International Monetary and Financial Committee

Twenty-Fifth Meeting
April 21, 2012

Statement by Hernán Lorenzino
Minister of Economy and Public Finance, Argentina

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

Statement by the Honorable Hernán Lorenzino
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
Washington, DC, April 21, 2012

I. Systemic Economies—Do Policies Add Up to Growth and Jobs?

The recovery of systemic economies is still fragile and warrants changes in the macro policy mix and structural reforms—which has to be clearly defined—although we tend to ask, as did the World Economic Outlook (WEO) presentation, whether the feelings of optimism, particularly in the U.S. and Europe, are justified. As the Consolidated Multilateral Surveillance Report (CMSR) points out, the recovery remains fragile and risks are firmly to the downside. In the short term, main risks are a re-intensification of the euro area crisis and the possibility that geopolitical uncertainty could cause oil prices to shoot up with its negative impact on global growth. Whereas in the medium term, major risks are associated with Advanced Economies (AEs), particularly in the euro area, with high public deficits and thus debt increases.

The situation in Europe, as mentioned above, is truly worrisome. Even though decisive actions have been taken in recent months, the delay in such actions oriented, as we believe, to avoid moral hazard, have aggravated the problems to the extreme. Now sovereign stress and large-scale bank deleveraging imply an added risk to global stability. Thus, in order to impulse short-term growth prospects, more efforts are needed to address the euro area crisis, fiscal restraint should be temperate and monetary and fiscal policies should be even more accommodative than they have been in recent months. Additionally, as highlighted in the recent G24 Communiqué, the euro area debt crisis faces us with the challenge to effectively tackle the need to further study of sovereign debt restructuring mechanisms.

While a case-by-case analysis and the different characteristics of countries have to be considered to avoid generalizations, the proper response to the balance between supporting near-term recovery and ensuring long-term fiscal sustainability has to combine elements of structural and institutional response (which have to be properly defined) as well as supportive macroeconomic policies, as long as there is no silver bullet to solve these problems. In any case, although a weak recovery is expected to continue in major AEs, it does not guarantee *per se* the resumption of strong job creation to reduce high unemployment. A large and growing fraction of unemployment is long term and, if it is not reduced, besides undermining social cohesion, in turn, it means less contribution to pension funds which jeopardizes their long-term sustainability in addition to the ageing population issues mentioned in the Global Financial Stability Report (GFSR). This is why, in the case that fiscal room is available, its best use could be oriented on the one hand to support growth policies from the demand side in the near and medium term, which consecutively will increase revenues and, on the other hand, to promote job creation from the supply and demand side by enhancing education and training and by supporting self-employment, entrepreneurship and small and medium-sized enterprises (SMEs) which account for the bulk of new jobs created.

The CMSR has addressed the crucial issue of the stabilization of the euro area financial markets and the future impact of the U.S. and Japan's fundamental medium-term issues that may have dire consequences for the rest of the world if left unresolved. In this regard, if the weak recovery has to be sustained in AEs, it should include an adequate flexible firewall in Europe, and more emphasis on growth-oriented policies. There is no evidence sustaining that an optimal policy mix is a high degree of fiscal tightening combined with an extraordinarily expansionary monetary policy. Advanced economies should strive to find a more balanced policy mix, taking into account the monetary policies' spillover effects on emerging markets.

Countries, in general, prefer foreign direct investment, rather than short-term speculative capital inflows. If fiscal consolidation is a brake on growth, spillovers through trade interconnections and clusters (among others, import reductions or lack of export finance) could affect other countries. In this regard, the Fiscal Monitor on fiscal multipliers in expansions and contractions provides additional analysis to a cautious and gradual approach. In the same vein, large-scale deleverage rooted on weak policies could also create important spillovers. All in all, monetary easing, the policy rate and liquidity policy, out of pace fiscal consolidation, lack of regulations in the financial and financial shadow system and of coordination of financial policies and frameworks, sovereign stress and extreme deleverage under weak policies scenario in AEs, can have important spillovers. The IMF's improved surveillance framework should address all these issues.

We agree with the CMSR that every country is connected and that they all play a part in building a stronger international monetary and financial system but the level of commitments and responsibilities are different among AEs and EMDCs. Major advanced countries cannot treat the economic malaise with austerity measures alone. The fundamental issues of the weak household balance sheets in the United States, weak sovereigns in the euro area and, fiscal consolidation in most advanced economies will need to be addressed in a more timely and bold manner than seen so far if conditions deteriorate again. Macroeconomic, and in particular monetary policies, with the caveats expressed above, should remain supportive in this environment and react flexibly to changing circumstances. A further bout of volatility and additional losses in confidence would have profound and lasting effects on the global economy and financial markets. On the other hand, the upside scenario with its positive spillovers and virtuous feedback loops is actually a combination of easier credit conditions in Europe alongside diminishing oil market tensions, enhancing global demand, and promoting employment and inclusive growth at the countries' level.

II. Emerging Markets, Middle East and North Africa (MENA) Countries in Transition, and Low-Income Countries

Emerging markets and developing countries (EMDCs), particularly the major emerging economies, are in a strong position, due to the benefits of the sound macroeconomic and structural policies applied, growth rates remaining high, and moderate or decreasing public debt. Many of these countries could provide fiscal support, not only to continue helping to sustain global economic recovery, but also to withstand a worsening of the current crisis. Thus, if the downside scenario takes place, responses will vary widely across the spectrum of more than 100 EMDCs. In this context, the macro policy response to volatile commodity prices and speculative capital flows will broadly be of a protective and defensive nature, using macroprudential tools at hand, when needed. In the case that oil prices increase, the scope for fuel subsidy reforms will be scarce, only leaving space for policies that would focus the subsidies on better targeting the beneficiaries. Moreover, many of these economies can expand pension and health coverage as a means to reduce social imbalances without derailing fiscal sustainability.

Given the substantial changes in the financial and economic environment, and if the presented risks materialize, the focus of the advice to emerging economies as a group should be on maintaining or achieving flexibility in policies to face double-sided risks going forward. In this regard, if the demand from advanced economies weakens and the price of oil increases due to geopolitical circumstances, while other commodity prices fall as a consequence, EMDCs should weigh these risks and organize policy room for maneuver.

The fact that 5/6 of the world's population has many unsatisfied basic needs and the will to consume existing in developing countries could be an opportunity for EMDCs to grow and narrow the development gap. Domestic and regional demand to replace demand from AEs could be promoted and regional and south-south financial, trade, technological, and complementary agreements be established. Today, several of these agreements exist, such as utilizing local currencies in trade or developing joint equipment, machinery and industrial products or creating new regional or supranational bank institutions. Investing in infrastructure is a key element for the economic development of emerging economies and developing countries. This policy could also help advanced countries—especially now as their growth prospects are weak—to restore their economic prospects. Infrastructure projects tend to produce movements and chain reactions benefiting the entire economy of one country. It creates jobs, eases transportation and logistical arrangements (which in turn facilitate exports); thus, it produces many externalities.

The IMF should respond to the needs of MENA countries in transition, as it should respond to any member country which asks for Fund support, by helping them to return to a path of growth and employment creation, by addressing the region's challenges in the midst of an uncertain global environment. The IMF should continue helping these countries with technical assistance when requested and particularly through the Middle East Regional Technical Assistance Center (METAC) that tailors assistance to the particular needs of the region, facilitates the strengthening of the capacity for effective macroeconomic and financial management, enhances the ability to respond quickly to emerging needs and helps to improve the coordination among development partners to promote effective implementation of economic initiatives.

Low-income countries' policy buffers can be rebuilt in a tough external environment without compromising development goals in different ways. Assuming that growth—the main driver of buffers—would be sluggish if downside risk materialize, LICs can rebuild buffers through the fiscal side; however, protecting social safety nets has to be the starting ground. One can think of enhancing the tax base through improving tax administration, given that higher tax rates or additional taxes could be counterproductive. The Fund may provide technical assistance on various fiscal issues for improving tax administration, helping—for example—to make tax collection more efficient.

In the same vein, external and internal debt refinancing would also contribute to improving the fiscal stance, taking advantage of the low interest rate environment. Once again, technical assistance in this task would be helpful. Focusing on subsidies is another area to improve the fiscal stance, even though pursuing neutrality in subsidy reform may result in social gains. Planning, multiannual budget and establishing stabilization funds, with savings or gains from exports, is also another way forward to rebuild buffers.

III. Institutional Issues

The Managing Director's Action Plan covers many issues, from surveillance to resources, lending and governance, all of which articulate and complement each other. We understand the immediate priority of containing the current crisis in Europe and, to this end, the measures implemented focus on limiting the effects of deleveraging, which benefits the rest of the world, promoting coordination and monitoring spillovers and contagion risks. Until now, too many efforts, human and financial resources, were devoted to this, particularly on wealthy regions, over too long a period of time and unfortunately much remains to be done. During this process, many rules of the Fund had been changed to accommodate the support to the most needed countries in Europe in a way that was not seen at the time of the Asian crisis in 1997 or the Latin American crisis in the 2000s.

Though it was right to prioritize Europe in this juncture, we believe that the highest priority should be given to governance. Governance should be the first point and not the last one in the Action Plan in order to enhance the Fund's legitimacy and effectiveness and to strengthen the multilateral and cooperative nature of the institution. The views of the whole membership must be reflected to deal, at the same time, with the democratic deficit of the Fund. In this regard, we support a voluntary re-composition of the Board that increases the number of emerging market chairs to enhance the voice and participation of EMDCs and particularly of middle and low-income countries. But this is not enough. We need to change the institutional culture of the IMF to definitely deal with the Fund's stigma. Some clues on this can be found in the reports published by the Independent Evaluation Office (IEO). At the same time, diversity is important not only in terms of gender and geographically, but particularly academic backgrounds, economic vision and experiences. Also, we believe that more training is needed on negotiation skills and on dealing with country authorities and the merit of the staff's efforts should be adequately recognized.

The adequacy of Fund resources should be assessed considering the whole membership needs. It is crucial to ensure the appropriate IMF support for the potential needs of EMDCs in case these countries are severely affected by a potential global economic breakdown. Therefore, the assessment of global financing needs must weigh the potential impact on these economies accurately. We must recall that advanced economies have more room for maneuver and more policy space. As regards increasing Fund resources, G20 Leaders in Cannes asked to explore various options, including bilateral loans and to consider new **SDR allocations**. Each alternative should be studied and discussed before reaching a decision. As an example, the general SDR allocation of US$ 250 billion, agreed at the G20 London Summit in 2009, was a wise and courageous decision in the midst of the worst financial crisis in recent decades and its pros overcome its cons. An SDR allocation is the best way to complement and increase Fund resources.

The reorientation of surveillance after the crisis from EMDCs to AEs has shaken the Fund's structure. Therefore, we welcome the ideas behind the proposed Integrated Decision on Surveillance (ISD), the Managing Director's Action Plan and the advance in the IMF's Surveillance Work Agenda which attempt to better integrate surveillance in the Fund, mainly, the integration of bilateral and multilateral surveillance. In the context of a more integrated global economy, spillover effects should be strongly monitored and the ability of the IMF to identify systemic risks wherever they may lie should be strengthened. The effectiveness and traction of the IMF's surveillance will depend on trust and even-handedness and on further progress on governance reforms, taking into consideration the vulnerabilities and recommendations highlighted in the IEO report.

Most countries, as our constituency members, are doing their utmost to achieve progress on the 2010 quota and governance reform but in many cases it depends of forces that are beyond the Fund or countries' good will. Each country has to follow the steps and the timetable given by the separation of powers and the respective checks and balances to arrive to a certain rule or law or decision. In the case of parliament approval of the 2010 quota and governance reform, each country's executive power can only submit the law project and wait for the decision of the legislative power; the political party in power could instruct its legislators to accelerate the steps but this intervention is sometimes counterproductive.

With regards to the quota formula, it is important to complete the schedule agreed on quota formula and the quota review on a full and timely basis. This includes the comprehensive review of the quota formula to better reflect economic weights and enhance the voice and representation of EMDCs by January 2013, and the completion of the next general quota review by January 2014. As the recent G24 Communiqué points out, the quota formula must be reformed to address its deficiencies and bias against developing countries. A reformed quota formula must give predominant weight to GDP measured in PPP terms, address the severe distortions in trade and financial openness through correcting or eliminating its role, and correct the measure of variability or find other means to capture the potential needs of vulnerable economies. The ultimate goal must be to better reflect the growing weight of EMDCs in the global economy while protecting the share of poor, small and vulnerable economies in quotas and voting power. The revised formula should lead to an increase in the calculated and actual quota shares of dynamic EMDCs in line with their relative positions in the world economy, and must not come at the expense of other EMDCs.

A feature which is a concern to us is the increasing concentration of the quota share in the largest members of the Fund. This not only presents an equity challenge, but also reflects a concrete weakness in the governance of the Fund.

Southern Cone Countries

Argentina

Since the 2001/02 crisis the **Argentine** economy has undergone a paramount structural transformation. Between 2003 and 2011, average annual economic growth was close to 8 percent, which constitutes the highest average growth rate in the country's economic history. A sequence of nine consecutive years of growth indicates that the stop and go cycle that characterized the Argentine post-war economic history has come to an end. But beyond figures, this unparalleled growth period has been socially inclusive, reflected in a clear reduction in poverty, unemployment, and inequality, making Argentina's GDP PPP per capita the highest in Latin America.

Argentina's economic policies are based on a sound macroeconomic framework. The main pillars are external and fiscal surpluses, maintaining external public debt at a low and sustainable level, responsible fiscal and monetary policies, a managed floating exchange rate regime, the implementation of a macroprudential policy framework to face volatile capital flows, and the accumulation of foreign reserves, among other countercyclical policies.

Growth recovered quickly during 2010 to reach 9.2 percent, and in 2011 it increased by 8.9 percent year-on-year. Exports have grown beyond US$ 80 billion and imports increased by almost 31 percent in 2011, the second highest increase in imports compared to other G20 countries.

We strongly believe that equality is an important ingredient in promoting and sustaining growth.[1] Since 2003, key components of the growth model are the creation of quality jobs, the progressive reduction of inequality, social inclusion and income distribution. During this period, more than 3.5 million jobs were created, with unemployment decreasing from 18 percent in 2Q 2002 to 6.7 percent in 4Q 2011, with a strong participation of employment formalization. In turn, the average real wage increased by more than 37 percent. The minimum wage improved continuously, benefiting both the functional and the personal income distribution.

Argentina's social safety net is built on several programs; the Universal Child Allowance Program "Asignación Universal por Hijo" provides coverage for 3.5 million vulnerable children; the program "Argentina Trabaja", social inclusion through work; the program "Manos a la Obra", productive projects for families and self-employees; the Food Security Plan (Seguridad Alimentaria) has improved the subsistence capacity of more than 1,500,000 families; the program Actions for Social Promotion and Protection and the Plan for Pension Inclusion, among others.

Along the same lines, the social security system has also increased its coverage to 6.5 million beneficiaries who have a legal right, beyond the will of the government authorities, to increase their pension twice a year, based on a formula that guarantees pensions' purchasing power. Social spending on non-contributory pensions has also been increased. Expenditure on education has risen to 6 percent of GDP, in line with the Education Law. Argentina's Connect

[1] Berg, A., et al., What makes growth sustained? Journal of Development Economics (2011), doi:10.1016/j.jdeveco.2011.08.002.

Equality Program (Conectar Igualdad), launched by the reelected President in 2011 (by 54 percent of votes) Cristina Fernández de Kirchner to distribute approximately 3 million laptops to secondary school students, and is being implemented successfully. Finally, health spending has also been raised to prevent pandemics like the H1N1A flu and other diseases, such as dengue fever.

The country has focused on income distribution. The recent implementation of a program for the rationalization of subsidies based on an income and wealth criteria, will allow the government to assign social spending more equally, guaranteeing the protection of the most vulnerable sectors of its population. As a source of social inequality, volatility in commodity prices is a menace against which Argentina has historically fought. Agricultural commodities play a very important role in the Argentine economy, as the country is a major producer, consumer and exporter of these products. Protection of rural families implied rural public investment that supported thousands of families with technical assistance and financial aid, 1.464 km of rural electrical network, and 223 rural roads were opened and improved.

After almost collapsing in 2001-2002, the financial system is now solvent, liquid, well-regulated and capitalized, thus allowing our economy to recover from the impact of the international financial crisis faster than others. Liquidity and solvency levels remain high, in a context of reduced credit risk which is reflected in low levels of loan irregularity with respect to other emerging and developed economies. Favorable prospects for economic growth help to strengthen the conditions for financial stability. Return on Assets (ROA) and Return on Equity (ROE) that were negative in 2003 (-2.9 percent and -22.7 respectively) have been positive since 2005, and in 2011 increased 2.7 percent and 25.3 percent respectively.

On the real side, investment grew by a significant 15 percent in 2010, and by 13.5 percent in real terms in 2011, accounting for 24.5 percent of GDP, a performance explained by both private and public investment. Long-term challenges are being addressed through the record rate of investments over the past 50 years and by doubling the percentage of expenditures in science and technology in relation to GDP, including thousands of fellowships per year for doctorate students. In 2007, the Ministry of Science, Technology and Productive Innovation was created to incorporate the benefits of science and technology and improve economic and social development. Investments in the provinces are supported by the government-established Federal Solidarity Fund (Fondo Federal Solidario), funded by a 30 percent export tax collection on soy complex, which has been oriented to infrastructure, such as building schools, houses, drinking water processing plants, and water and sewage networks.

With the purpose of enhancing financial deepening and inclusion, the Argentine government implemented a strong campaign to incorporate a considerable proportion of vulnerable sectors of the population into the banking system, through the Free and Universal Account Program, and through the adoption of additional measures aimed to facilitate banking access and operations to pension beneficiaries. Moreover, the government strongly supported the increase in lending to the private sector, particularly small and medium-sized enterprises (SMEs). Indeed, financing to the private sector grew by 42 percent in 2010 and by 46.2 percent in 2011, and achieved a record for the Argentine economy reaching 14.5 percent of GDP, which shows that there is still plenty of room for the financial deepening of the economy. In the same vein, the government has launched a number of programs to boost credit for investment and consumption, with a special focus on incentives and credit lines tailored for SMEs, in addition to working capital in general.

These programs include, among others, the Bicentennial Program to Finance Production (Programa de Financiamiento Productivo del Bicentenario), the Productive Recovery Program (Programa de Recuperación Productiva) and a lending program to renew the truckloads' fleet. The Plan for Industrial Development 2020 has been launched to foster technological development in the industrial sector, along with a new Strategic Plan Agri-food and Agro-industrial (PEA), which aims to increase grain production by 50 percent by the year 2020.

Since 2003, after the country's worst financial crisis that unfortunately lead to a default, Argentina has applied a set of measures aimed at progressively normalizing public debt and creating a sustainable repayment capacity. These measures involved a successful debt restructuring process that reached a substantial level of acceptance—more than 91 percent of the eligible debt—was tendered to the two-phase exchange process that had taken place in 2005 and 2010. Over the past nine years, the debt-to-GDP ratio has been reduced from 166 percent to around 42 percent. The current public debt stock shows a balanced composition in terms of currency, duration, interest rates and types of creditors. In terms of external debt, the debt-to-GDP ratio comes to less than 17 percent as of September 2011.

At the same time, Argentina is facing an extraordinary challenge dealing with creditors known as vulture funds, who seek privileged treatment through litigations within legal gaps even though they have acquired sovereign debt at cents on the dollar. Due to the lack of an international legal framework for sovereign debt restructuring, Argentina continues to deal with a minority of litigious creditors that impede a full completion of the debt-restructuring process.

This debt normalization process, as well as the current policy of Argentina based on the goal of a strong debt reduction, is a positive signal giving the markets confidence in the country's ability to continue servicing its public debt on regular basis, despite the strong attack of hold-out creditors. It is well known that credit rating agencies do not often reflect debtor solvency correctly; and in our case, current credit ratings do not reflect this effort from our country. We believe that it is necessary to continue discussing the role of credit rating agencies to propose concrete policies aimed at reducing dependence and enhancing supervision.

Argentina continues to advance step by step in strengthening its relations with the international financial community. As the IMF plays an undeniable and very important role, Argentina has demonstrated its commitment on working together on the bilateral agenda, which involves ongoing technical assistance to develop a new CPI on a national basis, and the completion of the ROSC and FSAP reports, which are also underway and are expected to be finalized by the end of the year. By the end of May 2011, Argentina fulfilled all of its commitments in relation to the IMF programs related to Low-Income Countries (LICs), Liberia and the Poverty Reduction and Growth Facility Trust. Since the deepening of the social disaster provoked by the 2001/2002 crisis, this has not been an easy step to take. Several former management and staff members of the IMF have said that the Institution made several important mistakes with Argentina at the time that they were in office. Among others, Michel Camdessus, Raghuram Rajan and Agustin Carstens, have expressed their disappointment on how the IMF dealt with the currency board, the crisis and the decision not to participate in the rescheduling of the Argentine debt.

We must underscore that the IMF once more decided to include a specific section on the risk of overheating in its latest World Economic Outlook report. We believe that the problem of so-called overheating has to be reviewed at a time when some systemic economies are struggling to cross the border of a double-dip recession. Overheating is not a risk that can be placed at the same level as high indebtedness, reluctant growth and high unemployment. Countries like Argentina, with 80 percent productive capacity utilization, 6.7 percent unemployment and high investment rates should not be considered as overheated. The brakes cannot be put just on the countries that are helping to pull the global economy out of recession.

A lesson has been learnt the hard way throughout Argentinean history: the crucial role that the State must play to achieve a steady, sustainable and inclusive path of economic development. Indeed, Argentina has strengthened its policy framework built upon a broad-based productive and socially inclusive development, a balanced fiscal policy, solid banking system, substantial debt reduction, the accumulation of international reserves and the promotion of regional integration and international cooperation. Growth has been sustained and social indicators have improved considerably. Argentina is now well placed to address the challenges of the post-crisis world, due to the structural transformation of the economy since 2003. The government has put the country back on track and has restored its potential for economic, human, and social development. In 2012, Argentina celebrates the Centennial of the institution of universal, mandatory and secret suffrage. It took Argentina 100 years to achieve the political maturity to understand that the rights and responsibilities need to be broadly shared in order to build a legitimate social, institutional and economic structure. Strengthening and continuing with these outcomes will be the main objective for the future.

Bolivia

In **Bolivia**, the gross domestic product (GDP) grew at a rate of 5.1 percent in 2011, driven mainly from several non-extractive activities including transport, storage and communications, financial services and manufacturing. In addition, non-renewable extractive activities contributed positively to GDP, such as hydrocarbons—powered with the increased demand for gas from Argentina—as well as the rebound in mining. Also in 2011, a remarkable recovery of the agricultural sector occurred (3 percent) with a contribution of 0.41 percent to growth, after having been exposed to adverse weather events in 2010. Policies for stockpiling, irrigation and agricultural production have had an important effect on the above-mentioned rebound, especially for soybeans, sugar, rice, cereals, vegetables and fruit. Livestock production also expanded in 2011.

Domestic demand continued underpinning growth through the dynamics of private consumption, as well as public and private investment, supported by an increasing trend in loans to the productive sector. Wage policies and social safety nets have improved the contribution of domestic demand to the dynamism of the economy, following the principle of growth with redistribution. The growth of GDP projection for 2012 will be in the range of 5-6 percent, which will be one of the highest rates of growth in Latin America, driven by a substantial increase in public investment as it would exceed $3 billion. Economic policy in Bolivia has been countercyclical since 2008.

Inflation accelerated in the first quarter of 2011 and stabilized between April and June. Afterwards, it fell steadily in the second half of the year converging gradually to 6.9 percent at the end of the 2011. Disinflation in this period overcame most of the effects of shocks of prices experienced at the end of 2010 and beginning of 2011. The fall in inflation was explained by three factors: the alleviation of external inflation pressures, the moderation of inflation of food supported by policies to restore internal supply of food; and the reduction of inflationary expectations. The Central Bank maintained countercyclical policies in 2011 proceeding proactively with anti-inflationary measures and other policies to moderate the negative effects of the economic cycle, using heterodox and innovative instruments.

Exchange-rate policy maintained a gradual appreciation of the domestic currency in line with external pressures. The increased pace of appreciation of the first half of the year mitigates the effect of the rise in prices of imported goods and currency appreciations in the region. The pace of appreciation was reduced in the second half of the year as imported inflation diluted and the international environment became more uncertain.

While public investment increased substantially in 2011 and the authorities continued to pursue a social protection policy to the population through delivering conditional and non-conditional cash transfer, the fiscal balance again registered a surplus, as in the previous five years. Austerity in fiscal policy as for current expenditure limited the fiscal impulse, which helped to reduce inflation and inflationary expectations. Public investment in strategic areas and other non-strategic sectors, contributes to job creation and provision of intermediate supplies and food.

The financial system had a positive performance and showed signs of deepening financial intermediation, favoring growth of the economy. Credit increased significantly, particularly loans for good-producing activities, which was encouraged by reforms in the reserve requirement schedule to include incentives for such kind of credit, while non-performing loans continue to decrease. In the same vein, deposits recorded significant increases. Measures taken to encourage the use of the national currency were effective, generating a record level of "bolivianization" since 1985, for both deposits and credits. Indicators of asset quality, solvency, earnings and liquidity illustrate the robustness of the financial system.

The favorable external context led to a positive balance in the current account, as well as the capital and financial account. In the first three quarters of 2011 the balance of payments stance was 5.3 percent of GDP, which drove to a new record in net international reserves, reaching $12 billion (49 percent of GDP). The surplus of the current account was the result mainly of the trade balance and remittances. The surplus of the private sector, explained by the flows of foreign direct investment (FDI), financial portfolio and medium- and long-term private debt stands out in the capital and financial account. Gross FDI was addressed mostly to hydrocarbons (41.6 percent) followed by transport, storage and telecommunications.

Chile

In spite of the uncertain global environment, the **Chilean** economy has continued to expand in a balanced way. Monetary policy, after a preventive 25bp cut to 5% in January 2011, has remained on hold, whilst fiscal policy remains on track to achieve the target of a structural deficit of 1% of GDP by 2014. An overall neutral stance in fiscal and monetary policy, coupled with the moderate prospects for the global economy in 2012, will help drive GDP growth in 2012 to a range between 4 and 5%, close to the estimated trend rate of growth.

After the very low prints in 2009 and 2011, inflation has returned to the Central Bank's target range of 2 to 4%, with headline inflation closer to the top of that range due to the direct effects of higher oil and food prices, as well as some domestic weather-induced price hikes. Underlying inflation, however, has accelerated modestly, thus showing the absence of mayor second round effects from the commodity price rises. The current account posted a small deficit of 1.3% of GDP in 2011, which is forecast to expand as domestic demand continues growing and export prices fall back somewhat from recent peaks.

The spike in prices of specific commodities, particularly oil and foodstuff, quickened the increase in headline inflation to around 4%. Although this has affected somewhat one-year ahead inflation expectations, medium term inflation perspectives, measured by either analyst's surveys or financial prices, remain firmly around 3%, the center of the target range for inflation. Core inflation measures also remain around 3%. As the balance of risks has shifted, with a less likely downside from external conditions but a more probable upside from high domestic demand growth, tight labor markets and the recent inflation increases, monetary policy has shifted its easing bias and remains in a broadly neutral stance of 5%. The Central Bank has stated that future movements in the policy rate will be conditional on external and internal conditions and their impact on inflation perspectives.

During 2011, real public spending growth reached 3.2%, mostly driven by a 9.7% real increase in capital expenditures. This, coupled with a significant real increase of over 11% in public revenues, thanks to high copper prices and the domestic economic dynamism, allowed the fiscal accounts to post a surplus of 1.4% of GDP. For 2012, the budget considers a 5% growth of real public spending, and a small fiscal deficit of 0.4% of GDP. Therefore, fiscal policy remains firmly on track to achieve a structural fiscal deficit of 1% of GDP by 2014, improving the structural position of the public accounts by two percentage points of GDP since 2009.

The strong fiscal position is also apparent in the accumulation of foreign assets in the Republic's sovereign wealth funds. As of the end of 2011, the two sovereign wealth funds (the Pension Reserve Fund FRP, and the Economic and Social Stabilization Fund FEES), plus other liquid foreign assets of the Treasury accumulated to USD28.4 billion, or close to 12% of GDP, a figure that is slightly higher than the total issuance of gross debt by the Treasury. Coupled with international reserves held by the Central Bank amounting to USD39.5 billion, after the culmination of its strengthening program by the end of 2011, and a moderate net debtor international investment position of USD24 billion, the external liquidity of the economy is comfortable.

Paraguay

Last year the Paraguayan economy expanded by 3.8 percent, in line with its potential following 2010's record economic growth of 15 percent. The strong economic performance has allowed the country to continue moving towards a solid growth path in an environment of relatively low inflation and unemployment. This is the result of continued strengthening of the institutional framework and prudent implementation of fiscal and monetary policies. Growth in 2011 was broad-based, although with significant differences among economic sectors. During the first part of 2011, supported by favorable climate and commodity prices, the agricultural sector obtained excellent results that surpassed the extraordinary output experienced in 2010. In the second half of 2011, the economy decelerated its impulse mainly because of a slowdown in activity in the construction sector and an outbreak of foot-and-mouth disease in the northwest region of the country that affected beef exports, Paraguay's second largest commodity export.

Continued strengthening in public financial management supported by a prudent fiscal policy and revenue efforts allowed the central government to record a small fiscal surplus for the eighth consecutive year. However, this year the Ministry of Finance will face a difficult challenge to avoid a deterioration of the public accounts, considering an expansionary budget that projects a 3.7 percent fiscal deficit.

Monetary policy was tightened until the third quarter of 2011 to contain inflationary pressures. More recently, the Central Bank of Paraguay began to ease its monetary stance in view of lower domestic demand and inflationary pressures as a result of poorer crop estimates and the global uncertainty generated by the fiscal crisis in Europe. Inflation reached 4.9 percent in 2011, within the Central Bank target band and projections for 2012 indicate that inflation will remain at the center of the Central Bank's target band of 2½-7½ percent.

The balance of payments registered a positive result for the ninth consecutive year, driven by a surplus in the financial accounts that compensated the small deficit in the current account. Net international reserves stand at 24 percent of GDP, which in the view of the authorities, is considered an adequate buffer against eventual external shocks. The effective real exchange rate depreciated during the first nine months of 2011, but the trend reverted in the last quarter due to the nominal depreciation of the currency vis-à-vis the US dollar. Nevertheless, the Guaraní appreciated in real terms by 8.1 percent in 2011 against a basket of currencies from main trade partners.

The outlook for 2012 is less optimistic. GDP projections for 2012 indicate a contraction of 1.5 percent, driven by an estimated 18 percent drop of the agricultural and livestock sector output, due to a severe drought in the last quarter of 2011 and the temporary closure of some beef export markets. However, the non-agricultural sector will likely expand by 4 percent this year, smoothing the sharp contraction caused by the negative supply shock. Growth is expected to strongly resume in 2013, assuming agricultural and beef exports return to normal levels and the recovery of the construction sector propelled by public and private sectors' investments.

Peru

In 2011, the **Peruvian** economy continued to show considerable momentum, despite the deterioration in the global environment associated with the escalation of the eurozone's debt problems. GDP grew 6.9 percent, around its potential level, led by private consumption (6.4 percent) and exports (8.8 percent).

In 2011, the public sector posted a surplus of 1.9 percent of GDP, in contrast to a deficit in 2010 (-0.3 percent of GDP), due mainly to higher tax collections and a slowdown in expenditure. A surplus of 1.1 percent of GDP is expected in 2012, despite a considerable fiscal impulse (0.7 percent of GDP).

During the first half of 2011, the Central Reserve Bank of Peru (BCRP) withdrew monetary stimulus by raising its reference interest rate, with an aim to prevent rising international prices and domestic demand pressures from translating into higher inflation expectations. During the following months, the BCRP held its reference rate in response to moderating growth, an aggravation of the debt crisis in the eurozone, and lower global growth expectations, while preserving a focus on anchoring inflation expectations. Although increasing international food and fuel prices and weather shocks brought annual headline inflation above the target (4.74 percent), inflation without food and energy prices, which measures the trend of inflation excluding exogenous shocks, and inflation expectations, remained within the BCRP's tolerance range.

Peru's good economic performance was reflected in a solid expansion of credit to the private sector. Even though dollarization has decreased considerably in recent years, the BCRP limits associated balance sheet risks through preemptive accumulation of international reserves and a managed floating exchange rate regime aimed at moderating exchange rate volatility. Since December 2010, the BCRP has accumulated US$ 11.5 billion in international reserves, for a total of US$ 55.6 billion by end-March 2012 (30 percent of GDP).

In view of the country's sound fundamentals and prudent economic policies, Consensus Economics Inc. expects Peru's growth and inflation performance in 2012 to be among the best in the region.

Uruguay

Uruguay has been reaping the fruits of years of prudent policies and structural reforms, added to the population's strong preference for respecting the rule of law, honoring commitments, and social equity, values that are fully reflected in the government's policies and actions.

2012 will be the tenth consecutive year of growth. Clearly, this kind of growth path is possible in the context of economic and financial stability. Fiscal discipline along with fundamental reforms in the tax system and revenue administration have allowed Uruguay to currently exhibit overall fiscal deficits of about 1 percent of GDP, while showing a steep reduction of debt-to-GDP ratios and critical progress on the de-dollarization of public debt (practically reaching the target established for 2014 of 45 percent regarding the share of debt in local currency). The institution-building process can explain the whole path Uruguay has followed in recent years and, particularly, the substantial progress on debt issues, and the creation of the Debt Management Unit, in December 2005, is a milestone in this regard. The authorities appreciate the staff's comment stated in the last Article IV staff report that debt management is "an area where Uruguay can be a model for other countries". It is worth noting that a few weeks ago, Standard & Poor's upgraded Uruguay's rating to investment grade.

Meanwhile, as in many emerging economies, domestic demand and commodity prices have exerted strong pressures to inflation, but the authorities' policies have been able to maintain inflation fully under control, observing a slowdown in recent months. Of course, the authorities remain vigilant with respect to inflationary pressures and, if needed, are ready to take additional measures. Moreover, a flexible exchange rate system continues to be critical to cushion external shocks. Furthermore, the financial system shows very healthy indicators in the context of robust regulatory and supervisory frameworks.

All of the above-referred economic and financial achievements are especially noteworthy to the extent they are mirrored in the population's welfare, demonstrating once again that it is absolutely possible to enjoy economic stability and a robust growth path simultaneously with sizeable social achievements. In 2011, the number of households under the poverty line continued its systematic decline, reaching 9.5 percent (compared, for instance, with 25.7 percent in 2006). At the same time, income distribution keeps displaying noticeable progress, while rates of informality are one of the lowest in the region.

Of course, there are substantial risks coming from very fragile conditions of the global economy. Once again, the Uruguayan authorities would like to firmly warn about the effects of the expansion of monetary policies in advanced economies, and, as economic history has demonstrated many times at individual, regional and global levels, the deeply detrimental and long-lasting consequences of protectionism everywhere. Global forums like the IMFC must serve to make profound reflections on these issues.

In sum, Uruguay is in a good position to mitigate further external shocks. The authorities are fully aware that much remains to be done to reinforce and sustain economic, financial and social achievements. Education and infrastructure constitute some of the important challenges lying ahead on which Uruguay is working. Thus, rather than only been reaping the fruits of policies and reforms, more importantly, Uruguay is sowing, and, based on economic, political and social stability, continues to establish sound pillars for further developments.