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**IMFC Statement by Rodrigo Vergara
President of the Central Bank of Chile, Chile**

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

**Statement by Governor Rodrigo Vergara, President of the Central Bank of Chile
On behalf of the Southern Cone Constituency
(Argentina, Bolivia, Chile, Paraguay, Perú, and Uruguay)**

Outlook and Current Macroeconomic Issues

Since October, expected global growth has weakened once again, both in advanced economies and emerging markets. Economic expansion continues to be driven by emerging economies, while growth in advanced economies is suffering from structural trends and some remaining crisis legacies. Moreover, downside risks have increased, stemming to a large extent from the threat of deflation in some major economic zones, the uncertain effects of the rebalancing process in China, the negative impact of low commodity prices in exporting countries and geopolitical tensions in different regions of the world. In addition, increased financial market volatility has compounded global risks, notwithstanding some recent recovery in market sentiment.

Considering the current global conjuncture and associated downside risks, we broadly support the Global Policy Agenda's three-pronged approach, with monetary, fiscal, and structural reforms taken in concert, geared to strengthening growth in advanced economies and securing resilience in emerging markets and developing economies. Regarding monetary policy, two of the world's biggest currency zones are engaged in monetary easing while the United States is, albeit prudently, tightening its monetary policy. We support the calibration of conventional and unconventional monetary policies according to the observed domestic cycles and inflationary outlooks. However, in addition to the risks related to speed and smoothness of the exit strategy in the U.S., we are also conscious of the potential reverberations that long-standing expansionary policies may have on financial stability. In this vein, we welcome the Fund's analysis and policy advice on the eventual damaging effects of extended periods of low or even negative interest rates on different segments of the financial sector, including banks' profitability and the insurance industry. Regulatory and supervisory prudence is in order to mitigate potential risks to financial stability.

We also see a case for positive fiscal stimulus in economies with fiscal space; at the current conjuncture, most likely to be found in advanced economies. The very low levels of long-term sovereign bonds is a clear sign that scope for accommodative fiscal policy is appropriate without undermining medium-term soundness. In our view, a coordinated contingency approach to foster not only domestic but also global demand, calls for a prompt identification of countries having fiscal space and being mindful of the constraints imposed by well-established fiscal rules. Moreover, whatever the fiscal space countries may count on, medium-term fiscal plans should be coordinated with monetary and structural reform policies.

Increasing sustainable and inclusive growth relies inevitably in advancing structural reforms that enhance productivity. In this vein, we consider the analytical chapter of the World Economic Outlook (WEO) on Structural Reforms in Advanced Economies to be very valuable by providing sensible policy advice. Identifying appropriate priorities, timing, sequencing, distributional effects and recommended interactions with complementary demand policies, represent critical questions for policymaking, across all the membership. We, therefore, encourage extending the analysis to emerging and developing economies, where we have also been observing slowdowns in productivity growth and systematic downside revisions by the Fund to estimates of potential growth. We are also mindful that in more specialized areas of reform, the Fund's policy advice may be largely enhanced by collaboration with other multilateral organizations.

The Latin American region has been particularly affected by the negative consequences of sharp drops in commodity prices and tighter financial conditions. Most economies have adequately deployed their policy tools within macroeconomic frameworks that include sound fiscal and monetary policies and a flexible exchange rate. These actions are complemented by modern approaches to regulation, supervision, and the use of macro prudential policies. Under the current conjuncture, we would also underline the need to continue improving policy frameworks that facilitate the reallocation of resources from declining natural resources sectors toward those gaining competitiveness, helping the diversification of the export base. We welcome further policy advice on these subjects, both in the context of country surveillance and the research agenda.

The conclusions of the WEO analytical chapter on Understanding the Slowdown of Capital Flows to Emerging Countries reassure the appropriateness of policies adopted in the region. The results presented tend to confirm that diminished prospects for growth in emerging countries can explain most of the slowdown in capital inflows. In terms of domestic policies, the results also confirm that flexible exchange rates have helped mitigate the slowdown and that capital swings are smaller in countries with larger fiscal and external buffers. As next steps, we encourage further research on the dynamics of capital flows during periods of market turbulence and liquidity shortages, including the effects of disorderly retrenchments of capital flows on balance sheets, derived from exchange rate adjustments.

IMF Institutional Issues

The International Monetary System (IMS) needs to continue progressing after the 2008 financial crisis in order to accommodate observed trends in the global economy. These include China's rebalancing and larger influence in financial markets, global current account imbalances and financial spillovers in the context of a more uncertain outlook of the global economy. In this vein, we welcome efforts to identify potential areas for improvement, including the recent stocktaking of the IMS, and associated reflections on the adequacy of the Global Financial Safety Net (GFSN) and Fund resources. In our view, a practical approach is warranted, benefiting from lessons of previous unsuccessful endeavors.

We are convinced that the cornerstone of a well-functioning IMS remains to be the observance by members of sound economic policies within adequate macroeconomic frameworks. The IMS is strengthened by macroeconomic discipline and financial stability in each member country of the system. In turn, the Fund may greatly contribute to having a better IMS through enhanced bilateral and multilateral surveillance, on both advanced and emerging economies, by adapting its financing tool kit and strengthening its technical assistance and capacity building functions.

The IMF needs to continue upgrading its crisis prevention capacity through enhanced surveillance frameworks. In particular, considering the growing importance of financial spillovers across sectors and borders, we welcome the integration of real and financial sectors in the analysis, including less regulated credit to non-bank institutions. Similarly, we support the Fund's participation on multilateral efforts to strengthen the global regulatory reform agenda and supervision. Coordination with other layers of the GFSN should also be explored considering the unique stages of development, mandate, and structures of Regional Financial Agreements.

As external financing conditions continue to change following a period of exceptionally loose monetary policy, the Fund must stand ready to support the membership. We look forward to revisiting the Fund's policy toolkit and are open to exploring proposals for the further enhancement of instruments, according to the new realities, including the consequences of commodity price declines and weather-related shocks. We also highlight the need to examine the recent experience with precautionary facilities, such as Flexible Credit Lines, and the possible explanations behind their low utilization by economies with sound economic fundamentals, including stigma and difficulties in defining exit strategies by users. The persistent environment of financial and commodity price volatility clearly shows that an exit from these precautionary facilities would be premature.

The Fund ought to focus its contribution on its core mandate, and establish priorities for advancing the process of policy advice on emerging macro critical issues. The agenda includes the macroeconomic impacts of migration in both recipient and sender countries, income inequality, gender issues, climate change, and factors affecting medium-term growth (demographic shifts, gender, governance, and technological change). We support building expertise on these new issues as long as it does not affect the capacity to continue providing high quality expertise on traditional core areas. In addition, we encourage retaining flexibility regarding the pace at which new issues are absorbed within the agenda, including a more global initiative to contain spillovers from non-economic sources, such as refugee flows sparked by geopolitical conflicts and global epidemics. The Fund should actively collaborate with other IFIs on these matters.

Quota and Governance Reform

We welcome the entry into force of the 14th General Review of Quotas and the Board Reform Adjustment which represents a crucial milestone in assuring the Fund remains a quota-based institution. At the same time, we support working expeditiously toward completion of the 15th General Review of Quotas, including a new quota formula, by the 2017 Annual Meetings and the maintenance of the current overall lending capacity, based on the “burden sharing” principle among the shareholder countries. A prompt and successful review will be an important step toward ensuring that members’ quota shares reflect their positions in the world economy.

Argentina

Substantial policy changes in Argentina. After 12-years of populism a new administration took office on December 10, 2015. Argentina was left with significant macro-economic imbalances and both its current account and its fiscal balance sheets in the red. The former administration financed them by printing fresh money and depleting the central bank’s reserves. Exchange rate controls and import restrictions were imposed in a fruitless effort to contain inflation and conceal the real appreciation of the peso. Exports collapsed, a foreign exchange black market flourished, and inflation was above 30 percent in the 12 months preceding the change of administration.

Rather than acknowledging problems, the previous administration “tailored” statistics to fit a triumphant narrative. Since 2007, the official statistics agency lost its independence and was turned into an Orwellian “Ministry of Truth”. Inflation figures were systematically under-estimated and output figures conveniently inflated to suit a triumphant narrative that demonized corporations, creditors, and “imperialism”. With large margins of political discretion, arbitrariness flourished. The administration picked winners and losers and corruption, admittedly an “endemic” problem, turned rampant.

Taking stock of the “heritage”. Underpriced public tariffs and an unfriendly business environment cooled investment. Between 2005 and 2015 Argentina descended from 54th position to 106th position in the competitiveness index prepared by the Global Economic Forum.¹ More than 1.2 million would-be workers cannot find jobs and about 3.8 million are in the informal sector. Unemployment figures under-estimate the problem because national and provincial governments are overstaffed. Disorder, mismanagement, corruption, poor records and lack of credible statistics compound the challenge.

¹ See <http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings> and http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2006-07.pdf, page xvii.

During its first week in office the new administration eliminated exchange rate restrictions and allowed the peso to float. Foreign exchange controls were dismantled in December 2015, resulting in an initial 55 percent nominal depreciation of the peso to the US dollar that largely closed the gap between official and parallel exchange rates. Argentina now has one single exchange rate, in line with the previous un-official “blue-rate”.² The pass-through of this depreciation to domestic prices was quite moderate (approximately 15 percent). In fact, this allowed for a real depreciation of the national currency of about 35 percent, partially reversing the accumulated real appreciation of the peso over the past five years.

The relatively smooth peso adjustment was accompanied by a sharp increase in policy interest rates by the Central Bank of Argentina (BCRA). In just two months the BCRA has reduced the monetary base, which was previously swelling (growing at 41 percent y-o-y, December 2015) and is now contracting (growing at 31 percent y-o-y). After a very pronounced rise in policy interest rates in December, the BCRA has been fine-tuning them and has recently announced that, henceforth, it will stop targeting monetary aggregates. Consistent with its intent to progressively move towards an inflation-targeting regime, it will, instead, use policy interest rate levels as its main tool.

Argentina is now in full compliance with its obligations under WTO and regional trade agreements. Importers were previously obliged to request the “approval of a non-automatic import license”³ and undertake investment and local-content commitments. This is no longer the case. At the beginning of 2016, the new administration eliminated all non-tariff restrictions to imports, as requested by the WTO. The government also eliminated most export taxes. The fall in commodity prices deteriorated Argentina’s terms of trade but the currency adjustment and the aforementioned removal of most export taxes are already boosting exports and turning around the trade balance. Moreover, the new business climate, the government’s sensible macro-economic policies and its determination to fight corruption, respect of the judiciary independence and enforcement of the rule of law will attract capital inflows.

Striving to cushion low and middle-income households. The size of the fiscal deficit inherited (approximately 7.5 percent of GDP, largely financed by the central bank) makes fiscal consolidation unavoidable. However, the administration is implementing it in a socially responsible manner. The prices of heavily subsidized public services (electricity, natural gas, transportation) have been steeply augmented, but, in parallel, the administration has also established “social-prices” for low-income households, increased pensions (by 15.35 percent) and hand-outs for low-income sectors, such as the “Asignación Universal por Hijo” (also

² The outlawed black market.

³ Declaraciones Juradas Anticipadas de Importación (DJAI).

increased by a similar percentage) and raised the minimum income-tax threshold by 160 percent (which despite very high inflation had not been adjusted up since 2013).⁴ Moreover, a bill will be sent to Congress to refund low-income households of VAT collected on all debit card purchases. All of these measures will help the middle-class and, especially, the most vulnerable to deal with this stage of relative price adjustments, for a total of 1.5 percent of GDP.

Reversing the sharp rise in fiscal expenditure by the last administration. As noted before, tariffs of public services needed to be adjusted. The government is phasing-out costly and unsustainable subsidies that were largely pocketed by households in the city of Buenos Aires. The government is also rationalizing the over-sized public payroll and trimming discretionary expenditures. It has vowed to gradually bring the fiscal deficit down to a more manageable level of around 2 percent of GDP in the coming years and eliminate it in four years' time. However, this administration is already delivering. Indeed during first two months of 2016 fiscal revenues grew by 28 percent (yearly) while the primary expenditure rose by only 23 percent (also yearly).

Neither denying inflation nor rigging statistics. The new authorities have publicly announced inflation targets and have re-established the independence of the official statistics agency (INDEC). The new INDEC is working at full speed to restore the integrity of official statistics and to produce credible CPI and GDP measures in the incoming months.

Ending more than a decade of litigation. Argentina is about to end a long-lasting litigation and regain access to capital markets. Creditors that had not accepted the debt restructuring offers made in 2005 and 2010 obtained favorable rulings in New York courts. The previous administration publicly stated that it would not abide by the relevant court rulings and refrained from negotiating a settlement with hold-out creditors. The new administration government made a 180-degree turn in direction. Rather than bullying litigating creditors and defying the competent courts, it declared its determination to strive for a fair and negotiated settlement to the long-standing dispute. Argentina's officials immediately engaged in serious negotiations and reached a middle-ground agreement with most of its litigating creditors. The agreement was then submitted to Argentina's congress and approved by ample majorities in both the lower chamber and the senate, a very successful outcome, considering that the government does not enjoy a majority in neither chamber.

At the time of drafting this statement, Argentina is doing everything necessary to tap financial markets and borrow over US\$ 12 billion to honor the agreement the country reached with its remaining creditors. Regaining access to credit markets will allow Argentina

⁴ The salary at which workers start paying taxes will now double, to 30,000.00 Argentinean Pesos (US\$ 2,000 per month). Reductions to the percentage of VAT for some products that benefit low-income sectors of the population are under analysis.

to redress its macro-economic imbalances in a socially responsible way and finance the infrastructure projects that it badly needs to improve competitiveness and to ensure that modernization and prosperity reach low-income families. The road show has already started.

Transparency and back to normal. President Macri has vowed to make his administration abide by best transparency practices. In that rationale, the new authorities have decided to publish the reports produced by the IMF since Argentina stopped accepting annual Article IV consultations with the Fund, including the Financial Sector Assessment Program. Furthermore, the authorities are committed to re-initiate the annual consultations with the Fund during the second semester of this year.

Bolivia

Despite adverse external shocks coming from the deterioration of terms-of-trade, Bolivia was still able to reach one of the highest economic growth and the lowest inflation rates in South America. As a result of the performance of domestic demand stemming from fiscal and monetary impulses, the country was able to sustain the dynamism of the economic activity aimed at further strengthening the output capacity and therefore making progress towards decreasing poverty in the country. As such, growth was still strong in 2015, estimated at 4.8 percent, close to the authorities' target. Non-extractive sectors, mainly manufacturing, agriculture, financial services, transport and communications performed very well unlike mining—which grew less than in 2014—and hydrocarbons which had a small negative growth. On the other side, domestic demand remained strong as investment and consumption kept momentum. Public investment is still the engine of the economy as it stimulates the economy along with the expansionary monetary policy. In 2016 the authorities will follow the same path and growth is expected to reach 5 percent, although climate events coming from El Niño and La Niña may affect such expectations.

The fiscal balance ended up with a deficit of 6.6 percent of GDP in 2015, higher than expected because the fiscal authorities were engaged in keeping the growth momentum for the economy using the buffers accumulated from 2006 onwards to domestically finance public investment which continued strong, aimed at expanding and upgrading physical infrastructure, particularly roads and energy projects. Fiscal income declined in 2015 due to lower tax income from exporting activities, particularly hydrocarbons, but the strong domestic demand was supportive of tax income and the authorities will continue to boost it. A fiscal deficit is expected for 2016 although smaller than in 2015 (6.1 percent) as implementation of the public investment program will go on within the framework of the 2016-2020 Development Plan using mainly domestic financial resources (75 percent) and external borrowing. Public investment is crucial for the country since it is pivotal for enhancing the potential output going forward and creating a friendly environment for private investment. The Bolivian economic model relies on a key role of the State which has proven

to be efficient since 2006, not only for income redistribution, but also for the sustainability of macroeconomic stability.

Foreign exchange reserves declined in 2015 but reserves-to-GDP remained at a comfortable level, which is still the highest in South America. The Bolivian authorities attach great importance to preserving external solvency and the country still enjoys a creditor international investment position. In 2016 the authorities are projecting a smaller decline in international reserves (around \$ 1 billion) but risking external stability is ruled out. The lower external liquidity in 2015 was offset by fiscal and monetary stimulus that allowed boosting domestic demand without affecting inflation, while generating significant increases in liquidity. At the end of 2015 liquidity reached unprecedented levels and government securities' rates dropped to near zero causing declines in relevant rates in the financial system. Credit in the banking system reached historically high levels, accompanying the stimuli for loans to the productive sector and social housing in compliance with the Financial Services Act.

The stability of the nominal exchange rate allowed the Central Bank of Bolivia (CBB) to anchor expectations and contributed to keeping imported inflation at bay, underpinning the expansionary monetary policy. Meanwhile, the stable exchange rate contributed to strengthening the de-dollarization process, but there are no persistent misalignments of the real exchange rate. Moreover, the fiscal authorities carried out several measures to support the productive sector and ensure food security while remaining vigilant of inflation developments. The CBB continued using policy instruments to encourage household savings while at the same time financing Strategic National Public Enterprises and it will continue to do so in 2016.

Inflation in 2015 was lower than in 2014 (3 percent) and also below the target announced at the beginning of the year, mainly due to the positive agricultural sector performance, low external inflationary pressures, and exchange rate stability. The fall in commodity prices, along with the imports of capital goods, led to trade balance and current account deficits. This outcome was partially offset by capital and financial account surpluses, based on the significant inflows of FDI and disbursements to the public sector. In 2016 the authorities are envisaging an inflation rate around 5.3 percent, given the expansionary fiscal and monetary policies. However, the CBB is prepared to deal with excess liquidity in order to prevent inflationary pressures emerging from supply shocks. The fiscal and monetary authorities will continue to coordinate among themselves to keep the macro variables in check, guided by the annually agreed financial programming framework and they will continue using the policy instruments at their disposal to attain the economy's objectives.

Chile

The Chilean economy is expected to continue growing at a slow rate in 2016, amid a weak external scenario and subdued domestic demand. The economy's deceleration cycle experienced in recent years is associated to the end of the super cycle on commodity prices, especially copper, which has resulted in a drop of investment and mining production, a delayed global economy recovery, and the tightening of external financial conditions faced by emerging economies. At the same time, domestic confidence indicators have remained low for an extended period, while the labor market has shown resilience, with low unemployment rates and high growth in private salaried employment during most of 2015.

The adjustment of the economy to the new global conditions has required an important change in relative prices, supported by exchange rate flexibility and favorable domestic financial conditions. Under its inflation targeting regime, the Central Bank has contributed to this adjustment with a monetary stance that remains highly accommodative, notwithstanding the tightening process that started by the end of 2015 and which is expected to continue at a pace that will depend on the accumulation on new data and its effect on expected inflation. According to the last Monetary Policy Report, the Board of the Central Bank expects that inflation will return within the band during the second half of 2016 and gradually converge to 3 percent in the first part of 2017. Private inflation expectations are coherent with this outlook, and foresee inflation to reach slightly above 3 percent by the end of 2016 and 3 percent within the 2-year inflation targeting horizon.

Fiscal authorities remain committed to a gradual structural fiscal consolidation in order to reach a structural balanced budget position over the medium term. In 2015, the effective deficit reached 2.2 percent of GDP as the result of a decrease in the copper price, the slowdown in activity and a fiscal expansion intended to ameliorate the cost of the macroeconomic adjustment process. In September 2015, the Chilean authorities announced a consolidation plan to gradually reduce the structural deficit by approximately 0.25 percentage points per year. As a result of the substantial decrease in the copper price by the end of 2015, in January of this year the authorities summoned an extraordinary meeting of the committee of experts responsible for defining the long-term price of copper to calculate the structural budget. As a result, the long-term price of copper was reduced by almost 14 percent, increasing the estimated structural deficit for 2016 up to 1.6 percent of GDP. In March 2016, the authorities announced an extraordinary reduction of 0.3 percent of GDP of expenditures included in the 2016 Public Budget in order to reach the preannounced objective of a 1.3 percent structural deficit in 2016, reaffirming their commitment towards fiscal consolidation and sound public finances.

The government has progressed in implementing its ambitious structural reform agenda oriented to improve the quality of Chile's human capital and secure medium-term inclusive growth. In January 2016 a simplification of the 2014 tax reform was approved. During this

year, a series of bills have started gradual implementation, including the ending of for-profit education, copayment, and discrimination practices at primary and secondary levels and the strengthening of public education. In turn, new labor legislation seeks to modernize labor relations by expanding the coverage and scope of collective bargaining, while preserving basic rights to unaffiliated employees. Finally, the authorities have continued progress within a productivity agenda aimed to enhance the inclusion and growth capacity of the economy. In this vein, they have recently announced a set of 22 initiatives on financing, export services promotion, and simplification of procedures for companies.

Paraguay

The dynamism of economic activity moderated in 2015, mainly during the second semester, largely affected by the continuous deterioration of the external and regional context, even more than originally expected. The Paraguayan economy basically experienced three significant external shocks: first, the sharp reduction in the international prices of main export products, especially soybeans, whose price decreased by around 40 percent until the end of the year with respect to the peaks observed in April 2014; second, the ongoing weakening of economic activity in Brazil, the country's main trading partner; and third, the increase in risk premiums, reflected in the augmentation of 140 basis points (bp) of Paraguay's EMBI Global since mid-2014. While GDP growth in 2015 (3 percent) was below average over the last decade, it remained above average for the region.

With regard to prices, inflation stood at 3.1 percent annually last year, consistent with the target over the projected horizon. This was mainly explained by price increases for food, services and durable goods in the imported basket. Likewise, lower fuel prices, due to the reduction of oil prices in the world market, were an important factor that contained inflation.

Nevertheless, since mid-2015 to early 2016 the different inflation trends measures showed a persistently upward trajectory. This prompted the Central Bank to move towards less accommodative monetary conditions, raising the monetary policy rate by 25bp in January 2016, in order to avoid deterioration in inflation expectations. Other central banks in the region have also made similar adjustments to their reference rates.

Regarding the exchange rate, Paraguay, as a small and open economy, was not absent to the US dollar strengthening. In 2015, the Guarani depreciated around 25 percent, lower than the currencies of other countries in the region and its trading partners. Nonetheless, since the beginning of 2016, the US dollar has been weakening in international markets, which partly contributes to the strengthening of regional currencies, including the Guarani. The flexible exchange rate scheme was an important external shock absorber in 2015. In addition, Paraguay still has sufficient levels of reserves to cope with sudden exchange rate volatilities.

As to the fiscal situation, the complex external scenario and moderate dynamism of domestic activity was also reflected in government revenues. In 2015, tax revenues grew 3.4 percent, below the rate in 2014 (18.2 percent), mainly explained by the lower revenues from domestic and foreign trade taxes. On the other hand, the composition of public spending continues to improve. Infrastructure investment grew at a higher level than average rate over the last five years, while current expenditures increased at relatively moderate rates, according to the Fiscal Responsibility Law. With respect to this fiscal rule, the Ministry of Finance is currently analyzing the possibility of introducing a structural balance rule.

The financial system continues to maintain good indicators of solvency, profitability and non-performing-loans, despite the complex economic scenario. The depreciation of the exchange rate has not represented a risk to the system, since most dollar loans are provided to borrowers whose income are in that currency. Regarding the legal framework, the National Congress recently approved amendments to the Banking Law. Moreover, there has been good progress in the reform of the charter of the central bank. These measures will strengthen the regulatory and supervisory role of the central bank, allowing harmonizing with the highest international standards.

Peru

During 2015, the Peruvian economy grew 3.3 percent, due mainly to the boost in mining sector production. On one hand, primary GDP grew 6.6 percent (-2.2 in 2014) due to the start of the production stage of new copper mining projects (Las Bambas and Constancia) and because of the partial recovery from supply shocks faced during 2014. However, some primary sectors, such as fishing and agriculture, were negatively affected by the El Niño phenomenon. On the other hand, the growth rate of non-primary GDP showed a slowdown from 3.6 to 2.4 percent, which was explained by a fall in construction and non-primary manufacturing. This drop was driven by a lower public expenditure, a decrease in private investment and a reduction in non-traditional exports.

The current account of the balance of payments registered a deficit of 4.4 percent of GDP in 2015, higher than that of the previous year (4.0 percent). The expansion in the current account deficit was explained by lower terms of trade (a fall in export prices of 14.9 percent) and because during 2015 no extraordinary income associated with to asset sale operations between nonresidents were recorded (these operations accounted for US\$ 1,213 million in 2014).

On the fiscal front, the economic balance of the non-financial public sector showed a deficit of 2.1 percent in 2015, higher than that of the previous year (0.3 percent). The deficit was mostly explained by a fall in government revenues, mainly because of tax measures adopted

by the end of 2014. The decline of terms of trade, the sol depreciation against the dollar, and the increase in central government expenditure also contributed to the deficit expansion.

In March 2016, 12-month inflation registered 4.3 percent, which mainly reflected the increase in prices of food and electricity impact on prices of the sol depreciation against the dollar. Inflation excluding food and energy increased by 3.58 percent. It is expected that the headline inflation will return to the 1-3 percent target range by the end of 2016.

The Executive Board of the Central Bank (BCRP) decided to raise the monetary policy benchmark interest rate four times starting in September 2015 until reaching 4.25 percent in February 2016. This new interest rate level is consistent with the convergence of inflation to the 1-3 percent target range. The BCRP Board has emphasized the importance of the evolution of inflation expectations on the future of the monetary policy rate.

The BCRP also continued easing reserve requirements in soles during 2015 up to 6.5 percent in order to facilitate credit expansion. At the same time, dollarization ratio of the private sector credit fell from 38.2 percent in 2014 to 30.4 percent in 2015 mainly due to the de-dollarizing measures implemented by the BCRP. In particular, the BCRP has promoted a reduction in foreign currency credit through additional reserve requirements and providing soles through foreign exchange repo operations. The BCRP keeps a high and solid level of international reserves (32 percent of GDP). The current level of reserves accounted for almost six times the level of short-term external liabilities.

Uruguay

Emerging economies and Latin America in particular are going through serious economic circumstances and, as foreseen, Uruguay is not totally immune to these complexities. In fact, the country is showing a considerable economic slowdown and its respective consequences on fiscal and external accounts, among others. The Uruguayan authorities have been facing the situation with their habitual approach: responses and instruments may vary according to the circumstances; however, sound policies, right incentives, and an unambiguous willingness for structural transformation and social improvements will be not only maintained but reinforced.

Notwithstanding the above-mentioned conditions, in 2015 Uruguay exhibited its thirteenth consecutive year of economic expansion. The country's economic slowdown is tangible; nonetheless, a year of positive growth amidst the above-referred regional turbulences would have been unlikely—or impossible—throughout most of Uruguay's history. Recessions and/or economic crises in a volatile region would have unavoidably harmed Uruguay, even more severely than in the originally affected countries. How has this behavior been altered so radically that, for instance, in Uruguay's recent IMF Article IV report it characterized

Uruguay as “a bastion of stability in the region”? How has Uruguay been able to exhibit one of the lowest sovereign spreads of the region and receive upgrades of its sovereign ratings in the middle of these regional economic circumstances and downgrades in other countries? The answers to these questions lie necessarily, among others, on policies and structural transformations introduced in Uruguay to strengthen the country’s resilience to shocks in recent years and, of course, on the country’s institutional quality.

Starting with the latter, it is worth underscoring a couple of indicators which, among some others, may reflect the above-referred quality: in the last Transparency International annual report on Corruption Perception Index, Uruguay ranks 21st among 168 countries, making it the country with the lowest level of corruption across all emerging countries (and lower than many advanced economies); and the Economist Intelligence Unit places Uruguay in the category of “full democracy” (implying an absolute respect for civil liberties and representative governance).

Past policies and structural changes are critical to assess current and future circumstances. Diversification of markets and products have substantially increased; Uruguay’s strong efforts to attract foreign direct investment have been successful; prudent policies have allowed the country to build strong liquidity buffers (for instance, Uruguay has accumulated an important amount of international reserves which the authorities have reiterated they will use only to smooth excessive exchange rate volatility; it is worth underlining that exchange rate flexibility is key for Uruguay and there has not been any policy or movements that goes against fundamentals); and Uruguay’s financial risks have drastically decreased by improving the country’s debt profile. Meanwhile, rigorous regulation and supervision of the financial system and the transformation of the Banco de la República have led to a healthy sector, which, for instance, exhibits a sound credit level and the lowest non-performing loans among the region (in percent of total loans). Although over the recent months Uruguay recorded a considerable real depreciation, there have not been any traumatic effects, precisely due to the above-referred conditions.

Of course, there are substantial challenges as a result of the economic slowdown; inflation rates are higher than envisaged; and there is a need to preserve the country’s competitiveness. The preservation of Uruguay’s investment grade is essential for the government, and the authorities have clearly underscored that fiscal prudence will be key and that public spending will have to be reviewed considering the current and prospective circumstances. Another relevant issue is that social expenditure will be absolutely protected (indeed, a few days ago, Uruguay’s President announced the initiation of the *Sistema Nacional de Cuidados*, aimed to substantially boost care for the most vulnerable sectors of the society, particularly in early and elderly ages). Furthermore, the central bank has recently announced an even firmer contractionary monetary policy stance aimed at reducing inflation; additionally, income policies will follow a consistent approach.

In sum, difficult conditions require decisive actions, without overreacting; the authorities have ratified the need to keep following Uruguay's path of prudence, consistency among objectives and policies, more structural transformations, and social equity and cohesion.