created the Argentine Debt Reduction Fund, aimed to meet public debt maturing this year with private debt holders and IFIs. This has been possible thanks to the substantial accumulation of international reserves followed since 2003 (these reserves have quintupled since 2002 and currently exceed USD 47.96 billion—equivalent to over 15 months of imports), supported by continuous current account surpluses. In 2009, despite the international crisis, our trade surplus has been strong (USD 18.62 billion) and we are convinced that a high surplus is expected this year. The goal is to channel this owned domestic saving in a meaningful way so as to lower rates for the public and private sector and thereby further support investment, growth, and job creation in a post-crisis world still loomed by uncertainty and capital instability. These renewed dis-indebtedness efforts will help strengthen the pillars of our economy, will enhance the macroeconomic financing of investment (funded with domestic resources) and bolster the effectiveness of our monetary and exchange rate policies vis-à-vis a sound and well-capitalized banking system.

With that aim, Argentina has recently announced a debt restructuring process replicating the exchange offer put forward in 2005. We are convinced that the success of this process will help turn the page of a sad phase of our recent past history (the 2001 default declared by the government of that time). Tellingly, in the last three decades, Argentina underwent debt restructuring operations subject to severe fiscal constraints, requiring continuous refinancing efforts at higher rates that only masked critical fiscal sustainability problems. Today, the situation is entirely different. We are committed to enduring twin surpluses that proves our ability and willingness to meet our obligations—as we have been doing it since 2005-. Hence, this debt swap is not a refinancing operation; it will further strength our policy framework and enhance our potential growth.

To conclude, Argentina is well placed to tackle the challenges of this post-crisis world anchored in the structural transformation that our economy has undergone since 2003. We can celebrate our Bicentennial anniversary confident that good prospects lie ahead. As a lesson from past crises, we have learnt that no country may legitimately claim its place in the world economy without sustainable growth, without broad-based social basis and without meaningful job creation. Our government has put Argentina back on its feet and has restored our country's potential for economic, human, and social development. Strengthening and building upon these achievements will be our main goal going forward.

By the end of 2009 **Bolivia** showed a very good performance. In fact, growth was around 3.5 percent, the highest among the Latin American countries. Inflation was at 0.23 percent, the lowest since 2002 and there were twin surpluses: fiscal and current account. The fiscal surplus ended up around 0.1 percent and the current account was close to 6 percent of GDP. The international reserves kept on growing amidst the global crisis and reached the record level of USD 8.8 billion, USD 1 billion greater than the level in 2008. In 2009 the financial position showed a creditor stance while the external debt is quite sustainable. The Central Bank decreased its domestic debt by USD 0.7 billion and the financial system is robust as its assets are expanding. In addition, dedollarization continued as expectations about devaluation disappeared, as a result of the sound exchange rate policy. This performance is a

result of the conditions of the Bolivian economy at the time of the crisis breaking-up, the policies applied right after that, and the rebound of the main emerging markets which are Bolivia's partners in trade.

In fact, consecutive surpluses in the current account from 2006 led to an unprecedented accumulation on international reserves. On the fiscal side, there were also consecutive surpluses while before 2006, the fiscal accounts showed chronic deficits, and the external public debt had reduced from 51.6 percent of GDP in 2005 to 16.6 percent. The Central Bank of Bolivia had been tightening the monetary policy while the financial system had a low level of liabilities to foreign institutions and almost no exposure to toxic assets. The dedollarization also speeded up from 2006 mainly due to exchange rate appreciation and the use of inflation indexed instruments for open market operations.

Right after October 2008 the Bolivian authorities applied countercyclical policies both on the fiscal and monetary policies. The exchange rate policy avoided high volatility (depreciations and appreciations like neighboring countries) which would have generated damaging devaluation expectations and inflation, as well as losses in international reserves and high costs in the real and financial sectors. The real exchange rate at the end of 2009 depreciated 12 percent in respect to 2008. Bottom line: Bolivia is at the same level of competitiveness vis-à-vis its neighbors. The fiscal policy not only stimulated the economy but also preserved the social safety nets created in 2006-2008 to reduce poverty.

In 2009 relevant international prices for Bolivian exports started to rise more rapidly than expected reaching 2007 level in some cases, which allowed having a positive current account and further international reserve accumulation.

In 2010 Bolivia will continue to follow its model for state-led economic development. The Government strategy aims to reach sustained growth with more equal income distribution, relying partly on the nationalized sectors (hydrocarbons and telecommunications) and a significant expansion of public investment, which is expected to reach 17.5 percent of GDP. Even though the public investment will increase substantially, the indebtedness associated will not put at risk the sustainability of the external debt. The fiscal stance may end up with a small deficit but there is up-side risk associated to international prices, while the monetary policy will continue to support the economy's liquidity needs and, at the same time, keeping control of inflation. The authorities are confident that the growth rate for will be above 5 percent, surpassing the IMF projections, as the economy is being stimulated decisively, (seeking job creation to further reduce poverty) and the exports are showing a positive growth rate as a whole, considering the 2010 first quarter figures. The financial system is strengthening regarding capital adequacy, liquidity, and solvency (first 2010 quarter figures). Additionally, both credit and deposits in domestic currency are expanding more rapidly than in 2009. Inflation is expected to increase compared to 2009 but not beyond 4.5 percent. The authorities intend to keep the exchange rate in line with its fundamentals noting that the recent stability of the exchange rate was a result of the response to the post-global crisis juncture and it does not mean change of the exchange rate regime, which is a crawling peg.

In **Chile**, output contracted 1.5 percent in 2009 driven by the large impact on expectations and confidence of the drastic worsening of the global scenario by the end of 2008. However, the contraction in economic activity in 2009 was lower than what was previously envisaged, as growth resumed more markedly by the fourth quarter due to a swift recovery in domestic demand, as consumption and investment improved significantly. At the same time, throughout 2009, inventories fell at a rate which was also lower than previously envisaged. In line with these developments, in the first two months of 2010 the economy was exhibiting an extension of the positive developments of the last quarter of 2009 in terms of a more dynamic growth and domestic demand, as evidenced by the increases in sales indicators and overall more optimistic business and consumption expectations. Labor markets have also improved, as employment was also recovering in response to the shift in the business cycle.

Internal financial conditions improved, with credit flowing again to the different sectors of the economy at a more normal pace. At the same time, the recovery of growth in the global economy and in Chile's main trading partners picked up speed, while the prices of Chile's main exports also remained high. Based on this scenario, the medium-term outlook for inflation indicated by the end of February that downward pressures on inflation would start to dissipate as a result of a faster closure of the output gap, so that annual inflation would likely return to the target from above in 2011. An update of the baseline scenario of December considered that growth for 2010 would be about one percentage point higher than the range between 4.5 and 5.5 percent forecast in December 2009.

In this context, the massive earthquake and tsunami hit most of the central south regions of the country. This natural disaster had a significant impact in terms of the country's capital stock. A part of the existing productive and transportation infrastructure was destroyed, directly impacting the productive capacity of the country. In terms of capital stock, the Central Bank of Chile estimated that the loss due to earthquake is equivalent to 3 percent of the net capital stock of the economy, which will consequently imply a reduction in trend GDP of between 1 to 1.5 percentage points during 2010 relative to the estimates before the crisis.

The most recent baseline scenario for the Chilean economy, released in early April, considers the impact of this natural disaster. Apart from the mentioned destruction of the capital stock, demand and output disruptions would significantly slow the recovery of economic activity in the very short run. Over the medium run, the reconstruction effort would add a relevant impulse to aggregate demand. Overall, the growth forecast for 2010 is in a range between 4.25 to 5.25 percent, as the negative effects of the earthquake and tsunamis will dominate over the positive effects of the reconstruction efforts. At the same time, inflation is expected to converge to the 3 percent target at a faster pace than envisaged prior to the earthquake, and the impact on inflation over the medium-term of this natural disaster will be determined by the impact on productive capacity as well as the persistence and magnitude of an eventual contraction in consumption. Inflation might remain at the upper value of the tolerance range of 4 percent and then return to the 3 percent target. If anything, uncertainty about the expected path for inflation and output has remained significantly high for the short run. However, given that the earthquake has not altered significantly the ongoing recovery nor the development perspectives of the Chilean economy, the Central Bank of Chile indicated in

early April that although monetary policy would remain highly stimulative over the next quarters, it would start to normalize the monetary stance at a somewhat faster pace in the short term than what were the expectations at the time. Since then, asset prices and analysts' expectations have incorporated this view.

In terms of fiscal policy, the new administration of President Sebastian Piñera took office on March 11, 2010 and the earthquake required the new authorities to focus on the development of a reconstruction plan in addition to the implementation of the new government's program, which included identifying also the main financing sources of the reconstruction plan. The new administration has established the following objectives and challenges as the most relevant ones for the 2010-2014 term: i) addressing the national emergency due to the earthquake and the reconstruction of Chile; ii) developing the government's program, and iii) to recover fiscal balance. According to the government, of the total losses due to the earthquake (USD 30 billion), USD 10.6 billion correspond to damaged public sector infrastructure, of which USD 1.3 billion are insured, resulting in a net cost of USD 9.3 billion to the public sector, a cost which will be dealt with throughout the 4 years of the administration. Due to the efficiency gains associated with reallocations of budget resources conducted after the earthquake, the total cost to the public sector is estimated to be USD 8.4 billion.

In order to finance these additional resources arising from the reconstruction plan due to the earthquake, the government will increase the corporate income tax rate temporarily reaching 20 percent in 2011, 18.5 percent in 2012 and returning to its initial 17 percent in 2013 in order to increase revenue during the current administration by USD 1.26 billion. At the same time, the existing royalty paid by the mining sector will be increased temporarily to a range between 3.5 to 9 percent of its operational margin from the existing 4 to 5 percent range in order to increase revenue by USD 700 million. A two years temporary surcharge in property taxes of 0.25 percentage points to the 5 percent highest valued houses is expected to yield additional revenue of USD 281 million, and finally a permanent increase in the specific tax to tobacco products would increase revenue by USD 994 million in the period 2010-2013. All of these tax measures would increase revenue by a total of USD 3.2 billion. Additional financing resources come from the expected recovery in economic growth (USD 2.5 billion over 4 years), a more austere budget and budget reallocations, the setup of a National Reconstruction Fund from changes in the existing donations law, partial use of external savings in the Economic and Social Stabilization Fund (ESSF), and the Copper Law Fund, the issuance of public debt in the domestic and international markets as well as the selling of divestible assets.

Prior to the earthquake, the envisaged fiscal position for 2010 was that of an actual fiscal deficit equivalent to 1.3 percent of GDP, or USD 2.55 billion, which would be equivalent to a structural fiscal deficit of 1.2 percent of GDP from the previous administration. However, due to additional expenditures associated with the earthquake, the overall expected actual fiscal position for 2010 will be a deficit of 1.7 percent of GDP, or USD 3.28 billion, where fiscal expenditure in 2010 is expected to grow by 8.5 percent in real terms. The associated structural fiscal deficit would then be equivalent to 1.7 percent of GDP. Such fiscal position should be understood as the result of the reconstruction efforts the new administration will

need to conduct during 2010 and onwards, where most of the additional spending under this program will be concentrated in public health, housing, education, as well as public infrastructure which was damaged by the earthquake. The structural fiscal position is expected to reach balance in 2014 by the end of the current administration.

Paraguay's economy is rebounding strongly from last year's recession. Economic output fell by 3.8 percent of GDP in 2009, mainly because of a severe drought that hit the agricultural sector just when the spillovers of the global financial crisis affected domestic demand. Immediate and decisive monetary policy measures provided liquidity to the financial system, and domestic demand began to recover during the second half of 2009. Fiscal policies were appropriately expansionary, supported by public investment and social transfers. Partly due to strongly performing tax revenues, the fiscal balance ended 2009 with a small surplus, after a 2008 surplus of 2.6 percent of GDP.

GDP growth for 2010 is conservatively forecast at 6 percent. Favorable climate and a significantly improved international environment have fueled a strong recovery of the agricultural sector, which will be the main driver of economic growth in 2010. Soybean crops are reportedly high, meat production is flourishing, commerce and transports are experiencing greater volumes, but there is also increased activity in the construction and services sectors, suggesting that recovery is broad-based.

At 1.9 percent, 2009 inflation was among the lowest in South America and well below the Central Bank's target of 5 ± 2.5 percent--this is now the third year that inflation is below the Central Bank's ceiling for the referential rate. Consistent with the accommodative monetary policy stance, interest rates of the Central Bank's monetary bills were kept low throughout 2009, reaching 2.9 percent at the end of the year. Still, Central Bank sterilization bills and domestic-currency treasury bonds settled at longer maturities, reflecting the increased confidence in macroeconomic stability, which continues to take hold after several years of prudent macroeconomic policies.

Paraguay's external position continues to be strong. Exports and imports have rebounded by 26.8 and 36.9 percent, respectively, in the first quarter of 2010. Remarkably, import dynamics reflect a strong pick-up of investment in the agricultural sector, thereby resuming a global trend of higher demand for commodities that was only briefly interrupted by the 2008/09 financial crisis. The level of net international reserves was USD 3.86 billion at the end of 2009, equivalent to 25.9 percent of GDP and about 141.1 percent of public external debt. Given the still fragile state of the world economy, and with a view to the country's exposure to eventual external shocks, the Paraguayan authorities consider this level of reserves an appropriate buffer to maintain the economy stable in the short and medium term.

Strong economic fundamentals and the adoption of sound macroeconomic policies are the main factors behind the resilience of the **Peruvian** economy. In 2009 GDP expanded 0.9 percent, as the effects of the international financial crisis materialized mainly during the first half of the year through a contraction in private investment, inventories, and exports. However, signals of recovery were evident since the second half of the year, reflected in a 15 percent growth rate (seasonally adjusted and annualized) in the last quarter, even higher than

at the beginning of the crisis. This economic cycle was therefore one of the shortest in the last 30 years, both in terms of the contraction and the recovery (four quarters altogether). Countercyclical monetary policy was implemented through conventional and unconventional measures. The policy rate has been maintained at a historical low of 1.25 since August 2009, starting the sequence of reduction in February 2009. Monetary injections through reductions in reserve requirements and repo operations during the international turbulence ensured timely funding to financial institutions. These measures prevented a “credit crunch” and secured continuous credit growth during the year, up to 9 percent at end-2009 and 10.2 percent in February 2010.

Monetary and fiscal policies also protected company balances against the effects of the crisis. Non-performing loans remained low (1.6 at end-2009), and there was an almost null increase in insolvency procedures.

In spite of the slowdown, employment continued to grow (1.3 percent in 2009), unlike in other economies. The dynamics of employment will support private consumption and contribute to a faster recovery in the coming years.

Access to capital markets continues to improve, with stable long-term interest rates and a longer yield curve in soles. Sovereign bond maturities have increased to up to 32 years (the longest in the region), with a 6.85 percent yield. At end-2009, Moody’s joined Fitch and Standard & Poor’s in granting investment grade to Peru, thereby reinforcing its standing among major emerging market economies.

In 2010 and 2011, growth is expected to reach 5.5 percent on average, on the back of a strong recovery in domestic demand. In particular, Peru’s solid fundamentals and optimistic business expectations would support rapid private investment growth (8.8 to 9.0 percent in 2010 and 2011, respectively), including projects that had been postponed due to the international financial crisis.

On the fiscal front, with a recovery in revenues associated with higher economic activity and increasing metal and fuel prices, in addition to a gradual reduction in the fiscal stimulus, the public sector deficit is forecasted at 1.6 and 1.0 percent of GDP in 2010 and 2011, respectively.

Finally, with a narrowing output gap and inflation expectations aligned with the inflation target, inflation is expected to gradually converge towards the target range.

Uruguay constitutes an excellent case to take into account during the current global economic and financial turmoil. The country has shown a strict adherence to honor debt and commitments and to follow the rule of law; to implement sound macroeconomic policies; to protect the most vulnerable groups; to further open its economy and enhance the business environment; and to make critical advances in enhancing regulation and supervision of the financial system. These pillars provided Uruguay a remarkable resilience to face the global crisis, which is clearly attested in the country’s performance in 2009 and its very positive prospects for the coming years. Hence, amidst the crisis, Uruguay has been able to grow

robustly (and, for 2010, the IMF's forecast for GDP growth is 5.7 percent, which is the second highest rate in Latin America and the Caribbean) without significantly resorting to fiscal stimulus (the overall fiscal deficit at the end of 2009 was 1.7 percent of GDP), which is not exactly a common development these days. The country continues to abundantly attract foreign direct investment to a large extent due to Uruguay is being regarded as a regional investment hub.

The authorities have reaffirmed a clear commitment to continue translating positive macroeconomic indicators into substantially better living conditions for the Uruguayan people. In this vein, the results have been encouraging, as unemployment rates have significantly declined to reach historical low levels, while poverty has declined substantially. The five-year budget is currently being prepared—and will be submitted to Congress in a few months—considering the government's strong commitment to preserve fiscal stability (the fiscal deficit is projected at 1.2 percent of GDP for 2010, whilst the net public debt-to-GDP ratio is estimated to be 30 percent), implement a further expenditure rationalization (improving its efficiency and quality), and maintain strict spending priorities (with particular focus on education, health, and infrastructure). In sum, demonstrating the importance of the international community's solidarity, but especially that a country's failure or success ultimately relies on its actions and the authorities' ownership, while following the path of prudent macroeconomic policies, sound structural transformations, improved social conditions, and political maturity, Uruguay reaffirms why in many international economic and social forums it is cited as a successful case.