



## **International Monetary and Financial Committee**

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Statement by José De Gregorio, President, Banco Central de Chile, Chile

On behalf of Argentina, Bolivia, Chile, Paraguay, Peru, 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**  
**Washington, DC, September 24, 2011**

In the past few months, the near-term prospects for the global economy have worsened significantly and financial risks have increased. What some time ago was a modest, albeit unbalanced recovery, risks turning into a new economic downturn, particularly in major Advanced Economies (AEs). This new scenario poses urgent challenges to the IMF and to the membership in terms of decisive political and policy responses to solve fundamental weaknesses and mitigate the negative impact of this new downturn. Against this backdrop, the Fund's surveillance capacities, and a well-functioning International Monetary System (IMS), are being and will again be put to the test only a couple of years after the 2008-2009 Great Recession and financial crisis.

**I. The Immediate Challenges Ahead and the Fund's Policy Advice**

Two forces are influencing each other and weighing down on economic prospects in major advanced economies. On the one hand, uncertainty and volatility have increased to their highest levels since October 2008, constraining credit and leading to more cautious behavior by households and financial institutions. On the other hand, fully credible medium-term fiscal consolidation in those economies with high debt burdens is still lacking, prompting even higher sovereign spreads and more calls for short-term fiscal retrenchment when private demand has yet to recover to its pre-crisis levels. The policy debate surrounding the appropriate fiscal and monetary policy mix, as well as the assessment of public debt sustainability, have become muddled. It would be paradoxical that only a few years after witnessing an example of successful global policy coordination and sound financial policies, which staved off another Great Depression, the lessons learned were to be ignored. The Fund can provide guidance and leadership on a number of issues, and the membership should heed its advice. In particular, we would like to note that:

- The political will to achieve meaningful short-term fiscal adjustment is more present in those core AEs where public sector financing conditions are benefiting the most from flight to quality, whereas in cases of more acute solvency concerns, and thus higher spreads, adjustment fatigue is dangerously settling in.
- The negative growth implications of further short-term fiscal retrenchment have not been given proper regard by the global community. The bulk of the evidence, and appropriate risk considerations in the weak economic environment of today, suggest much caution should be exercised when implementing short-term fiscal consolidation measures, especially in those cases where the long-term sustainability of public finances is not threatened.
- Structural reform fatigue is settling in, with electorates weary in both creditor and debtor countries to pursue tough measures to ensure medium-term fiscal

consolidation and containment of the sovereign crisis in Europe. Moreover, financial markets remain jittery as the final outcomes of agreed commitments are not a foregone conclusion.

- The risk of disorderly outcomes is high, and balance sheet repair, especially of those banks most exposed to the European periphery, should be bolstered. Hoping for the best is no substitute for preparing for the worst, and the markets are well aware of that. More extreme measures on debt restructuring might be unavoidable if fiscal transfers are ruled out and fatigue settles in debtor countries.
- In an environment of financial uncertainty and fiscal retrenchment, monetary policy should remain supportive.

Emerging Market Economies (EMEs) and smaller, financially stable AEs, are threading carefully in this uncertain environment, and as we saw a few years ago, it is unlikely that full decoupling will occur under most scenarios. The Fund's advice should properly recognize that the rebalancing challenges are not the same across this heterogeneous group of economies; thus, an adequate level of differentiation in terms of policy advice is called for. In this regard, we would like to note that:

- If the external scenario should worsen significantly, many EMEs with flexible exchange rates and inflation-targeting regimes would have scope to adjust monetary policy, thanks to a timely process of raising interest rates to contain overheating risks. Going forward, these economies will be able to react flexibly to changing global circumstances in a context of anchored inflationary expectations.
- Other EMEs have limited room for maneuver, as their economies have expanded beyond their potential output, with widening fiscal and external deficits, and thus today face the risk that external shocks might unhinge inflationary expectations and force pro-cyclical monetary and fiscal policy adjustments.
- A third group of EMEs has maintained structurally high national saving rates throughout the expansion phase of the global cycle and might be subject to a natural deceleration as the global economy cools down. In these cases, undertaking reforms to boost domestic demand would help sustain both medium-term global rebalancing and short-term policy accommodation.
- Economies that are being affected by high commodity prices, particularly Low-Income Countries (LICs), should strive to develop targeted policies to the most vulnerable groups through efficient cash transfers, instead of across-the-board subsidies. The international community should strive to support these efforts through similar measures, as demand subsidies or export constraints in non-LIC economies exacerbate commodity price pressures.

Policy advice by the Fund should be tailored to these different groups of economies. Policy recommendations that are appropriate for some economies are not necessarily suitable for other economies. One salient theme, however, is that fiscal policy space is more limited

across the spectrum than it was in the run up to the 2008-2009 financial crisis. Moving from broad policy recommendations to concrete messages on policy implementation is required to draw the policy-makers' attention and establish a constructive dialogue. The Consolidated Multilateral Surveillance Report is a positive step in that direction.

## **II. The Medium-Term Challenges and the Fund's Action Plan**

Under the current circumstances, the Fund should focus on its short-term policy challenges. Indeed, one of the main issues that the Fund is tackling right now, namely the Triennial Surveillance Review, will be shaped directly by the lessons that the practice and traction of surveillance reveal in the current uncertain environment. Such surveillance practices will be the basis on which to revamp the surveillance framework, for instance, through an integrated surveillance decision that encompasses both its bilateral and multilateral aspects.

The Fund's resource adequacy is, in our view, directly linked to the functioning of Regional Financial Arrangements (RFA) and the existence of bilateral central bank swap lines. It is welcome that major central banks are currently cooperating in this area. A reasonable question is whether current Fund resources, plus those available through RFAs and bilateral swap lines, are sufficient to deal with a significant major financial dislocation.

Assessing these resource needs is critical to evaluate whether, for instance, the New Arrangements to Borrow will have to remain active, even if the quota increase is fully implemented by next year. Moreover, the discussion of resources would have to be linked to a broader rethinking of the need for alternative lending instruments to bolster the global safety net.

This topic should be given higher priority at the current juncture and not, as in our previous IMFC meeting, simply as part of a broader agenda for IMS reform. The activation and deactivation, and the criteria for conditionality, for the Flexible Credit Line or similar instruments could be reviewed, towards making them closer substitutes to bilateral swap lines that have been implemented by major central banks. This would help reduce the stigma associated with the Fund's toolkit, and would contribute to ensure adequate liquidity provision in times of market stress.

## ARGENTINA

In the past decade, Argentina's economy has undergone an unprecedented structural transformation. Since the 2001/02 crisis, Argentina has recorded eight consecutive years of growth, a sequence that has not been witnessed since the 1963-1974 period. Between 2003 and 2010, average annual economic growth was almost 8 percent, but the outstanding aspect of this unprecedented growth period is that it was achieved together with a noticeable reduction in poverty, unemployment, and inequality. From the point of view of the Argentinean experience, growth must be broadly shared in order to build a more mature and sustainable economic and social structure.

Argentina follows a solid path that sustains high rates of growth as a result of the policy framework followed by the country since 2003. It is based on a sound macroeconomic policy framework supported by continuous twin surpluses, external and fiscal, a dis-indebtedness process with no precedents, responsible fiscal and monetary policies, a floating exchange rate regime, and the accumulation of foreign reserves. In this regard, the historical pattern of stop and go that has characterized the Argentinean economy since the post-war period was avoided. Key components of the model are job creation, fairness and social inclusion and income distribution. In the past eight years, the average income per capita grew by 60 percent in real terms and public expenditure per capita increased tenfold during the same period. 3.5 million jobs were created, with unemployment decreasing from 18 to 7.3 percent, while the average real wage climbed 37 percent. Improvements in the minimum wage, as recently occurred, benefit both the functional and the personal income distribution. We share the view that equality is an important ingredient in promoting and sustaining growth.<sup>1</sup> Social and political stability supported economic stability, and social participation was preferred to social repression. Argentina has also been particularly successful in guarding the most vulnerable sectors of its population, as well as its producers from the recent episodes of volatility in international commodity prices. Agricultural commodities play a very important role in the Argentine economy, as we are a major producer and exporter of these products.

When Argentina was hit by the impact of the international financial crisis, it was resilient due to the solid macroeconomic framework. The country had the needed fiscal space and financial robustness to implement a countercyclical policy. This policy could sustain domestic demand and employment, at the same time that it made it possible to protect the weakest sectors of the population. GDP growth was close to 1 percent in 2009 and recovered swiftly during 2010 to reach 9.2 percent. In the first quarter of 2011 it increased by 9.9 percent year-on-year. Unemployment in the second quarter of 2011 fell to 7.3 percent from 7.9 in the second quarter of 2010.

The financial system proved to be resilient and emerged unscathed from the international financial crisis. After almost collapsing in 2001-2002, the financial system is now solvent, liquid, well-regulated and capitalized. It continued increasing the dynamism of its financial intermediation activity with the private sector, in a scenario in which the economy is

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<sup>1</sup> See Finance & Development, September 2011, Vol. 48, No. 3, Page 13.

recovering from the impact of the international financial crisis faster than other regions. 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.

Since 2003, Argentina has applied a set of measures aimed to progressively stabilize public debt, creating a sustainable repayment capacity. In the past eight years, the debt-to-GDP ratio has been reduced from 166 percent to 43 percent; balancing composition by currency, terms, interest rates and types of creditors, these outcomes show that financial policies have been effective. Among said outcomes, it is important to highlight that more than 92 percent of creditors accepted Argentina's restructuring proposal in 2005 and 2010 debt exchange. This displays a clear commitment of the country to repay its debts.

At the same time, it contrasts with creditor behavior, known as vulture funds, who seek privileged treatment through litigations within legal gaps even though they have acquired sovereign debt at abusive prices. Due to the lack of an international legal framework for sovereign debt restructuring, Argentina continues dealing with a minority of litigious creditors whose greed impedes a full completion of the debt-restructuring process. During said dis-indebtedness process, Argentina is also sending positive signals to the markets in order to avoid the excessive reliance on the opinions of credit rating agencies. It is well known that credit rating agencies do not often reflect debtor solvency correctly, as can be seen in the case of the downgraded U.S. Treasury Bonds. We believe it is necessary to continue to rethink the role played by credit rating agencies through concrete policies aimed at reducing dependence and enhancing supervision.

Argentina has a clear intention to advance step by step in the recovery of a normal relation with the international financial community and the IMF. In November 2010, there was an agreement with the Fund to produce a new CPI at the country level, and two IMF missions have already visited Argentina. The Report on the Observance of Standards and Codes was requested in December 2010 and the mission has already visited Argentina and prepared the reports. In April of this year, the Financial Sector Assessment Program was requested and will take place in 2012. By the end of May, Argentina fulfilled all of its commitments in relation to the IMF programs related to Low-Income Countries (LICs), Liberia and the Growth and Poverty Reduction Trust. In early June, a law was sanctioned in the Argentine Congress to fight money laundering, in agreement with the international legislation on this matter. There is a team and a program assigned to implement the law.

Long-term challenges are being addressed through the record rate of investments of the past 50 years and by doubling the percentage of expenditures in science and technology in relation to GDP. Investment grew by a significant 15 percent in 2010, accounting for more than 23 percent of GDP, a performance explained by both private and public investment. In 2007, the Ministry of Science, Technology and Productive Innovation was created to incorporate science and technology to the service of economic and social development. Investments in the provinces are supported by the government-established Federal Solidarity Fund (Fondo Federal Solidario), funded by the collection of 30 percent of the export taxes on

soy complex, which has been oriented to infrastructure such as building schools, houses, drinking water processing plants, and water and sewage networks.

In order to enhance financial deepening, the Argentine 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 achieved a record for the Argentine economy reaching 22.7 percent of GDP, which shows that there is still room for 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 the Bicentennial Program to Finance Production (Programa de Financiamiento Productivo del Bicentenario) the Productive Recovery Program (Programa de Recuperación Productiva) and the Local Development and Social Economy Plan “Manos a la Obra”. 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.

As a key component of Argentina’s social safety net, the government has put into effect the Universal Child Allowance Program “Asignación Universal por Hijo”, which was recently heavily increased and has been extended to pregnant women, and other social programs, as well as the social security system, have also been strengthened. The impact of these measures in education has been that around of 300,000 children have been incorporated into formal education. These actions are key steps for fostering a more inclusive society and enhancing distributional fairness as part of the policies aimed at ensuring that the results of growth are shared by the whole population. The program benefits workers in the informal sector, the unemployed, and workers in domestic service who have children under 18, and provides coverage for 3.5 million vulnerable children. The government has budgeted 1 percent of GDP to this program.

Similarly, the social security system has also increased its coverage to 6.5 million beneficiaries and the government has consistently implemented a policy of pension increases to guarantee pensions’ purchasing power. Social spending on non-contributory pensions has also been increased. The Food Security Plan has improved the subsistence capacity of more than 1,500,000 families and expenditure on education has risen to 6 percent of GDP, in line with the Education Law. Argentina’s Connect Equality Program (Conectar Igualdad), launched by President Cristina Fernández de Kirchner to distribute approximately 3 million laptops to secondary school students, is being implemented successfully and more than 1 million laptops have already been distributed. Finally, health spending has also been raised to prevent the H1N1A flu and other diseases, such as dengue fever which, and now at the end of the winter season in the South Hemisphere, it has been very successful.

We must underscore that the IMF decided to include a specific section on the risk of overheating in its latest World Economic Outlook report. We believe that the problem of the so-called overheating has to be reviewed with some systemic economies on the brink of a double-dip recession. In any case, it is not a risk at the same level as high indebtedness,

reluctant growth and high unemployment. Countries like Argentina with 80 percent of productive capacity utilization, 7 percent unemployment and high investment rates should not be considered as overheated. The brakes cannot just be put on the countries that are pulling the global economy out of recession.

The country has learnt a lesson the hard way throughout its history: the crucial role the State must come into 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, a solid banking system, a 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. In respect to regional integration, Argentina has backed the creation of the Economic and Financial Council of UNASUR (Union of South American Nations) to have a forum for economic coordination. Argentina is now well placed to address the challenges of the post-crisis world, based on the structural transformation that the economy has undergone since 2003. The government has put the country back on track and has restored its potential for economic, human, and social development. Last year, the country celebrated its Bicentennial anniversary as a free Republic. In 2012, Argentina will celebrate another anniversary, the Centennial of the institution of universal, mandatory and secret suffrage. It took Argentina 100 years to achieve the political maturity to understand the rights and responsibilities needed to be broadly shared in order to build a legitimate social, institutional and economic framework. Strengthening and continuing with these outcomes will be the main objective for the future.

## **BOLIVIA**

In the first quarter of 2011, aggregate production grew by 5.7 percent (2.7 percent in 2010), as result of an increase in the dynamics of most of the sectors, the greater credit to the private sector, and a favorable external context. Hydrocarbons annual growth exceeded 15 percent. Natural gas production volumes showed levels higher than those observed last year. Also, oil production recorded a reversal of its declining trend experienced over the past years.

On the expenditure side, growth has been underpinned by domestic demand, driven by private consumption and investment. Investment in the private sector would be pointing to sustained growth and its trend coincides with the increase in the portfolio of the financial system since the second quarter of 2009. GDP Growth in 2011 would be greater than estimated at the beginning of the year (5 percent vs. 4.5 percent).

The favorable external context has brought positive results to the current account and capital and financial accounts. The balance of payments surplus has led to the greater accumulation of international reserves, which reached a new record of \$ 10.751 million at the end of June. The surplus in the balance of payments in the first quarter comes from the positive current account balance (0.8 percent of GDP) and the surplus in the capital and financial account (3.1 percent of GDP). Remittances from abroad also contributed to this performance. The

positive balance of trade allowed an improvement in the terms of exchange of 7.7 percent. Greater flows of foreign direct investment (mainly hydrocarbons and industries) have boosted the capital account.

As of July 2011, the fiscal position is positive (4.5 percent of GDP), even though the authorities are engaged in expanding public investment. They have projected a manageable deficit for the whole year. Tax collection has increased by 35 percent, *vis-a-vis* the same period in 2010. Bolivia will continue to follow its model for state-led economic development relying on a significant expansion of public investment, while at the same time aiming to reach fiscal discipline and sustained growth, with more equal income distribution through social programs to reduce poverty. The fiscal authorities are seeking a greater efficiency in public finances administration, as well as expanding the tax base through administrative and corrective measures rather than tax increases. External public debt is evolving smoothly and is below 15 percent of GDP as of August 2011.

In line with the orientation of monetary policy, the growth of the monetary base recorded a substantial slowdown between January and June 2011. In the same vein, the wider monetary aggregate growth rates remained moderate keeping pace with their long-term fundamentals, an indication that there is not an excess supply of money in the economy. Indeed, money in the broad sense recorded a growth rate of approximately 13 percent at the end of the first semester. The continuation of the process of bolivianization led to growth of domestic currency in circulation and to a greater preference for less liquid assets in such currency.

The policy of the Central Bank of Bolivia aims to mitigate the adverse effects of economic cycles. In the first half of 2011, there was a progressive increase in the prices of commodities for export, as well as an improvement in the external inflows of income. Also, there has been a growing trend of imported inflation, ample liquidity in the financial system and good prospects for net domestic credit. Accordingly, the Central Bank began the withdrawal of monetary impulses, increased the range of open market operations and implemented changes on the reserve requirement rate. These policies were complemented with a currency appreciation to mitigate the effects from imported inflation. Thus, the liquidity of the banking system was declining and inflation decelerated since March 2011. It is expected that the rate of inflation at the end 2011 will not exceed 6 percent.

Financial intermediation has deepened while there have been moderate increases in money market interest rates, without affecting the dynamics of credit, especially in the productive sector. In the first half of 2011, the authorities also implemented other measures to control inflation, like increasing the supply of some staple foods. Inflation risks are concentrated on imported inflation and the evolution of expectations, which could affect prices in both directions, while better performance of the agricultural sector would be an important factor to tackle inflation pressures. The positive performance of the financial system has given signs of stability of the market.

## CHILE

The Chilean economy has continued to experience a healthy expansion, and is expected to grow between 6.25 and 6.75 percent in 2011. The normalization of monetary policy (through sustained monthly hikes in the monetary policy rate from 0.5 percent in mid 2009 to 5.25 percent by mid 2011), the withdrawal of fiscal policy stimulus in place in 2009, and the softening of global growth, lead the authorities to expect a convergence in GDP growth through the rest of 2011 and into 2012, with an expected growth rate of 4.25 to 5.25 percent next year. Such moderation in growth prospects is consistent with avoiding overheating risks and ensuring overall macroeconomic and financial stability, given the uncertain current external environment.

A normalized monetary and fiscal policy stance and the consequent moderation in terms of growth outlook, along with the reduction in international commodity prices have all lowered inflation expectations significantly. Whereas six months ago the authorities considered likely that inflation would reach above 4 percent by end year, currently inflation is expected to remain close to the Central Bank's target of 3 percent over the next two years. Private and market inflationary expectations have moderated in line with official projections.

Monetary policy prospects have adjusted accordingly. The Central Bank has stated that from the current monetary policy rate of 5.25 percent, considered within a normal range, future movements will depend on the inflationary implications of domestic and external developments.

Domestic financial markets have reflected global financial turbulences but without local disruptions. The stock market has gyrated closely with global equity prices, long-term interest rates have fallen, along with lower expected inflation and the moderation of growth and monetary policy expectations, and the exchange rate has weakened somewhat. Money market conditions have remained normal and risk spreads have stayed stable. Credit conditions for households and firms have moderated without becoming restrictive. In a recent international bond issuance, the Government issued a USD 1 billion bond and a USD 350 million peso-linked bond, to bolster the liquidity position of the public sector, receiving historical low yields, of 3.25 percent and 4.4 percent, respectively.

Although more significant disruptions in global financial markets are unlikely to leave the Chilean economy unscathed, its underlying conditions ensure that mayor damages can be prevented. Liquidity and solvency buffers in financial intermediaries are high, and the current account is expected to post a moderate deficit of 1 percent of GDP this year. The fiscal balance will show a surplus of over 1 percent of GDP this year, consistent with a moderate spending growth rate of 4.6 percent for 2011. The international reserve position, along with the neutral stance of monetary policy in a context of contained inflation expectations, leave significant policy space for the Central Bank to react in case of a further worsening of the outlook.

Chile's sound regulatory framework has been instrumental in maintaining macro-financial stability during 2008-2009 and to prevent the appearance of financial excesses in the subsequent recovery. Recently implemented institutional reforms, aiming at improving the coordination of regulators, the Ministry of Finance and the Central Bank, also contribute to bolster the capacity of the Chilean economy to face the challenges the current uncertain global environment poses.

## **PARAGUAY**

After last year's record output, Paraguay's GDP growth is projected to reach at least 5 percent in 2011, driven by the continued expansion of the agriculture sector, favorable macroeconomic conditions and strong private sector investment. High prices for Paraguayan commodity exports and rising foreign investments are expected to continue this year, given the country's vast natural resources and predictable fiscal and monetary policies. The current efforts at enhancing public infrastructure are expected to stimulate growth in the remaining months of the year, as suggested by the private-sector survey of expectations for economic variables, which estimates 5.7 percent output growth for 2011.

Monetary policy has remained focused on keeping inflation within the Central Bank's target range of  $5 \pm 2.5$  percent. Although current year-on-year inflation is slightly above target, prices are stabilizing, assisted by the tightening of the policy interest rate and by the substantial appreciation of the Guaraní. More recently, the Central Bank has maintained its policy interest rate unchanged considering that inflationary pressures have eased and that credit growth has also started to come down toward more sustainable levels.

Fiscal policies have played a countercyclical role in recent times to mitigate the impact of the global crisis. Sound fiscal management during the years prior to the world economic turmoil resulted in eight consecutive years of fiscal surpluses. For 2011, strong tax revenues and moderate spending growth are expected to keep the fiscal position in balance. Moreover, public finances will benefit from the recent approval by the Brazilian Congress of a threefold increase in compensation paid to Paraguay for the use of electricity from Itaipu Binacional, the hydroelectric power company jointly owned by Paraguay and Brazil. The authorities are looking forward to the approval of a special Development Fund (FONDES) that will channel the extra annual revenue windfall to public investments and an anti-cyclical stabilization fund.

The banking system remains healthy despite the difficult international financial scenario. The recently conducted Financial Sector Assessment Program (FSAP) confirms the soundness of the financial sector and provides a roadmap for the areas of improvement, which the government is currently implementing. Bank credit and deposits are continuously expanding, non-performing loans remain low, and bank profitability continues to be very high. In line with international trends, the Central Bank has decided to increase the required minimum capital of banks and finance companies and to establish generic provisions for the sector. These macro-prudential policies will come into effect at the beginning of 2012.

The external position continues to be strong, as evidenced by the record level of international reserves, currently more than twice the size of public external debt, which the authorities consider an appropriate buffer against external shocks. Notwithstanding the favorable prospects for the Paraguayan economy, the authorities are aware of domestic and external risks to this outlook, and stand ready to fine-tune policies in case economic imbalances appear.

## **PERU**

The newly elected government, which took office in July 2011, has signaled its commitment to deepening reforms with an aim to further diminish poverty and equalize opportunities while preserving macroeconomic stability. Considering the uncertain international environment and the moderation of growth associated with the 2011 election process, the growth forecast for 2011-2012 is estimated at around 6 percent on average. At the same time, Peru's performance remains solid, as reflected by sound economic indicators and the recent upgrade of Peru's sovereign debt.

Between June and September of this year, the Board of the Central Bank has kept the reference rate preventively at 4.25 percent, in view of continuing global deceleration and uncertainty. This scenario is consistent with favorable economic activity, with inflation converging gradually towards the target range during 2011, helped by subsiding food and fuel inflation. The Central Bank stands ready to use its whole range of monetary tools (including the reference rate, reserve requirements, macroprudential measures, and interventions in the foreign exchange market) to ensure adequate liquidity and prevent real-sector spillovers in case risks materialize. The Central Bank and the Ministry of Economy have ample room for maneuver, underpinned by solid fundamentals, especially high official reserves, declining dollarization, greater export diversification, and a sound fiscal position. Regarding the latter, Peru's persistent fiscal strength is reflected in considerable fiscal surpluses (estimated at 1.0 percent and 1.2 percent of GDP in 2011 and 2012, respectively) and in the continuously declining trend of public debt (21.4 percent and 20.2 percent of GDP expected for 2011 and 2012, respectively).

## **URUGUAY**

In Uruguay, the authorities are fully aware of the challenges and risks that the new phase of the global crisis brings about, although, at the same time, they are confident that the country will face it from a position of strength. The latter does not mean complacency at all, but a renewed impulse to continue reinforcing sound policies and structural reforms, which have allowed Uruguay to build important buffers in recent years.

The country's economic activity keeps increasing robustly, while future GDP expansions are projected to be more in line with Uruguay's potential growth; exports are well diversified in terms of product and markets; unemployment rates remain at historical lows; and fiscal policies continue to be prudent, which is reflected in the government's stance with regard to the current annual review of the budget (*Rendición de Cuentas*), and, more generally, in a modest overall fiscal deficit, and debt-to-GDP ratios following a declining trend. Confidence in Uruguay's situation and prospects allows the authorities to substantially strengthen the country's debt profile: for instance, just 3.2 percent of the debt is due in one year; 92 percent of the debt is established at fixed rates; and a critical change of the debt denomination is evident (58 percent and 42 percent in foreign and local currency respectively, compared to 85 percent and 15 percent five years ago). As in many developing economies, inflation has been a matter of concern for the authorities, which required further efforts from the monetary and fiscal sides, exhibiting a deceleration over the last two months. Meanwhile, a flexible exchange rate has constituted another sound buffer to deal with external shocks; and international reserves, at solid levels, cooperate to reinforce confidence.

Regulatory and supervisory frameworks, as well as public banks, have been drastically transformed over the past decade, and the fruits of this transformation are patent, for instance, in a negligible amount of non-performing loans, a healthy level of bank credit relative to GDP, and sound liquidity and capitalization indicators, all of which compose key aspects to cope with the new challenges. Furthermore, in addition to Uruguay's current financial buffers, the authorities have been working to further reinforce the country's available battery of responses, and, in this regard, they have already obtained contingent credit lines from regional and multilateral institutions.

Of course, Uruguay's robust growth and economic stability constitute a necessary condition to strengthen the population's welfare. Prudent policies, meanwhile, allowed Uruguay to have more room to implement a number of coordinated, transparent and well-targeted social policies, which have paved the way for Uruguay to make sizeable social achievements. In this vein, it is worth noting that poverty declined from 25.7 percent of households in 2006 to 12.6 percent in 2010, while extreme poverty dropped from 2.7 percent to 1.1 percent during the same period. Once again, it is possible to see a virtuous process in which economic and social attainments fortify each other. In sum, while preparing for the considerable challenges stemming from the global crisis, Uruguay is making important efforts towards reaching a higher degree of development, which comprises a sustainable prosperity, as well as increasing and equitable opportunities for the entire society.