Table 18
**Algeria: Selected Economic Indicators**
*(Data as of Board discussion in June 1996)*[1]

| | 1992 | 1993 | 1994 | 1995 | 1996[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 1.6 | –2.2 | –1.1 | 4.3 | 4.0 |
| Unemployment rate | 21.3 | 23.2 | 24.4 | 24.8 | 28.0 |
| Change in consumer prices (end of period) | 28.0 | 16.1 | 38.6 | 21.9 | 15.1 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 11.5 | 10.4 | 8.9 | 10.3 | 12.6 |
| Imports, f.o.b. | 8.3 | 8.0 | 9.2 | 10.2 | 9.6 |
| Current account balance | 1.3 | 0.8 | –1.8 | –2.3 | 0.2 |
| Direct investment | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 |
| Capital account balance | –1.2 | –0.8 | –2.5 | –3.9 | –2.8 |
| Gross official reserves (end of period) | 1.5 | 1.5 | 2.6 | 2.1 | 3.7 |
| Current account balance (in percent of GDP) | 2.8 | 1.6 | –4.3 | –5.6 | 0.3 |
| External debt (in percent of GDP) | 52.0 | 53.0 | 70.3 | 78.4 | 72.4 |
| Debt service (in percent of exports of goods and services) | 78.3 | 82.2 | 48.7 | 43.8 | 32.7 |
| Change in real effective exchange rate (in percent) | 27.0 | 14.2 | –28.7 | –6.0 | 5.0 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| Central government balance | –1.2 | –8.7 | –4.4 | –1.4 | 2.6 |
| Gross national saving | 31.2 | 30.8 | 27.4 | 26.5 | 28.3 |
| Gross national investment | 28.4 | 29.2 | 31.8 | 32.0 | 28.0 |
| Change in broad money (in percent) | 23.9 | 21.5 | 15.4 | 10.5 | 15.0 |
| Repurchase rate (in percent) | 17.0 | 17.0 | 21.0 | 23.0 | 20.0 |

[1]Unless otherwise noted.
[2]Fund staff estimates.

with the authorities' view that the krona appeared to be at or close to equilibrium. They were concerned, however, with the high rates of wage increases, which could increase inflation, decrease competitiveness and the momentum of growth, and slow the reduction of unemployment.

Directors welcomed the initiatives of the Employment Bill, although a number of Directors considered them insufficient to meet the authorities' employment objectives. They urged reforms to increase the flexibility of the labor market and supported the formulation of a new wage-setting mechanism. Several Directors stressed the importance of greater wage differentiation and of measures to facilitate the employment of new entrants into the labor market.

## Developing Countries

### *Algeria*

The Board concluded the Article IV consultation with Algeria in June 1996 and conducted the second review under the extended arrangement for Algeria. In 1995, real GDP was estimated to have increased by 4.3 percent—after two years of decline—driven by a strong export-led expansion in the hydrocarbon sector, a rebound of agriculture, and an upturn in the construction and services sectors (Table 18). Inflation fell from 39 percent in the 12 months to the end of 1994, to 22 percent by the end of 1995. Unemployment remained high.

The fiscal deficit narrowed to 1.4 percent of GDP in 1995 from 4.4 percent in 1994. The ratio of revenue to GDP increased, mainly owing to higher hydrocarbon receipts. On the expenditure side, interest payments exceeded targets, but the fiscal program was kept on track as the authorities cut current outlays and contained salary increases. As a result, civil service wages fell substantially in real terms.

Fiscal adjustment provided the underpinning for a tight monetary policy, as demand for broad money continued to grow less than nominal GDP. Credit to the economy rose by 85 percent in 1995; an expansion in credit to food-importing agencies and the railway company was partly offset by a sharp contraction of credit to the government and by increased bank provisioning and recapitalization. Real interest rates became positive in late 1995.

Notwithstanding demand restraint and a substantial real depreciation of the Algerian dinar in 1994, the external current account deficit increased by 1.3 percentage points to 5.6 percent of GDP in 1995. Imports rose in response to trade liberalization and higher cereal prices. However, the balance of payments strengthened significantly in the first half of 1996, as the trade balance responded strongly to the dinar depreciation, more than offsetting a drying up of short-term inflows in the form of suppliers' credit pending an expected debt-rescheduling agreement, and official reserves rose.

In financial sector reform, the introduction of regular repurchase auctions on the money market in May 1995 was later followed by the institution of a formal auction system to sell negotiable treasury bonds on the money market, with a view to establishing open market operations by the central bank. In the public enterprise sector, enterprises were put under hard budget constraints and relieved of their quasi-fiscal functions in preparation for privatization. In addition, 84 local public enterprises were liquidated, and a number of public enterprises in the construction sector were merged or dissolved. The authorities also took decisions to address the financial difficulties of the public housing program and to maintain the pace of housing construction.

In their discussion, Directors commended the authorities for courageously and steadfastly implementing the strong adjustment and reform program despite difficult political and external circumstances. Substantial progress had been made in stabilizing the economy, resulting in a significant deceleration of inflation and a recovery of growth and per capita income, as well as in establishing market mechanisms, restructuring the public sector, and substantially liberalizing the trade regime.

Directors thus considered that Algeria was now better positioned to realize the fundamental objectives of the program: macroeconomic stabilization, an outward-oriented economy, and private-sector-led growth. In view of the high unemployment level and the acute housing problem, Directors called for intensified efforts by the authorities to marshal public support for the program and supported continuation of ongoing political reforms. Establishing security and political stability would be essential to elicit the foreign investment and technology transfers needed for private sector development, which, in turn, was crucial to sustaining growth at a sufficently high level to absorb the increase in the active population and reduce unemployment.

Directors emphasized the importance of consolidating macroeconomic stabilization by bringing inflation down to single-digit levels in 1997. It was therefore essential to continue implementing the tight incomes policy. Most Directors considered that a small budget surplus was needed in 1996 and called for deploying oil revenue both to reduce public debt and to meet infrastructure and social safety needs. Directors commended the authorities for their decision to eliminate quasi-fiscal deficits and fully budget all public expenditure on housing beginning in 1996. They also underscored the importance of strengthening the monitoring and control of expenditure, restraining wages, reducing subsidies, and improving tax administration. Many Directors cautioned against a premature relaxation of monetary and interest rate policy, emphasizing that interest rates should be kept positive in real terms. Directors welcomed that the exchange rate was being determined in an active interbank market and recommended that it continue to be set flexibly.

Directors considered that the proposed housing reform would put that critical sector on a firmer footing. They called for the accelerated development of a private housing market, noting that expanded housing construction would help to absorb excess labor. Directors also urged the authorities to move decisively on privatization to signal the government's commitment to a market economy. In that connection, some Directors expressed concern about the government's decision to assume temporarily wage payments of some insolvent enterprises. Directors also called for the establishment of a more effective legal framework.

Although Algeria's medium-term balance of payments prospects were encouraging, Directors observed that in view of the vulnerability of the external position to external shocks, rapid movement on structural reform and diversification was needed. The large medium-term debt-service burden also called for prudent external debt management. Algeria's exemplary adjustment and reform efforts, it was agreed, merited the continued support of the international financial community.

### *Bangladesh*

The Board concluded the Article IV consultation with Bangladesh in August 1996 following the assumption of office by a new government elected in June 1996. The erosion of macroeconomic stability during the preceding period of political uncertainty had served to demonstrate the weakness of institutions of economic management in Bangladesh.

Real GDP was estimated to have increased by about 5½ percent in 1995/96, with growth triggered principally by recovery in agricultural output. The performance of the mining and quarrying sectors was satisfactory, as was that of the transport, trade, and housing sectors. Growth in the industry, power, and construction sectors, however, fell short of performance in 1994/95. Inflation decelerated somewhat in 1995/96, although it remained above 6 percent based on a new national index with updated (1985–86) weights. The import of food grains increased substantially, and the current account deficit rose from 3.3 percent of GDP in 1994/95 to 4.8 percent of GDP in 1995/96 (Table 19).

Pressures on the budget increased in 1995/96, and budget policy weakened in important respects. Although reduced development spending helped to lower the budget deficit below the original projection, the domestic financing burden on the banking system was twice the original budget target. Locally financed projects formed a much higher proportion of development spending, and the composition of current expenditures also shifted owing to election-related spending, flood relief, and unbudgeted higher interest payments. To avoid an increase in official interest rates, the higher domestic financing need was met by the central bank's absorption of unsold treasury bills.

With the sharp increase in net domestic credit by 22.8 percent, as against 16.5 percent in the previous

Table 19
**Bangladesh: Selected Economic Indicators**[1]
*(Data as of Board discussion in August 1996)*[2]

| | 1993 | 1994 | 1995 | 1996 Projections at time of Board discussion | 1996 Outturn[3] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP[4] | 5.0 | 4.5 | 4.9 | 4.9 | 5.6 |
| Change in consumer prices (period averages)[5] | 2.5 | 3.7 | 8.9 | . . . | 6.7 |
| | | | *In billions of U.S. dollars*[2] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 2.4 | 2.5 | 3.5 | 3.9 | 3.9 |
| Imports, c.i.f. | 4.1 | 4.2 | 5.8 | 6.8 | 6.9 |
| Current account balance | –0.6 | –0.4 | –1.0 | –1.6 | –1.6 |
| Capital account balance | 1.3 | 1.3 | 1.2 | 0.6 | 0.6 |
| Gross official reserves | 2.1 | 2.8 | 3.1 | 2.0 | 2.0 |
| Current account balance (in percent of GDP) | –2.6 | –1.5 | –3.3 | –4.8 | –4.7 |
| External debt (in percent of GDP) | 47.9 | 55.3 | 51.5 | 49.7 | 44.0 |
| Debt service (in percent of exports of goods and services) | 12.0 | 11.4 | 9.7 | 10.7 | 9.4 |
| Change in real effective exchange rate (in percent) | –3.3 | –2.0 | –4.6 | 1.9 | 1.9 |
| | | | *In percent of GDP*[2] | | |
| **Financial variables** | | | | | |
| Central government balance | –5.4 | –5.5 | –6.4 | –5.7 | –5.3 |
| Gross national saving | 10.6 | 12.9 | 12.3 | 10.3 | 11.0 |
| Gross fixed investment | 13.2 | 14.3 | 15.6 | 15.1 | 15.7 |
| Change in broad money (in percent) | 11.4 | 14.5 | 16.0 | 8.2 | 8.2 |
| Bangladesh Bank rate (in percent; end of period) | 6.5 | 5.5 | 5.5 | 6.5 | 6.5 |

[1]Data are for fiscal years ending June.
[2]Unless otherwise noted.
[3]Updated Fund staff estimates.
[4]Fund staff estimates based on rebenchmarking the national accounts to 1989/90; official data based on 1984/85 weights show slightly lower estimates of GDP.
[5]Based on the updated 1985/86 national index.

year, monetary policy remained relaxed. However, as net foreign assets declined sharply, broad money growth decelerated to 8.2 percent as against 16 percent in the preceding year. The real effective exchange rate appreciated slightly during 1995/96. To slow the appreciation, the exchange rate of the taka vis-à-vis the U.S. dollar was depreciated several times during 1995/96.

In their discussion, Directors welcomed the opportunity that the new government now had to adopt bolder polices. They urged the authorities to undertake a fundamental overhaul of the role of government and to reform the financial sector.

Directors viewed the strengthening of fiscal policy as the central element of the adjustment effort. They emphasized the need for the government to resist pressures for higher public sector wages, to make timely cuts in low-priority domestically financed expenditure, and to be ready to implement additional measures. In view of the country's low ratio of revenue to GDP, Directors suggested that the authorities should vigorously pursue tax administration reform, a broadening of the tax base, and elimination of tax exemptions.

Directors stressed the importance of reducing domestic credit growth by limiting the expansion of bank borrowing by the government and curbing central bank lending to banks and to specialized institutions. They pointed to the need for a more independent and effective role for the central bank. They noted the need to increase further the flexibility of interest rates and for the authorities to be prepared to tighten their monetary targets for 1996/97 to bring about a desired reduction in inflation and to strengthen the international reserve position.

Directors generally encouraged the authorities, in conjunction with tightening financial policies, to adopt a more market-based exchange rate regime. This would help to prevent a further decline in reserves and help the conduct of monetary policy while avoiding recourse to administrative controls on imports.

Directors observed that prolonged delays in implementing structural reforms were an important reason for the economy's lackluster performance over the past few years. They considered that top priority should be given to the early reform of the closely related problems in the financial sector and public enterprises. While welcoming ongoing improvements in bank supervision, they urged the authorities to expedite implementation of plans to restructure the banking system. Noting the large losses in public enterprises, Directors urged the authorities to proceed quickly to develop a comprehensive program of reform and privatization. Establishing a strong record of fundamental and sustained reforms would help Bangladesh to mobilize needed external assistance.

## Benin

The Board concluded the Article IV consultation with Benin in August 1996 and approved a request for a new arrangement under the ESAF (see Chapter 6). The discussions were held against a background of continued satisfactory performance by Benin, attributable to adjustment undertaken in the 1980s, the devaluation of the CFA franc in January 1994, and improved terms of trade.

Real GDP growth is estimated to have reached almost 5 percent in 1995, while the rate of inflation declined and public finances continued to improve (Table 20). Benin observed all the performance criteria under the ESAF for the end of September 1995, but at the end of December it missed the benchmarks for net credit to the government and net domestic assets of the central bank.

Investment rose to about 19 percent of GDP in 1995 from 15.8 percent in 1994, in part because of strong construction activity and rising private investment in the cotton sector, and in part because of public infrastructure projects undertaken in connection with the summit of francophone countries. Benin's improved terms of trade raised incomes and boosted private consumption by about 10 percent. The investment boom was not matched by an equivalent increase in savings, and the external current account deficit rose to 8.6 percent in 1995. Imports rose by 38 percent because of the robust growth in domestic demand, whereas exports of goods were virtually flat because of a disappointing cotton crop.

Fiscal developments were generally favorable in 1995, with Benin meeting key targets, including the narrowly defined primary surplus and the ratio of revenue to GDP, with some margin. The overall budget deficit was held to about 7 percent of GDP, somewhat lower than envisaged. In contrast, primary expenditure exceeded the target, in part because of unanticipated outlays for infrastructure. These were partly offset by lower expenditures for health and education. Net credit to the government also exceeded the program target but was expected to be reversed in the second half of 1996. Although the net domestic assets of the banking system expanded, its net foreign assets grew less than envisaged.

Table 20
### Benin: Selected Economic Indicators
*(Data as of Board discussion in August 1996)*

| | 1993 | 1994[1] | 1995[1] | 1996[1] |
|---|---|---|---|---|
| | | *In percent* | | |
| **Domestic economy** | | | | |
| Change in real GDP | 3.2 | 4.3 | 4.8 | 5.5 |
| Change in consumer prices (end of period) | 4.1 | 54.3 | 3.1 | 6.7 |
| | | *In millions of U.S. dollars*[2] | | |
| **External economy** | | | | |
| Exports | 111.7 | 174.5 | 234.9 | 289.3 |
| Imports | 369.2 | 277.1 | 435.8 | 458.8 |
| Current account balance[3] | –158.6 | –76.5 | –177.7 | –163.6 |
| Capital account balance | –33.7 | –20.7 | 10.3 | 48.1 |
| Gross official reserves | 174.6 | 173.7 | 128.5 | 164.8 |
| Current account balance (in percent of GDP)[3] | –7.5 | –5.0 | –8.6 | –7.3 |
| External debt (in percent of GDP) | 72.4 | 86.4 | 82.0 | 79.6 |
| Debt service (in percent of exports of goods and nonfactor services)[4] | 18.6 | 19.7 | 17.5 | 15.1 |
| Change in real effective exchange rate (in percent) | –0.2 | –35.8 | 7.5 | . . . |
| | | *In percent of GDP*[2] | | |
| **Financial variables** | | | | |
| General government balance | –4.7 | –6.9 | –7.0 | –6.6 |
| Gross national saving[4] | 9.6 | 12.8 | 11.7 | 12.6 |
| Gross national investment | 14.9 | 15.8 | 19.0 | 17.8 |
| Change in broad money (in percent) | 5.9 | 41.2 | 16.1 | 14.0 |
| Interest rate (in percent)[5] | 7.5 | 5.5 | 6.0 | 5.5 |

[1]Fund staff estimates.
[2]Unless otherwise noted.
[3]Excluding official grants.
[4]Including current official grants, but excluding project grants.
[5]Average monthly money market rate; end of period.

The authorities continued to address the task of strengthening the private sector through privatization, restructuring, and price liberalization. Price controls were lifted on seven products in early 1995, leaving those on only five subject to government approval.

In their discussion, Directors noted the considerable improvement in Benin's macroeconomic performance in recent years, with robust growth and lower inflation, following the implementation of successive adjustment programs. However, they observed that the economy was not sufficiently diversified and that policies needed to be strengthened to increase national saving, attract foreign direct investment, and support private sector activities.

In the fiscal arena, Directors called for stronger efforts to reduce reliance on foreign resources and to help raise domestic saving. They also stressed the need to increase budgetary allocations for education, health, and other social sectors. While they welcomed the decision to reduce the burden of taxation on the cotton sector by raising producer prices, they called for offsetting revenue measures. Directors welcomed a number of developments in Benin that would promote a more efficient allocation of financial resources in the region: the broadening of financial instruments, the creation of a regional financial market, and the deepening of the regional interbank market.

Directors emphasized the need for a larger private sector role and encouraged the authorities to persevere with privatization to help foster private-sector-led growth. While noting the recent substantial increase in cotton production, they recommended reducing the government's role in that sector.

Directors took the view that Benin's adjustment efforts deserved continued support by the international financial community. The external debt was high, but the operations to reduce the debt stock requested by the authorities should improve debt indicators in the coming years. Nevertheless, the economy would remain vulnerable to external shock. To achieve broadly based growth and external debt sustainability over time, Benin therefore needed to implement sound macroeconomic policies and structural reforms combined with a prudent debt-management policy and adequate financing on concessional terms.

Table 21
**Cambodia: Selected Economic Indicators**
*(Data as of Board discussion in February 1997)*

| | 1993 | 1994 | 1995[1] | 1996[2] |
|---|---|---|---|---|
| | | *In percent* | | |
| **Domestic economy** | | | | |
| Change in real GDP | 4.1 | 4.0 | 7.6 | 6.0 |
| Change in consumer prices (end of period) | 31.0 | 26.1 | 0.1 | 10.0 |
| | | *In millions of U.S. dollars*[3] | | |
| **External economy** | | | | |
| Exports, f.o.b.[4] | 102 | 234 | 269 | 305 |
| Imports, f.o.b. | –305 | –509 | –650 | –700 |
| Current account balance[5] | –189 | –329 | –469 | –430 |
| Direct investment | 0 | 80 | 151 | 171 |
| Capital account balance | 75 | 136 | 206 | 195 |
| Gross official reserves | 71 | 100 | 182 | 217 |
| Current account balance (in percent of GDP) | –9.4 | –13.7 | –16.0 | –13.9 |
| External debt (in percent of GDP)[6] | 20 | 20 | 19 | 21 |
| Debt service (in percent of exports of goods and services) | 0.4 | 3.2 | 1.3 | 3.7 |
| Change in real effective exchange rate (annual percent change; end of period) | –10.1 | 8.7 | –0.2 | –10.6[7] |
| | | *In percent of GDP*[3] | | |
| **Financial variables** | | | | |
| General government balance (cash basis) | –5.6 | –6.8 | –7.7 | –7.0 |
| Gross national saving | 4.7 | 4.8 | 5.6 | 5.8 |
| Gross national investment | 14.1 | 18.5 | 21.6 | 19.7 |
| Change in broad money (end of period; in percent)[8] | 40.0 | 29.4 | 44.3 | 33.0 |

[1]Fund staff estimates.
[2]Fund staff projections.
[3]Unless otherwise noted.
[4]Excludes reexports.
[5]Excluding official transfers.
[6]Excludes debt to countries of the former Council for Mutual Economic Assistance amounting to an estimated Rub 840 million, for which dollar valuation is not available.
[7]October.
[8]Including foreign currency deposits.

## *Cambodia*

The Board concluded the Article IV consultation with Cambodia in February 1997. Real growth had rebounded to 7½ percent in 1995 (Table 21), boosted by a record rice harvest and buoyant activity in construction, tourism, and the garment industry, and was projected at about 6 percent for 1996, the modest slowdown arising from the negative impact of recent floods on rice output. Inflation dropped to single digits during 1995 and the first nine months of 1996 (from over 100 percent in 1993).

Fiscal policy continued to play the central role in sustaining macroeconomic stability. Fiscal discipline was maintained in 1996 despite revenue shortfalls (because of tax exemptions and persistent difficulties in bringing extrabudgetary revenue into the budget) and higher-than-budgeted operational outlays on security and defense. Civilian nonwage expenditures, particularly for health and education, however, were compressed below budgeted levels. The overall deficit for 1996 was projected at about 7 percent of GDP, to be fully financed through official aid flows.

Monetary developments were marked by a pronounced shift away from foreign currency in circulation toward domestic currency and foreign currency deposits. This portfolio shift resulted in an acceleration in the growth of measured broad money (including foreign currency deposits) to 44 percent in 1995. With a slowdown in the growth of riel in circulation, monetary expansion moderated in the second half of 1996 and was projected to fall to 30 percent by the end of the year.

In 1996, the balance of payments benefited from large official financing flows and increased foreign direct investment, and the current account deficit was expected to narrow to 14 percent of GDP, with the overall balance in a small surplus. International reserves strengthened to slightly over two months of imports, and the exchange rate remained broadly stable, in contrast with earlier years.

Progress was made in key areas of structural reform, though the pace of implementation was slower than anticipated. Steps taken included the adoption of a new institutional framework for the few enterprises slated to stay in the public sector and for privatization of the remaining state enterprises, enactment of a new central bank law, and some progress in military reform. But only limited progress was made in developing a monitoring system for foreign direct investment and associated tax exemptions, and civil service reform was set back by large-scale new hiring for political integration.

In their discussion, Directors welcomed Cambodia's solid progress in economic rehabilitation over the past three years, including favorable macroeconomic performance with robust growth, low inflation, and a significant improvement in the external position. However, sustained progress in the transition to a market economy would require attention to key fundamental weaknesses in the economy. Directors called for accelerated structural reforms, especially in the fiscal and financial areas, and for the implementation of transparent resource management policies, particularly in the forestry sector.

Directors stressed the key importance of continued fiscal discipline if macroeconomic stability were to be consolidated. Revenues were currently a very low percentage of GDP and had to be increased decisively by strengthening tax administration, eliminating ad hoc tax exemptions, implementing the planned tax reform measures to broaden the domestic tax base, and rigorously applying legislative provisions to enhance budgetary transparency and strengthen financial controls over the use and transfer of state assets. Directors also urged the authorities to implement civil service reform and rein in military spending to accommodate increased social spending and human capital development.

Directors encouraged the authorities to continue avoiding bank financing of the budget deficit; this was critical to keeping inflation low in Cambodia's highly dollarized and largely cash-based financial system. Continued financial stability was the key to reversing currency substitution and establishing a viable system of financial intermediation in the domestic currency. Directors stressed the urgent need for the National Bank to reinforce its supervision capacity through on-site inspections of commercial banks. On exchange rate policy, the market-based system had served Cambodia well.

Directors considered the reform of public institutions and improved governance in the management of public resources as the most urgent structural tasks at hand. They called on the authorities to implement transparent and effective procedures in the management of forestry resources. This was an area in which the authorities had to demonstrate that they could deliver on their policy commitments and reestablish the credibility of their economic reform program. This was vital if private sector confidence and the support of the international community were to be sustained.

Directors noted that Cambodia's balance of payments outlook would continue to depend on substantial external financing from official and private sources, which was essential to meet Cambodia's massive infrastructure needs and rebuild its productive base.

### *Cameroon*

The Board concluded the Article IV consultation with Cameroon in October 1996. At that time, the country was recovering from a prolonged economic decline, which had begun to turn around in 1994 following the devaluation of the CFA franc in January. In 1995/96, real GDP grew by 5 percent, largely because of a strong expansion in agriculture and manufacturing. Production of coffee, cocoa, and cotton rose despite a drop in world prices. Non-oil real GDP is estimated to have risen by about 6 percent owing to buoyant export activity and a recovery in domestic demand. Public finances also strengthened considerably. Between 1993/94 and 1995/96, total revenue relative to GDP increased by 4 percentage points, total expenditure was reduced by 2 percentage points, and the primary fiscal balance moved from a deficit of 1½ percent of GDP to a surplus of more than 5 percent of GDP. Consumer price inflation slowed to 4½ percent in the year ended June 1996 from 13½ percent the year before (Table 22).

Following the devaluation of the CFA franc, external competitiveness improved in early 1994, leading to a strong recovery in the tradable goods sector. With the recovery, imports of intermediate and investment goods rebounded strongly in 1995/96, giving rise to a slight deterioration in the trade surplus. The current account deficit widened to 2½ percent of GDP from 2 percent in 1994/95, while the capital account deficit narrowed because of lower official amortization payments and a resumption of private capital inflows. The overall balance of payments deficit fell by 7 percent of GDP in 1995/96.

Despite relatively favorable economic conditions and a good start, the government's 1995/96 economic adjustment program, which had received support under a Fund Stand-By Arrangement approved in 1995, went off track toward the end of that year. Fiscal performance improved in 1995/96, with the overall deficit declining and the primary surplus rising, but not to the extent envisaged in the program.

Table 22
**Cameroon: Selected Economic Indicators**[1]
*(Data as of Board discussion in October 1996)*

| | 1992/93 | 1993/94[2] | 1994/95[2] | 1995/96[3] |
|---|---|---|---|---|
| | | *In percent* | | |
| **Domestic economy** | | | | |
| Change in real GDP | –3.2 | –2.5 | 3.3 | 5.0 |
| Change in consumer prices (end of period) | –4.1 | 33.8 | 13.4 | 4.4 |
| | | *In millions of U.S. dollars*[4] | | |
| **External economy** | | | | |
| Exports | 1,651.7 | 1,433.3 | 1,662.2 | 1,755.2 |
| Imports | 1,020.7 | 1,016.7 | 1,074.6 | 1,192.0 |
| Current account balance | –620.1 | –337.0 | –170.0 | –226.7 |
| Direct investment | 134.0 | 102.2 | 88.6 | 91.9 |
| Capital account balance | –286.1 | –266.4 | –661.7 | –167.2 |
| Gross official reserves | 45.1 | 13.5 | 12.7 | 13.7 |
| Current account balance (in percent of GDP) | –5.2 | –4.3 | –2.1 | –2.5 |
| External debt (in percent of GDP) | 70.8 | 122.7 | 116.2 | 104.3 |
| Debt service (in percent of exports of goods and services) | 42.5 | 55.0 | 60.9 | 54.5 |
| Change in real effective exchange rate (in percent) | –2.6 | –24.7 | –13.6 | 6.6 |
| | | *In percent of GDP*[4] | | |
| **Financial variables** | | | | |
| General government balance | –6.8 | –9.2 | –4.9 | –2.8 |
| Gross national saving | 11.3 | 11.0 | 12.4 | 13.5 |
| Gross national investment | 16.6 | 15.3 | 14.5 | 16.0 |
| Change in broad money (in percent) | –10.3 | 17.7 | 6.1 | –5.1 |
| Interest rate (in percent) | 11.5 | 12.5 | 8.8 | 8.0 |

[1]Data are for fiscal years (July 1–June 30).
[2]Estimated.
[3]Updated Fund staff estimates.
[4]Unless otherwise noted.

Moreover, revenue collection was lower and outlays higher than anticipated. A number of structural reforms in 1995/96 were delayed or incompletely implemented, including civil service and administrative reforms, public enterprise divestiture, banking sector restructuring, and the securitization of domestic arrears. Although the authorities reduced external arrears to official creditors by CFAF 309 billion, arrears to these creditors were not eliminated because of a shortfall in the primary balance, an unanticipated buildup of government deposits in the banking system, and a shortfall in external program assistance.

Monetary developments in 1995/96 included an apparent weakening of money demand, a slight deterioration in the net foreign asset position of the banking system, and a pickup in private sector credit. Recorded broad money contracted by 5 percent, implying an increase in income velocity, attributable to problems in the domestic banking system.

At their meeting, Directors noted the strengthening of Cameroon's economic recovery in 1995/96, accompanied by a sharp drop in inflation and an improved balance of payments. They regretted, however, that slippages in implementing fiscal policy and delays in key structural reforms had led to a continued buildup of external arrears, which affected the credibility of the economic program. Directors urged the authorities to strengthen the implementation of fiscal and structural policies expeditiously to facilitate discussions of a program that could be supported by an arrangement under the ESAF. Prompt action would also help solidify the gains from the CFA franc devaluation and allow Cameroon to achieve its full growth potential.

While recognizing that Cameroon had made progress in improving public finances, Directors expressed concern about revenue shortfalls and expenditure overruns and exhorted the authorities to strengthen the country's fiscal performance and to implement promptly the measures outlined in the government's 1996/97 budget. In particular, they urged the authorities to improve tax administration, reduce tax fraud, close tax loopholes, step up expenditure controls, and strictly monitor and prioritize expenditures. Directors also noted that Cameroon had progressed in liberalizing the trade regime and labor markets. But they expressed concern over the persistent delays in implementing other structural reforms, notably in the areas of the financial system and public enterprises.

With respect to Cameroon's debt burden, Directors were disappointed with the recent further increase in external arrears and urged the authorities to clear them, in line with the terms of the last Paris Club agreement. They emphasized that normalization of relations with external creditors was crucial for mobilizing new external resources to support the country's adjustment efforts. Directors concluded by underscoring the importance of achieving all fiscal and structural program targets for the second half of 1996, which would allow Cameroon to regain donor confidence and establish a credible track record for consideration of an ESAF arrangement.

## Chile

The Board concluded the Article IV consultation with Chile in August 1996. Chile's economy had continued to perform strongly in 1995. Output grew at a rate of 8.5 percent, and inflation declined to 8.2 percent, from 8.9 percent in 1994. Unemployment fell to 4.7 percent at the end of 1995, from 5.9 percent at the end of 1994 (Table 23). Domestic demand pressures intensified during the year, and aggregate domestic expenditure grew by 13 percent. The growth of private sector credit increased to 23 percent in 1995, from 20 percent in 1994. Exceptionally high copper prices and lower-than-expected budget expenditures increased the public sector surplus to 2.8 percent of GDP in 1995, from 1.2 percent in 1994.

The external current account shifted to a virtual balance in 1995, from a deficit of 1.2 percent of GDP in 1994, as a result of a sharp improvement in Chile's main export prices. Partly because of prepayment of external public debt and a shift in portfolio investment to net outflows, total capital inflows dropped to less than $1 billion in 1995, from $3.8 billion in 1994. Official reserves at the end of 1995 were $14.2 billion, an increase of $1.4 billion. The Chilean peso, in real effective terms, appreciated by 2.2 percent in 1995.

Table 23

**Chile: Selected Economic Indicators**

*(Data as of Board discussion in August 1996)*[1]

| | 1993 | 1994 | 1995[2] | 1996 Projections at time of Board discussion | 1996 Outturn[3] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 6.3 | 4.2 | 8.5 | 7.4 | 7.2 |
| Unemployment rate | 4.7 | 6.0 | 5.4 | . . . | . . . |
| Change in consumer prices (end of period) | 12.2 | 8.9 | 8.2 | 7.0 | 6.6 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 9.2 | 11.6 | 16.0 | 15.1 | 15.4 |
| Imports, c.i.f. | –10.2 | –10.9 | –14.7 | –16.4 | 16.5 |
| Current account balance | –2.1 | –0.6 | 0.2 | –2.7 | –2.9 |
| Direct investment | 0.9 | 1.9 | 1.9 | 2.1 | 4.2 |
| Portfolio investment | 0.8 | 1.3 | 0.0 | 1.3 | 1.2 |
| Capital account balance | 2.7 | 4.6 | 1.2 | 3.7 | 5.0 |
| Gross official reserves | 9.7 | 13.2 | 14.2 | 14.8 | 14.9 |
| Current account balance (in percent of GDP) | –4.5 | –1.2 | 0.2 | –3.8 | –4.1 |
| External debt (in percent of GDP) | 42.0 | 41.2 | 32.4 | 34.5 | 36.3 |
| Debt service (in percent of exports of goods and services) | 24.6 | 19.2 | 26.0 | 25.4 | 31.8 |
| Change in real effective exchange rate (in percent)[4] | –1.9 | 4.9 | 2.2 | . . . | 3.9 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| General government balance | 1.9 | 2.7 | 3.7 | 2.9 | 3.0 |
| Gross national saving | 24.2 | 25.6 | 27.6 | 23.9 | 23.6 |
| Gross domestic investment | 28.8 | 26.8 | 27.4 | 27.7 | 27.7 |
| Change in broad money (in percent) | 27.0 | 19.3 | 27.4 | 19.3 | 23.5 |
| Interest rate (in percent)[5] | 6.5 | 6.4 | 6.1 | . . . | 7.3 |

[1]Unless otherwise noted.
[2]Preliminary.
[3]Updated Fund staff estimates.
[4]Twelve months ended December. Decline indicates depreciation of the Chilean peso.
[5]Average annual rate on 90-day central bank indexed promissory notes.

Performance in the first quarter of 1996 was strong. Aggregate domestic demand grew by 13 percent and output by 9 percent, compared with the same period in 1995. The trade surplus dwindled because of lower export prices, and capital inflows rebounded sharply in the first half of 1996.

In their discussion, Directors commended the authorities for their skillful management of the economy and had much praise for its impressive performance in recent years: declining unemployment, lower inflation, high saving and investment, a strong external position, and encouraging improvements in social conditions.

Although the medium-term outlook remained favorable, Directors felt that Chile's most important challenge was to bring inflation down to industrial country levels. In that context, Directors emphasized that more decisive action to reduce the scope of indexation would help in achieving the inflation target. The current tight monetary policy was generally considered appropriate by Directors, in view of the need to curb private demand to a sustainable level. They recommended keeping that stance until signs were clear that inflation was declining in line with the authorities' target for 1996.

Directors endorsed the authorities' fiscal stance for 1996, which was stronger than envisaged in the budget. Such a stance would help to reduce the burden of monetary policy and the upward pressure on the currency. Directors noted that achieving the budgeted outcome would require containment of wages and keeping nonpriority spending under close review.

The substantial progress in freeing capital outflows was welcomed by the Board. With respect to regulations to discourage capital inflows, several Directors endorsed the authorities' view that measures to discourage capital inflows had helped to increase the share of longer-term, non-debt-creating inflows and thus protected the economy from undesirable volatility. Those Directors thought there were risks in liberalizing controls at present. Several other Directors observed that, even though those regulations had been in place for a number of years and had progressively been broadened, inflows had remained strong. They noted that such regulations tended to lose effectiveness over time while their cost for the economy increased, and they advised the authorities to liberalize them over time. Those Directors argued that a more flexible exchange rate system would be more fitting, both to deal with capital inflows and to reduce indexation.

Directors commended the authorities' emphasis on targeted social policies and their efforts to address income inequalities without compromising fiscal stability. In that connection, the planned ambitious education reform was welcomed. Directors stressed that, although the authorities were aware of environmental problems, environmental protection should be given greater importance.

Data available subsequent to the Board discussion show that output growth slowed to 7.2 percent and inflation declined to 6.6 percent in 1996. Reflecting lower export prices, the fiscal position (including central bank losses) weakened but still registered a surplus of about 1.2 percent of GDP, while the external current account balance shifted to a deficit of about 4 percent of GDP. Private capital inflows (mostly direct investment) surged to a record \$4.1 billion (5.7 percent of GDP). Official foreign reserves increased by \$0.7 billion to \$15 billion by year-end (equivalent to about 11 months of imports of goods and nonfactor services). In real effective terms, the Chilean peso appreciated by 3.8 percent during 1996.

## *China*

The Board concluded the Article IV consultation with China in June 1997. Although the consultation took place after the end of the 1997 financial year, the period covered by this *Annual Report*, as an exception the consultation with China has been included in consideration of the fact that the Fund's 1997 Annual Meetings are being held in Hong Kong, China.

Directors met against the background of continued robust growth and steadily declining inflation in China. Real GDP growth was 9¾ percent in 1996 (Table 24) and 9½ percent in the first quarter of 1997, with a strong pickup in net exports offsetting some weakening of domestic demand. Owing to the moderation of demand pressures and favorable agricultural supply conditions, retail price inflation decelerated to 4½ percent at the end of 1996 and averaged 2.6 percent in the first quarter of 1997.

Both fiscal and monetary policy remained moderately restrictive in 1996 and early 1997. The deficit of the general government narrowed, because of continued expenditure restraint and an apparent stabilization of the revenue ratio.

The authorities had aimed to slow M2 growth to 25 percent by the end of 1996. This goal was achieved, and there was a further easing in early 1997. Reserve money growth picked up late in 1996, as the People's Bank of China accommodated an increase in required reserves resulting from stricter enforcement of reserve requirements, but the underlying growth rate was broadly unchanged, with tight control over central bank credit to the banking system offsetting further large increases in net foreign assets. Administered interest rates were cut twice in view of the significant decline in inflation in 1996.

The growth of both exports and imports slowed temporarily in 1996, with a slight net reduction in the trade surplus. In the first quarter of 1997, the trade balance showed a surplus of nearly \$7 billion. Foreign direct investment inflows were strong in 1996, and official reserves reached \$108 billion (nine months worth of imports) by year-end. The renminbi remained stable against the U.S. dollar but appreciated in real effective terms owing to higher inflation in China than in its trading partners.

The strong macroeconomic picture masked considerable disparities across sectors and regions, largely owing to differences in the performances of the state-owned enterprises and the nonstate sector, which continued to outpace the state sector by a considerable margin. Structural reform was concentrated on the external and financial sectors. A trade package, including cuts in import tariffs, a phasing out of duty exemptions, and selected measures to ease nontariff restrictions, was introduced in April 1996. Effective December 1, 1996, China accepted the obligations of the Fund's Article VIII. In the financial sector, steps were taken to strengthen the infrastructure and instruments for indirect monetary control.

Directors congratulated the authorities for their skillful and sustained implementation of prudent macroeconomic policies and structural reforms that had made possible the achievement of a soft landing while continuing China's opening to, and growing integration with, the global economy. They agreed that the key challenge was to take advantage of this favorable situation to undertake bold and comprehensive structural reforms, particularly to address deep-seated weaknesses in the state enterprises and the financial system in order to accelerate China's transition to a more fully market-based economy.

Directors stressed the importance of maintaining cautious macroeconomic policies to sustain low inflation. Noting the rapid growth of broad money, they generally cautioned that more restrained broad money growth than envisaged in the authorities' monetary policy framework for 1997 would be prudent.

Directors also stressed that the development of a medium-term framework for fiscal policy would help in prioritizing public expenditures, identifying the associated sources of financing, and assessing the overall fiscal policy stance. They also emphasized the need to improve the transparency of the budget. Also, a marked improvement in budgetary revenue would be required to ensure a strong overall fiscal position. In that connection, they suggested a broadening of income taxes and the value-added tax, the strengthening of tax administration, and the phasing out of tax concessions for foreign-funded enterprises. More generally, they emphasized the importance for a market economy of a broad-based, simple, and nondistortionary tax system.

In view of the continuing weakness in the state-owned enterprise sector, Directors considered that an acceleration of enterprise reform should be a priority to ensure a stable macroeconomic framework and to improve competitiveness and efficiency. They welcomed the authorities' decision to allow greater management authority and diverse forms of ownership.

Directors emphasized the need to improve the commercial orientation and soundness of the financial system.

Directors commended the authorities for their acceptance of Article VIII. Noting the rapid accumulation of international reserves in recent years and the prospect for further increases in the future, Directors suggested the acceleration of trade liberalization would assist in the adjustment process, improve efficiency, and ease the pressures on monetary policy emanating from the very strong external position.

Much remained to be done to improve economic statistics, Directors stressed, including in the national, fiscal, and external accounts.

Directors congratulated China on the historic occasion of the reunification of Hong Kong with China, which promised new opportunities for further enhancing the prosperity of China, Hong Kong, and the global economy.

Table 24
### China: Selected Economic Indicators
*(Data as of Board discussion in June 1997)*

| | 1993 | 1994 | 1995 | 1996[1] |
|---|---|---|---|---|
| | *In percent* | | | |
| **Domestic economy** | | | | |
| Change in real GDP | 13.5 | 12.6 | 10.5 | 9.7 |
| Change in retail prices (period average) | 13.0 | 21.7 | 14.8 | 6.1 |
| | *In billions of U.S. dollars*[2] | | | |
| **External economy** | | | | |
| Exports, f.o.b. | 75.9 | 102.6 | 128.1 | 128.5 |
| Imports, c.i.f. | –86.3 | –95.3 | –110.1 | –114.6 |
| Current account balance[3] | –11.9 | 7.7 | 1.6 | 3.9 |
| Direct investment | 23.1 | 31.8 | 33.8 | 38.8 |
| Portfolio investment | 3.0 | 3.5 | 0.8 | 2.4 |
| State gross official reserves[4] | 23.0 | 53.5 | 76.0 | 107.7 |
| Current account balance (in percent of GDP) | –2.7 | 1.4 | 0.2 | 0.5 |
| External debt | 84.4 | 95.0 | 106.6 | 116.2 |
| Debt service (in percent of exports of goods and nonfactor services) | 12.6 | 11.6 | 10.6 | 10.9 |
| Change in real effective exchange rate (in percent)[5] | –1.90 | 9.01 | 5.34 | 4.95 |
| | *In percent of GDP*[2] | | | |
| **Financial variables** | | | | |
| Overall budgetary balance[6] | –2.0 | –1.6 | –1.7 | –1.5 |
| Gross national saving | 40.6 | 42.6 | 41.1 | 42.9 |
| Gross domestic investment | 43.3 | 41.2 | 40.8 | 42.4 |
| Change in broad money (in percent)[7] | 24.0 | 34.5 | 29.5 | 25.3 |
| Interest rate (in percent; one-year time deposits, year-end) | 10.98 | 10.98 | 10.98 | 7.47[8] |

[1]Fund staff estimates.
[2]Unless otherwise noted.
[3]Series has breaks in 1995 and 1996 owing to changes in the coverage of services items.
[4]Includes gold, SDR holdings, and reserve position in the Fund.
[5]December averages.
[6]Central and local governments.
[7]End of period; banking survey. Owing to break in the series in 1993, growth rates for that year are not available and monetary survey data (broadly similar) are reported instead.
[8]End-March 1997.

Table 25
**Egypt: Selected Economic Indicators**[1]
*(Data as of Board discussion in October 1996)*

| | 1992/93 | 1993/94 | 1994/95 | 1995/96 |
|---|---|---|---|---|
| | *In percent* | | | |
| **Domestic economy** | | | | |
| Change in real GDP | 0.5 | 2.9 | 3.2 | 4.2 |
| Change in consumer prices (period average) | 11.1 | 9.0 | 9.4 | 7.1 |
| | *In billions of U.S. dollars*[2] | | | |
| **External economy** | | | | |
| Exports, f.o.b. | 3.4 | 3.3 | 5.0 | 4.6 |
| Imports, c.i.f. | 10.7 | 10.6 | 11.9 | 13.7 |
| Current account balance | 2.2 | 0.2 | 1.6 | 0.2 |
| Direct investment | 0.5 | 1.3 | 0.7 | 0.5 |
| Portfolio investment | . . . | 0.0 | 0.0 | 0.1 |
| Capital account balance | 0.8 | 2.1 | –0.4 | 0.8 |
| Gross official reserves | 15.5 | 17.0 | 18.4 | 18.9 |
| Current account balance (in percent of GDP)[3] | 5.6 | 0.4 | 2.7 | 0.2 |
| External debt (in percent of GDP) | 65.8 | 58.0 | 55.7 | 47.1 |
| Debt service (in percent of current account receipts, including all transfers) | 13.6 | 12.1 | 10.3 | 10.7 |
| Change in real effective exchange rate (in percent)[4] | 7.9 | 10.4 | –0.4 | 2.4 |
| | *In percent of GDP*[2] | | | |
| **Financial variables** | | | | |
| General government balance | –3.5 | –2.1 | –1.3 | –1.3 |
| Gross national saving | 17.0 | 17.2 | 19.4 | 17.2 |
| Gross national investment | 16.2 | 16.8 | 16.7 | 17.0 |
| Change in broad money (in percent) | 16.4 | 12.4 | 11.1 | 10.5 |
| Average interest rate on three-month treasury bill (in percent) | 16.3 | 13.9 | 11.0 | 10.5 |

[1]Data are for fiscal years ending June.
[2]Unless otherwise noted.
[3]Including official transfers.
[4]For 1995/96, the change relates to the 12-month period ended May 1996.

## *Egypt*

The Board concluded the Article IV consultation with Egypt in October 1996 and approved Egypt's request for a two-year precautionary Stand-By Arrangement. Since 1991, Egypt had been implementing wide-ranging stabilization and structural reforms with the support of two successive Stand-By Arrangements. Real GDP growth, stagnant in 1991/92, at the time of the consultation was estimated to have increased to more than 4 percent in 1995/96, while the annual rate of inflation was reduced from more than 21 percent to slightly over 7 percent (Table 25).

Significant progress had been made toward fiscal consolidation. The overall fiscal deficit, which exceeded 15 percent of GDP in the late 1980s, stood at about 1.3 percent of GDP in 1995/96, in line with the budget target and about the same level as in the preceding year. While total revenues declined relative to GDP, current outlays fell commensurately, although priority social sectors such as health and education were shielded.

There had been a further easing of interest rates, and excess reserves of commercial banks had decreased. The rate on three-month treasury bills dropped to 10½ percent, from about 14 percent two years earlier. The nominal exchange rate of the pound vis-à-vis the U.S. dollar remained virtually constant; in real effective terms, the pound appreciated 9 percent, reflecting the stronger U.S. dollar. Overall, the rate of appreciation of the pound in real effective terms slowed significantly from 1993 as the inflation differential between Egypt and its trading partners declined and capital inflows subsided.

The overall balance of payments remained in surplus, leading to a substantial accumulation of net international reserves, which stood at the equivalent of about 15 months of imports in October 1996. With limited external borrowing and further debt relief from the Paris Club, the ratio of external debt to GDP fell to about 47 percent in mid-1996, and the debt-service ratio declined to about 11 percent of current account receipts (including all transfers).

The current account remained in surplus in 1995/96, albeit at a lower level than in 1994/95 (0.2 percent and 2.7 percent of GDP, respectively), despite a substantial widening of the trade deficit, a decline in private remittances, and little change in official transfers. The widening of the trade deficit, which reached 14 percent of GDP in 1995/96, was attributable to a decline in exports from exceptional levels in 1994/95; the impact on imports of more robust economic growth—intermediate and capital goods accounted for a large share of import growth; and rising world prices for imports of wheat and maize. Higher tourism receipts mitigated the deterioration in the trade account. In the capital account, sizable net inflows (largely associated with commercial banks' drawdowns of deposits abroad) helped to sustain the overall external surplus at about $800 million.

Since 1991, progress had been made in strengthening the revenue system through the introduction of a general sales tax and a global income tax; liberalizing the trade and exchange system; decontrolling interest rates; and initiating a reform of the public enterprise sector, including privatization. The pace of structural reform, particularly privatization, accelerated following the formation of the new government in January 1996.

Directors commended the authorities for the improvement in Egypt's economic performance over the past few years and welcomed their intention to consolidate and build on recent gains by embarking on a reinvigorated economic reform program.

Directors considered fiscal discipline as crucial to Egypt's program and stressed the need to maintain the prudent stance of demand management policy as a basis for further reducing inflation and ensuring continued external viability. They noted that Egypt's exchange system was now virtually free of restrictions and urged the authorities to accept the obligations of Article VIII of the Fund's Articles of Agreement.

In the area of structural reform, Board members welcomed the wide-ranging measures incorporated in the program. They regarded those related to fiscal restructuring—particularly tax reform and the reorganization of the civil service—as potentially far-reaching and noted that implementation of the plans in the money and foreign exchange markets, in conjunction with the restructuring of the financial sector, would enhance the authorities' macroeconomic management capacity while broadening and deepening the financial sector. Directors stressed the need to continue to strengthen prudential standards and banking regulations.

In the Board's view, the privatization program sent a clear signal of the government's intention of disengaging from the productive sector. On trade liberalization, Directors welcomed the recent round of tariff reductions. Directors supported steps to liberalize rents and investment procedures and emphasized the importance of early passage of a unified investment law. They encouraged the authorities to promote greater flexibility in the labor market to alleviate unemployment. Directors also attached considerable importance to the authorities' efforts to improve the collection and compilation of data.

## *Ghana*

The Board concluded the Article IV consultation with Ghana in June 1996 and reviewed the country's progress under the first annual ESAF arrangement. This arrangement had been approved on June 30, 1995 in an environment of intensifying inflationary pressures resulting from slippages in fiscal policy and large credit expansion caused by the difficulties of the Ghana National Petroleum Corporation (GNPC). As part of the program, the authorities took steps to reduce the GNPC's large overdraft at the central bank, cut off its access to new credits, and placed its oil-trading transactions under the control of the Ministry of Finance. These measures helped reduce inflation, at seasonally adjusted annual rates, from 120 percent in July 1995 to 70 percent in September 1995.

Monetary growth in 1994 was also boosted by the central bank's inability to absorb the liquidity impact of larger-than-expected foreign exchange inflows from gold and timber exports. Such pressures reemerged in the fourth quarter of 1995 in connection with capital inflows from the cocoa sector. These inflows, combined with a strong current account performance, increased Ghana's foreign exchange reserves. The central bank's net foreign asset position exceeded the end-1995 target by the equivalent of 30 percent of reserve money. Broad money consequently grew by 37 percent in 1995 (Table 26). Nonetheless, inflation fell further, to 54 percent at an annualized seasonally adjusted rate at the end of the year.

Real GDP growth reached 3.8 percent in 1994 and 4.5 percent in 1995. Mining grew strongly in 1995, and agriculture expanded by 4.5 percent, but manufacturing output was sluggish. The revenue picture was also mixed: public dividends and royalties from the banking and mining sectors performed favorably, but collections from petroleum and import taxes fell short of expectations. In 1995, Ghana contained recurrent expenditures, holding the government wage bill at 5.7 percent of GDP and making lower domestic interest payments than expected. The budget recorded an overall deficit on a commitment basis of 4.5 percent of GDP in 1995, exceeding the program target by 1.3 percentage points, partly because of overspending on roads and highways.

In their discussion, Directors noted that, through its prolonged adjustment and reform efforts, Ghana had made significant progress, although performance under the ESAF-supported program had been disappointingly uneven. In 1995, inflation had risen to an unacceptably high level, private saving and investment had remained weak, economic growth had fallen short of target, and deregulation of the petroleum and cocoa sectors had been delayed.

Directors observed that high inflation and policy slippages through mid-1995 had undermined confidence, precluding a private saving and investment response, which was essential for sustained growth. Although external sector performance in 1995 had been stronger than anticipated, stop-and-go policies had prevented Ghana from fully reaping the benefits of its earlier efforts.

Directors welcomed the steps that Ghana had taken since late 1995 to reverse slippages in policy implementation and noted the satisfactory performance during the first quarter of 1996. They saw the economic program for 1996 as constituting a serious effort to comply with the original program targets and as providing

Table 26
**Ghana: Selected Economic Indicators**
*(Data as of Board discussion in June 1996)*[1]

| | 1993 | 1994 | 1995 | 1996 Projections at time of Board discussion | 1996 Outturn[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 5.0 | 3.8 | 4.5 | 5.0 | 5.2 |
| Change in consumer prices (end of period) | 27.7 | 34.2 | 70.8 | 25.0 | 32.7 |
| | | | *In millions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 1,063.6 | 1,226.8 | 1,431.2 | 1,597.4 | 1,510.1 |
| Imports, f.o.b. | –1,728.0 | –1,579.9 | –1,687.2 | –1,947.2 | –1,835.1 |
| Current account balance[3] | –559.1 | –264.9 | –141.8 | –210.6 | –273.0 |
| Direct investment | 25.0 | 30.0 | 35.0 | 20.0 | 20.0 |
| Overall balance | 41.2 | 163.8 | 284.0 | 115.3 | –18.9 |
| Gross official reserves | 420.4 | 592.9 | 779.7 | 832.5 | 598.9 |
| Current account balance (in percent of GDP)[4] | –9.2 | –4.9 | –2.2 | –3.4 | –4.3 |
| External debt (in percent of GDP) | 82.5 | 94.5 | 80.8 | 84.8 | 78.8 |
| Debt service (in percent of exports of goods and services) | 35.7 | 27.4 | 35.8 | 24.0 | 27.9 |
| Change in real effective exchange rate (annual average; in percent) | –13.2 | –17.6 | 14.1 | . . . | 12.2 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| General government balance[5] | –7.7 | –3.5 | –4.5 | –2.0 | –8.8 |
| Gross national saving | 5.6 | 10.8 | 16.4 | 14.6 | 14.4 |
| Gross national investment | 14.8 | 15.9 | 18.6 | 17.9 | 18.7 |
| Change in broad money (in percent) | 27.4 | 46.2 | 37.4 | 5.0 | 34.2 |
| Discount rate on 91-day treasury bills (in percent; end of period) | 32.0 | 29.5 | 40.5 | . . . | 42.8 |

[1]Unless otherwise noted.
[2]Updated Fund staff estimates.
[3]Excluding divestiture receipts.
[4]Including official grants.
[5]Including divestiture proceeds.

a disciplined framework for economic policy during the run-up to the elections in late 1996. Directors exhorted the government to resist spending pressures and stressed the importance of strictly implementing all elements of the program. They also stressed that a substantial and durable reduction in inflation was the priority of the program and should be the key objective of monetary policy. Directors welcomed indications that the growth of reserve money had declined to within program ceilings and that inflation was also declining. They emphasized that the credibility, strength, and sustained implementation of financial policies were critical in achieving low inflation.

As regards fiscal policy, Directors were encouraged by the measures implemented to regularize outstanding arrears to local contractors and to bring road spending under control. They noted, additionally, that the favorable outcome of civil service pay negotiations would help to maintain fiscal restraint and stressed the importance of adopting effective instruments to monitor and control government expenditures. Over the medium term, Directors observed that Ghana needed to rely less on trade taxes and to widen the tax base.

Directors saw structural reforms as essential for accelerating growth and alleviating poverty. These should focus on enhancing private sector activity and on relieving the financial burden public enterprises imposed on the state. While welcoming the progress in deregulating the marketing and pricing of oil and in curtailing the access of the GNPC to central bank credit, Directors expressed concern about the practice of providing the GNPC with official guarantees and urged the authorities to continue with the restructuring of the oil sector. They also encouraged the authorities to move forward with liberalizing cocoa exports by reducing, if not eliminating, export taxes in a framework that would balance competition and regulation to secure a free market while ensuring quality control. Directors welcomed the authorities' intention to divest the government's share in the banking sectors.

Directors agreed that, with sustained strong policies, Ghana's external debt burden appeared manageable in the medium term and that the balance of payments position looked sufficiently robust to sustain modest adverse shocks. They suggested, nonetheless, close monitoring of Ghana's debt situation.

## *Guatemala*

The Board concluded the Article IV consultation with Guatemala in October 1996. The Guatemalan authorities had succeeded in 1995 in reducing the combined public sector deficit by increasing government revenue and restraining expenditure. In 1995, real GDP grew by 5 percent, spurred by high coffee prices, and inflation dropped to 8½ percent (Table 27). The foreign reserve position deteriorated, owing to lax credit policies and shortfalls in official financing.

In 1996, under a new administration, the fiscal position continued to improve as a result of additional revenue measures, on the one hand, including an increase in the value-added tax rate to 10 percent from 7 percent and the introduction of an extraordinary and temporary solidarity tax, and, on the other hand, tight expenditure control. Despite the improvement in the two preceding years, Guatemala's tax ratio at 8½ percent of GDP remained relatively low by regional standards, and the resources devoted to basic social needs and infrastructure continued to be insufficient. Credit to the private sector continued to expand rapidly in the first half of the year, but it slowed subsequently as the central bank tightened credit policy.

Growth of economic activity slowed in 1996, to an estimated 3 percent, because of the effects of lower coffee prices on domestic demand, while inflation rose. The external current account deficit was projected at the time of the consultation to decline marginally, and the overall balance of payments to be in approximate equilibrium (in the event, the current account deficit fell to less than 3 percent of GDP, and the overall balance moved into surplus). Following downward pressure on the quetzal in the first quarter of 1996, which prompted the central bank to sell foreign exchange, the currency appreciated a little in nominal terms in the second quarter, with the central bank intervening on the buying side; in real effective terms the quetzal appreciated by 2 percent during January–June 1996.

Table 27
### Guatemala: Selected Economic Indicators
*(Data as of Board discussion in October 1996)*[1]

| | 1993 | 1994 | 1995[2] | 1996 Projections at time of Board discussion | 1996 Outturn[3] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 3.9 | 4.0 | 4.9 | 3.8 | 3.1 |
| Unemployment rate | 5.5 | 5.2 | 4.2 | . . . | . . . |
| Change in consumer prices (end of period) | 11.6 | 11.6 | 8.6 | 10.0 | 10.9 |
| | | | *In millions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 1,462 | 1,687 | 2,156 | 2,246 | 2,213 |
| Imports, c.i.f. | –2,599 | –2,781 | –3,292 | –3,424 | –3,146 |
| Current account balance | –746 | –697 | –589 | –616 | –418 |
| Direct investment, net | 228 | 65 | 70 | 103 | 81 |
| Portfolio investment, net | 155 | 359 | –102 | 0.0 | 88 |
| Capital account balance[4] | 955 | 533 | 369 | 607 | 560 |
| Gross official reserves[5] | 3.5 | 3.2 | 2.3 | 2.2 | 2.9 |
| Current account balance (in percent of GDP) | –6.6 | –5.4 | –4.0 | –3.9 | –2.7 |
| External debt (in percent of GDP) | 19.8 | 18.6 | 15.9 | 14.7 | 15.0 |
| Debt service (in percent of exports of goods and services) | 14.3 | 13.0 | 9.2 | 9.3 | 9.9 |
| Change in real effective exchange rate (in percent) | 1.5 | 7.5 | –0.2 | . . . | 5.4 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| General government balance | –1.4 | –1.1 | –0.7 | . . . | . . . |
| Gross national saving | 10.7 | 10.3 | 11.4 | 10.9 | 11.8 |
| Gross domestic investment | 17.2 | 15.7 | 15.4 | 14.8 | 14.8 |
| Change in broad money (in percent) | 18.5 | 17.9 | 14.7 | 14.0 | 14.0 |
| Interest rate (in percent; end of period) | | | | | |
| Lending | 25.7 | 20.2 | 22.2 | . . . | 22.4 |
| Time deposits | 18.0 | 12.5 | 14.2 | . . . | 13.3 |

[1]Unless otherwise noted.
[2]Estimated.
[3]Updated Fund staff estimates.
[4]Includes errors and omissions.
[5]In months of imports of goods and services.

Soon after assuming office in January 1996, the new administration, under the auspices of the United Nations, resumed peace negotiations with insurgent groups, and in December 1996 peace accords were signed. The government is committed to implementing an ambitious Peace Program over the next several years to achieve durable progress in the political, social, and economic areas. The program includes (1) the strengthening of democratic institutions, the judicial system, and public security; (2) higher spending on basic infrastructure, low-income housing, primary health care and education, and land reform; and (3) a reduction in military expenditures and higher tax revenue to finance the peace-related outlays within a sound fiscal framework.

Directors, at their meeting, welcomed the progress made in the peace negotiations. They were of the view that this important achievement provided a clear opportunity to address the economy's fiscal and external fragility and to improve basic social conditions.

Directors considered that the fiscal position needed to be strengthened substantially. They were of the view that the tax effort, low by regional standards, hindered efforts to address the country's deep-rooted social problems, develop a more modern infrastructure, and give due attention to human capital formation. To that end, Directors called on the authorities to move quickly with measures to raise the tax effort and strengthen public finances. The additional revenue was needed to ease pressure on interest rates, reduce inflation, and improve the external position. Given the substantial income inequality, Directors felt that attention should be paid to the progressivity of the tax system. They noted that it was important to maintain strict control over government expenditures, particularly the wage bill.

Directors welcomed the steps to curb the rapid growth of credit to the private sector and emphasized the importance of pursuing a conservative credit stance. They recommended that the exchange rate continue to be allowed to respond to market forces in the context of financial policies aimed at lowering inflation and strengthening the reserve position. Directors agreed with the authorities' position that large-scale intervention in the interbank foreign exchange market should be avoided.

The slow implementation of structural reforms was noted by Directors. They urged the authorities to press on with privatization in the electricity, telecommunications, and railroad sectors, as well as with their plans to modernize the public sector and move to a pension system based on private capitalization. They also encouraged moving ahead with financial modernization, including giving more autonomy to the central bank and strengthening prudential regulations. Directors welcomed the progress made in settling external arrears and urged the authorities to ensure the timely payment of all official financial external obligations. They emphasized that strong macroeconomic and structural reforms were needed to ensure donor support for Guatemala's adjustment efforts.

### *India*

The Board concluded the Article IV consultation with India in November 1996. The new government that took office in June 1996 had inherited a strong economy, with GDP rising by 7 percent in 1995/96 (Table 28), fueled by a vigorous supply response to reforms, although there were signs of a slowdown in industrial production in early 1996/97. Tight monetary policy combined with a delay in administered price adjustments brought wholesale price inflation down to 5 percent in 1995/96, while consumer price inflation was also on a downward trend. In mid-1996, however, inflation had begun to pick up, mainly reflecting a 20 percent increase in petroleum prices in July.

The fiscal deficit had been on a gradually declining path since 1993/94 but remained large. The central government deficit fell to 5.7 percent of GDP in 1995/96. The combined public sector deficit was estimated to have remained at about 9¼ percent of GDP. The budget for 1996/97 aimed to reduce the central government deficit further to 5 percent of GDP, largely on the basis of higher divestment receipts and cyclical gains to tax revenues.

With the fiscal deficit remaining high, monetary policy had carried the main burden of stabilization. Broad money growth was lowered to 13.2 percent in 1995/96, and corporate liquidity was further constrained by weakness in the stock market and a slowdown in capital inflows. The prime lending rate reached 16–18 percent. However, the monetary policy stance was eased significantly during the early months of 1996/97, reflecting official concerns for the effects of a credit squeeze on investment.

On the external front, the current account deficit widened to 1.6 percent of GDP in 1995/96, mainly because of rapid import growth. At the same time, the capital account weakened as portfolio equity inflows slowed because of preelection uncertainties. The authorities responded to several episodes of sharp downward pressure on the exchange rate by intervening in the foreign exchange market and tightening money market conditions, while taking administrative measures to discourage the use of trade financing for speculative purposes. After February 1996, the foreign exchange market was more stable.

In their discussion, Directors commended India's impressive economic performance—strong output growth, controlled inflation, and a satisfactory external position—but were concerned over the strains that were beginning to emerge. The high fiscal deficit continued to put upward pressure on interest rates; infrastructure constraints were taking their toll; and inflation was beginning to pick up. Directors were encouraged by the new government's commitment to adjustment and reform but emphasized that continued economic success would depend on bolder steps.

The too large fiscal deficit still needed to be tackled decisively, Directors stressed. They urged that an ambitious front-loaded adjustment be launched at the time of the next budget, aimed at a more accelerated pace of deficit reduction than presently envisaged by the authorities. Delaying the fiscal adjustment, Directors cautioned, would leave the economy more vulnerable to adverse external developments.

In view of the low revenue-to-GDP ratio, Directors considered that deficit reduction should focus on improving revenue mobilization—including at the state level—through broadening the tax base, eliminating exemptions, and enhancing cost recovery. Considerable scope was also seen for curbing expenditures by improving the targeting of food and fertilizer subsidies and proceeding quickly with civil service reform to reduce the wage bill.

Directors stressed that monetary policy should be firmly focused on inflation and cautioned against undue easing of monetary conditions. They underlined the need to stick to the target for broad money in light of the recent pickup in inflation. Directors also urged the authorities to phase out ad hoc financing from the Reserve Bank of India to the government at the end of the fiscal year as an important step in building the framework for greater central bank independence.

Directors emphasized the need for flexible exchange rate management in close coordination with other macroeconomic policy instruments. They stressed that the exchange rate should be allowed to respond to market signals and that, in managing intervention policy, the authorities should avoid a too mechanical reliance on indicators of the real exchange rate. They also pointed to the considerable efficiency gains from freer capital flows. A number of Directors considered that more could be done to open up the Indian economy to foreign investment and urged that priority be given to removing the remaining obstacles to foreign direct and portfolio investment.

While welcoming the new government's reform program, Directors emphasized that early elaboration of a comprehensive framework of structural reforms and bold initial action would help to foster an efficient and dynamic private sector response. They pressed for accelerated trade liberalization, including the early phasing out of quantitative restrictions on imports of consumer goods. Directors also called for further efforts to strengthen public sector banks and to ensure effective supervision; more ambitious public enterprise reform, including privatization and implementation of an effective exit policy; and actions to establish a framework for private participation in infrastructure.

Subsequent to the Board meeting, revised national accounts data indicated significantly higher real GDP growth over 1993/94–1995/96 than previously estimated: GDP growth in these years is now estimated at 6.0 percent in 1993/94, 7.2 percent in 1994/95, and 7.1 percent in 1995/96. For 1996/97, by contrast, despite slowing industrial activity, strong agricultural performance helped to maintain GDP growth close to 7 percent. A good harvest also helped to ease pressures on food prices, and wholesale price inflation receded to 6½ percent by early April 1997. While exports slowed markedly, import growth also came down sharply, and the current account deficit remained about 1½ percent of GDP in 1996/97. The overall balance of payments

Table 28
### India: Selected Economic Indicators[1]
*(Data as of Board discussion in November 1996)*[2]

| | 1993/94 | 1994/95 | 1995/96[3] | 1996/97 Projections at time of Board discussion | 1996/97 Outturn[4] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP (at factor cost) | 4.3 | 6.3 | 7.0 | 6.8 | 6.8 |
| Change in consumer prices (end of period) | 9.9 | 9.7 | 8.9 | 9.5 | 9.5 |
| | | | *In billions of U.S. dollars*[2] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 22.7 | 26.9 | 32.5 | 34.9 | 34.3 |
| Imports, c.i.f. | 25.1 | 31.7 | 41.1 | 43.1 | 45.3 |
| Current account balance | –1.2 | –2.6 | –5.2 | –6.2 | –5.1 |
| Direct investment, net | 0.6 | 1.3 | 2.0 | 2.3 | 2.4 |
| Portfolio investment, net | 3.6 | 3.6 | 2.1 | 4.2 | 3.3 |
| Capital account balance | 9.8 | 8.7 | 4.0 | 9.1 | 11.4 |
| Gross official reserves | 15.7 | 20.8 | 17.0 | 20.0 | 22.3 |
| Current account balance (in percent of GDP) | –0.5 | –0.9 | –1.6 | –1.7 | –1.5 |
| External debt (in percent of GDP; end of period) | 36.3 | 32.9 | 29.2 | 26.8 | 27.2 |
| Debt service (in percent of exports of goods and services) | 26.5 | 26.4 | 26.2 | 28.4 | 27.8 |
| Change in real effective exchange rate (in percent; end of period) | 6.9 | –5.1 | –0.6 | 6.0 | 8.0 |
| | | | *In percent of GDP*[2] | | |
| **Financial variables** | | | | | |
| General government balance | –8.8 | –7.4 | –7.6 | –7.4 | –7.4 |
| Gross national saving | 21.4 | 24.4 | 24.6 | 26.2 | 25.5 |
| Gross domestic investment | 21.6 | 25.2 | 26.2 | 27.5 | 27.5 |
| Change in broad money (in percent; end of period) | 18.4 | 22.3 | 13.2 | 16.1 | 15.6 |
| Interest rate (in percent)[5] | 12.5 | 12.7 | 13.9 | 13.7 | 13.7 |

[1]Data are for fiscal years ending March.
[2]Unless otherwise noted.
[3]Fund staff estimates.
[4]Updated Fund staff estimates.
[5]Ten-year government bonds.

registered a $6¼ billion surplus, boosted by strong private capital inflows, and international reserves rose to about six months of imports by April 1997. The central government's budget for 1997/98 provided sharp reductions in tax rates, while aiming to lower the deficit to 4½ percent of GDP from 5 percent in 1996/97. Monetary policy aimed at containing inflation to 6 percent in 1997/98, while steps were taken to ease cumbersome regulation of bank lending and to foster development of the government securities and foreign exchange markets. Other recent reform initiatives included further liberalization of the foreign direct and portfolio investment regimes and elimination of quantitative restrictions on a range of consumer goods imports.

### *Indonesia*

The Board concluded the Article IV consultation with Indonesia in July 1996. Over the past few years, Indonesia had been able to sustain the impressive record of economic development established in the 1970s and 1980s through market-oriented reform. In 1995/96, domestic demand grew faster than GDP for a third year, based on strong growth of consumption and investment. Real GDP growth rose to 8 percent (Table 29), although a tightening of the fiscal position helped to mitigate demand pressures. The overall rate of inflation remained at 9 percent, underpinned by food price inflation, which averaged 14 percent in 1995, owing to shortfalls in rice supply and high import prices.

A rapid expansion of credit to the private sector in 1995/96 contributed to the substantial rise in domestic demand, and also to pressures on prices and the external current account. The rupiah/U.S. dollar exchange rate continued to depreciate steadily, reflecting the inflation differential with partner countries, while at the same time Bank Indonesia increased the short-run flexibility of the exchange rate by widening the intervention band.

The external current account deficit widened from 1.8 percent of GDP in 1994/95 to 3.4 percent of GDP in 1995/96, owing to a sharp deterioration in the trade balance as imports increased rapidly. Strong capital inflows financed the current account deficit and financed an increase in reserves. Although debt levels remained high relative to levels in some other Asian countries, the external debt burden declined relative to GDP and exports.

In May 1995, the government introduced a substantial package of across-the-board tariff reforms, scheduled to be implemented in stages to 2003. The package lowered tariffs on 6,000 items and resulted in a significant and immediate reduction in the average tariff rate from 19½ percent to 15 percent. Further reductions in tariffs were also scheduled over the period to 2003, in line with the Association of South-East Asian Nations (ASEAN) Free Trade Area's accelerated Common Effective Preferential Tariff scheme, which would reduce the average tariff to 7 percent.

Directors commended the authorities for Indonesia's economic achievements of recent years, especially the sizable reduction in poverty and the improvement in many social indicators, as well as the reduced reliance on the oil and gas sectors and the liberalization of important sectors of the economy. They noted that continued excess demand pressures and large capital inflows had raised important policy challenges. The authorities' flexibility in adapting the policy mix to meet changing circumstances had been an important aspect of their success over the years and would remain essential in addressing those challenges.

Most Directors viewed a stronger fiscal effort as key to restraining demand. While recognizing that the balanced budget rule had served the country well, they generally agreed with further tightening of fiscal policy, with surpluses being used to prepay external debt. Directors emphasized the strengthening of non-oil revenues through tighter tax administration, as well as through revenue measures and broadening the base of existing taxes. At the same time, many Directors supported increased government spending in the medium term on education, health services, and infrastructure.

The Board strongly endorsed the authorities' aim to reduce broad money growth in 1996. Directors agreed with the authorities' emphasis on maintaining an open capital account and welcomed the steps already taken to widen the exchange rate band and give greater flexibility to exchange rate policy. That process should be continued as an important component of policies to discourage short-term capital inflows and enhance the effectiveness of monetary policy. Of particular importance in reducing inflation inertia would be the setting of administered wage increases on the basis of forward-looking inflation targets. Moreover, with the impact of the policy mix helping to reduce inflation and with faster structural reform to maintain competitiveness, it should be feasible to move to a more market-determined exchange rate with greater emphasis on achieving the inflation objective.

In the Board's view, further substantial reforms, including financial sector reforms and the development of a strong capital market, were essential for maintaining rapid, sustained growth. Directors urged the authorities to address weaknesses in the banking sector, and in particular to act decisively to resolve the problem of insolvent banks and recover nonperforming loans. They considered these actions as critical to reduce the vulnerability of the economy to shocks and to lessen moral hazard. Further deregulation and opening of the economy to world markets were the key to maintaining competitiveness, and they welcomed the recent reduction in tariffs. Directors supported accelerated liberalization of internal and external trade of the main commodities in order to enhance equity as well as encourage non-oil exports. More generally, they strongly urged greater transparency in policy implementation, especially a regulatory framework and tax system that provided a level playing field.

Table 29
**Indonesia: Selected Economic Indicators**[1]
*(Data as of Board discussion in July 1996)*[2]

| | 1992/93 | 1993/94 | 1994/95 | 1995/96 Projections at time of Board discussion | 1995/96 Outturn[3] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 7.2 | 7.3 | 7.5 | 8.1 | 8.2 |
| Change in consumer prices (end of period) | 5.0 | 10.2 | 9.6 | 9.0 | 9.0 |
| | | | *In billions of U.S. dollars*[2] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 35.3 | 36.5 | 42.1 | 47.8 | 47.8 |
| Imports, c.i.f. | 30.3 | 32.3 | 37.9 | 46.1 | 46.1 |
| Current account balance | –2.6 | –3.0 | –3.3 | –6.9 | –6.8 |
| Direct investment | 1.7 | 2.0 | 2.6 | 5.4 | 5.4 |
| Portfolio investment | 1.2 | 2.0 | 0.8 | 1.7 | 1.8 |
| Capital account balance | 6.6 | 4.5 | 7.2 | 14.7 | 12.3 |
| Gross official reserves | 12.0 | 12.7 | 13.3 | 16.0 | 16.0 |
| Current account balance (in percent of GDP) | –1.8 | –1.9 | –1.8 | –3.4 | –3.3 |
| External debt (in percent of GDP) | 58.9 | 55.9 | 56.8 | 54.8 | 52.9 |
| Debt service (in percent of exports of goods and services) | 32.2 | 33.4 | 33.7 | 34.8 | 33.2 |
| Change in real effective exchange rate (in percent) | –2.4 | 1.6 | –2.5 | –0.6 | –0.6 |
| | | | *In percent of GDP*[2] | | |
| **Financial variables** | | | | | |
| General government balance | –1.3 | –0.5 | 0.2 | 1.0 | 1.0 |
| Gross national saving | 30.2 | 31.4 | 32.4 | 34.8 | . . . |
| Gross national investment | 32.4 | 33.2 | 34.3 | 37.8 | . . . |
| Change in broad money (in percent) | 22.2 | 20.8 | 22.1 | 28.0 | 28.0 |
| Three-month time deposit rate (in percent) | 15.7 | 11.5 | 15.9 | 17.3 | 17.3 |

[1]Data are for fiscal years ending March.
[2]Unless otherwise noted.
[3]Updated Fund staff estimates.

## *Islamic Republic of Iran*

The Board concluded the Article IV consultation with the Islamic Republic of Iran in August 1996. Having addressed the 1992/93 foreign exchange difficulties in the First Five-Year Development Plan (ended 1994/95), the authorities had shifted the emphasis of the Second Five-Year Development Plan (1995/96–1999/2000) to boosting growth and lowering inflation in the context of increasing openness and liberalizing the economy. Under this plan, the real GDP growth rate rose from 1.6 percent in 1994/95 to 3.1 percent in 1995/96 (Table 30). Year-on-year inflation soared to 49 percent from 35 percent during that period, but the 12-month rate fell from a peak of 59 percent in May 1995 to 26 percent by May 1996. Despite doubling at the start of the year, domestic energy prices remained far below international prices in 1995/96.

The fiscal deficit narrowed further to 3.8 percent of GDP in 1995/96, following a decline in 1994/95 to 4.5 percent from the peak of 7.2 percent in 1993/94. Although the ratio of total budgetary revenue to GDP fell from the previous year, the authorities contained budgetary expenditure within the scope of revenue collection. As in the two preceding years, the deficit resulted mainly from extrabudgetary foreign exchange losses.

Broad money grew by 37 percent in 1995/96, compared with 29 percent in the previous year. Both net domestic asset expansion (caused partly by bank support for the servicing of external debts incurred before March 1994 by public enterprises and the private sector) and net foreign asset expansion fueled the growth. Deposit rates, already negative in real terms over the past several years, became more strongly misaligned as inflation rose. The subsequent deceleration of inflation reduced this misalignment, but the disintermediation associated with negative real rates of return contributed to the growth, albeit incipient, of alternative channels for financial intermediation, including the Teheran stock exchange.

In the external sector, the authorities continued to strengthen their reserve position in 1994/95–1995/96, reducing the stock of external arrears to $315 million in March 1996 from over $11 billion in

Table 30
**Islamic Republic of Iran: Selected Economic Indicators**[1]
*(Data as of Board discussion in August 1996)*

| | 1992/93 | 1993/94 | 1994/95 | 1995/96 |
|---|---|---|---|---|
| | | *In percent* | | |
| **Domestic economy** | | | | |
| Change in real GDP | 5.9 | 4.9 | 1.6 | 3.1 |
| Change in consumer prices (period average) | 24.4 | 22.9 | 35.2 | 49.4 |
| | | *In billions of U.S. dollars*[2] | | |
| **External economy** | | | | |
| Exports, f.o.b. | 19.9 | 18.1 | 19.4 | 18.3 |
| Imports, f.o.b. | 23.3 | 19.3 | 12.6 | 12.8 |
| Current account balance | –7.3 | –4.5 | 5.1 | 3.5 |
| Capital account balance | 3.7 | –4.5 | –2.9 | –2.9 |
| Gross official reserves | 2.9 | 2.9 | 3.9 | 6.7 |
| Current account balance (in percent of GDP) | –5.6 | –5.6 | 7.7 | 3.9 |
| External debt (in percent of GDP) | 12.2 | 28.7 | 34.5 | 24.4 |
| Debt service (in percent of exports of goods and services) | . . . | . . . | 13.9 | 27.1 |
| | | *In percent of GDP*[2] | | |
| **Financial variables** | | | | |
| General government balance | –1.2 | –7.2 | –4.5 | –3.8 |
| Gross national saving | 29.8 | 23.6 | 32.0 | 33.2 |
| Gross national investment | 35.4 | 29.2 | 24.2 | 29.3 |
| Change in broad money (in percent of stock) | 24.7 | 34.8 | 29.4 | 37.0 |
| Short-term deposit rate (in percent) | 7.5 | 8.0 | 8.0 | 8.0 |

[1]Data are for fiscal years ending on March 20.
[2]Unless otherwise noted.

March 1994. This improvement was driven by a sharp turnaround in the external current account, which, in turn, was caused by the almost 50 percent drop in imports achieved over that time through intensified import controls and exchange restrictions instituted in May 1995. Total exports, meanwhile, fell by 5.6 percent in 1995/96, as non-oil exports, affected by the imposition of exchange controls and a misalignment of the export exchange rate, declined by 33 percent. The overall capital account deficit was roughly unchanged from 1994/95, and the overall balance of payments shifted to a surplus, the first in several years. The exchange controls gave rise to a parallel market, in which the exchange rate depreciated gradually from May 1995 to June 1996.

In their discussion, Directors commended the authorities for the considerable progress made over the past two years in regularizing the external debt situation, lessening the vulnerability of the foreign exchange reserve position, and reducing inflation despite an unfavorable external environment. Those positive developments put the authorities in a position to design and implement in a timely fashion a comprehensive reform effort, which should give priority to unifying the exchange rate at a realistic level, abolishing exchange restrictions, and liberalizing imports while substantially strengthening public finances and pursuing a prudent monetary policy.

Directors encouraged the authorities to strengthen further the fiscal stance by cutting the deficit, including by reducing the extra-budgetary foreign exchange losses, and by significantly lessening the dependence on oil revenue. They noted in that connection that the fiscal position would benefit by broadening the domestic tax base through the introduction of a value-added tax and improvement in tax administration, by reducing the gap between domestic and international energy prices, and by containing public expenditure. Directors underscored the need for prudent credit and monetary policies based on greater use of market-based instruments of control, including positive real interest rates, to lower inflation. They encouraged the authorities to promote sound money and securities markets by liberalizing credit allocation and control and by strengthening the regulatory and prudential policy framework.

Directors noted that the existing exchange rate system was severely hampering investment and growth of the non-oil sector. They encouraged the authorities to develop a firm timetable leading to the early unification of exchange rates under the Second Five-Year Development Plan and called for the liberalization of the remaining exchange restrictions and trade controls. They also emphasized the importance of addressing long-standing distortions in the economy arising from the heavy implicit subsidy on domestic energy consumption.

### *Jordan*

The Board concluded the Article IV consultation with Jordan in February 1997 and completed the second review under the Extended Arrangement approved on February 9, 1996. Since the balance of payments crisis of the late 1980s and the regional disturbances associated with the Middle East crisis in 1990–91, Jordan had made impressive progress toward achieving macroeconomic stability and growth. In 1996, despite a difficult external environment, the overall economic performance remained favorable. Real GDP growth was estimated at 5.2 percent, and the 12-month inflation rate declined to 2.5 percent (Table 31). The external current account deficit (including grants) was estimated to have narrowed to 3 percent in 1996 from 3.9 percent in 1995, as the larger-than-envisaged trade deficit arising from a sharp increase in imports of foodstuffs (related to higher world prices) and transport equipment was offset by a pickup in workers' remittances. The capital account, however, was adversely affected by regional developments, and the overall balance of payments deficit widened.

The favorable 1996 macroeconomic performance was underpinned by the authorities' continued steadfast and responsive policy implementation. Important steps were taken toward fiscal consolidation, mainly through containment of expenditures. Food and animal feed subsidies were reformed, and capital expenditures and spending on nonwage goods and services were reduced. Consequently, the fiscal deficit (excluding grants) as a percentage of GDP was estimated to have dropped to 4.6 percent in 1996 from 5.3 percent in the previous year.

Despite regional uncertainties and the deteriorating economic conditions in the West Bank and Gaza Strip, significant progress was made in building up official foreign exchange reserves in 1996 in the context of the exchange rate policy of maintaining a tight link between the Jordan dinar and the U.S. dollar. This involved sizable open market operations and an increase in interest rate spreads. The result has been a tight monetary policy, with low growth in money supply and net domestic assets of the banking system.

Structural reforms were implemented in public finance and the social safety net, the financial sector, trade, and the regulatory framework with a view to opening up further the Jordanian economy, to encourage competition, and to facilitate domestic and foreign private investment. Although progress in privatization was slow, institutions for implementing it were established.

The Board welcomed the authorities' steadfast implementation of adjustment and reform policies, which, despite the difficult external environment, had led to an impressive economic performance. Directors emphasized that continued strong macroeconomic policies and an intensification of structural reforms would consolidate the economic gains and further reduce Jordan's vulnerability to external developments.

Directors generally welcomed the policy package for 1997. Looking forward, a number of Directors stressed the importance of further budgetary revenue reform over the medium term in order to strike a better balance in the composition of fiscal adjustment. Directors considered that a greater effort by the government to address poverty issues, especially through the World Bank–supported social productivity program, was also essential for sustained adjustment and reform.

Directors noted that Jordan had maintained an appropriately tight monetary policy, accompanied by financial sector reforms, and that the exchange rate policy had contributed to financial stability. Monetary policy should continue to be geared toward building up official foreign exchange reserves. Directors indi-

Table 31
**Jordan: Selected Economic Indicators**
*(Data as of Board discussion in February 1997)*

| | 1993 | 1994 | 1995 | 1996[1] |
|---|---|---|---|---|
| | *In percent* | | | |
| **Domestic economy** | | | | |
| Change in real GDP | 5.6 | 8.1 | 6.9 | 5.2 |
| Change in consumer prices (end of period) | 1.9 | 4.9 | 4.2 | 2.5 |
| | *In billions of U.S. dollars*[2] | | | |
| **External economy** | | | | |
| Exports, f.o.b. | 1.2 | 1.4 | 1.8 | 1.9 |
| Imports, c.i.f. | 3.5 | 3.4 | 3.7 | 4.3 |
| Current account balance | –0.6 | –0.4 | –0.3 | –0.2 |
| Capital account balance | –0.1 | –0.0 | 0.2 | 0.2 |
| Gross official reserves | 0.6 | 0.4 | 0.4 | 0.7 |
| Current account balance (in percent of GDP) | –11.7 | –6.6 | –3.9 | –3.0 |
| External debt (in percent of GDP) | 121 | 112 | 103 | 100 |
| Debt service (in percent of exports of goods and services) | 35.9 | 30.6 | 26.3 | 24.9 |
| Change in real effective exchange rate (in percent) | 2.7 | –3.8 | –6.8 | . . . |
| | *In percent of GDP*[2] | | | |
| **Financial variables** | | | | |
| General government balance (excluding grants) | –5.9 | –6.1 | –5.3 | –4.6 |
| Gross national saving (including grants) | 25.7 | 27.9 | 29.4 | 32.0 |
| Gross national investment | 34.3 | 33.1 | 31.8 | 33.4 |
| Change in broad money (in percent) | 6.9 | 8.0 | 6.6 | 2.0 |
| Six-month CDs of the Central Bank of Jordan (in percent) | 4.1 | 7.9 | 9.0 | 9.5 |

[1]Fund staff estimates.
[2]Unless otherwise noted.

Table 32
**Kuwait: Selected Economic Indicators**[1]
*(Data as of Board discussion in August 1996)*

| | 1993 | 1994 | 1995 | 1996[2] |
|---|---|---|---|---|
| | *In percent* | | | |
| **Domestic economy** | | | | |
| Change in nominal GDP | 23.6 | 1.6 | 8.0 | 1.9 |
| Change in consumer prices (period average) | 0.4 | 2.3 | 1.0 | . . . |
| | *In billions of U.S. dollars*[3] | | | |
| **External economy** | | | | |
| Exports, f.o.b. | 10.2 | 11.1 | 12.6 | 12.9 |
| Imports, f.o.b. | 7.0 | 6.7 | 7.7 | 9.1 |
| Current account balance | 1.9 | 2.4 | 3.7 | 3.0 |
| Direct and portfolio investment | –0.7 | –1.0 | –0.3 | –0.4 |
| Capital account balance | –0.9 | –1.5 | –4.5 | –3.8 |
| Gross official reserves[4] | 3.6 | 3.7 | 3.6 | 3.6 |
| Current account balance (in percent of GDP) | 8.1 | 9.6 | 13.9 | 11.1 |
| External debt (in percent of GDP)[5] | 24.5 | 25.5 | 15.0 | 3.3 |
| Change in real effective exchange rate (in percent) | –2.1 | –3.6 | –0.2 | . . . |
| | *In percent of GDP*[3] | | | |
| **Financial variables** | | | | |
| General government balance | –22.4 | –17.7 | –11.7 | –6.9 |
| Gross national saving (in percent of GNP) | 31.0 | 35.3 | 29.0 | . . . |
| Change in broad money (in percent) | 5.6 | 5.4 | 9.4 | 4.5 |
| Three-month interbank rate (in percent) | 7.43 | 6.27 | 7.07 | 6.84 |

[1]Fiscal data are for year ending June; all other data are for calendar years.
[2]Fund staff estimates.
[3]Unless otherwise noted.
[4]Central Bank of Kuwait reserves only.
[5]Government external debt only.

cated that, given the fluid regional conditions, the authorities should continue monitoring monetary developments carefully and adjust their policies in the event of an unanticipated decline in money demand. In that regard, they stressed the importance of a flexible interest rate policy and of monitoring external competitiveness.

Directors observed that the authorities' far-reaching structural reforms in the regulatory framework, the financial sector, and the subsidy system were transforming the Jordanian economy. They emphasized that the pace of privatization should be accelerated to encourage private sector activity and attract much-needed foreign direct investment. Directors also called for progress in the reform of the public pension system and the civil service.

## *Kuwait*

The Board concluded the Article IV consultation with Kuwait in August 1996. Economic performance had been generally good over the previous three years: overall nominal GDP growth had averaged 11 percent, and the program of reconstruction and rehabilitation following the Iraqi occupation had been successfully completed. In 1995, enhanced private sector confidence and high oil prices toward the end of the year contributed to strong overall nominal GDP growth of 8 percent (Table 32). Inflation remained low.

Owing to higher oil revenues and the containment of expenditures, the fiscal position improved in 1994/95, as the deficit as a percentage of GDP dropped to 11.7 percent from 17.7 percent in the previous year. However, the budget structure remained weak. Kuwait's dependency on oil receipts had increased in recent years because of the lower contribution of investment income to revenues, in connection with the drawdown of foreign assets. In addition, postliberation current spending on wages, salaries, subsidies, domestic transfers, and defense had drifted upward.

Private sector confidence in the financial sector, shaken by the disruptions caused by the Iraqi invasion, revived with the encouraging repayments made under the Debt Collection Program (which covered nonperforming loans associated with the collapse of the informal stock market in 1982 and the 1990 invasion).

The overall improvement in the fiscal accounts carried over to the balance of payments in 1995, as the current account surplus rose to the equivalent of 13.9 percent of GDP from 9.6 percent in 1994. The overall balance also benefited from the reversal of the capital outflows associated with the 1994 military alert. Government external debt as a share of GDP fell from 25.5 percent at the end of 1994 to 12 percent at the end of March 1996, as the postliberation syndicated bank loan was amortized on schedule.

The Board commended the authorities for successfully implementing the reconstruction and rehabilitation program and for maintaining economic growth with low inflation. Those developments placed Kuwait in a good position to address forcefully its remaining economic and financial challenges, which included restoring a strong fiscal position, further enhancing the integrity of the financial system, reforming the labor market, and generating employment opportunities. Directors welcomed the incorporation of those policy priorities in the Five-Year Development Plan, which was supported by the Privatization Bill before parliament.

Directors noted that a reassessment of the role of the government and the elimination of the fiscal deficit held the key to restoring Kuwait's tradition of accumulating assets for future generations. A front-loaded effort, starting with a large deficit reduction in 1996/97, would be needed to eliminate the deficit by 1999/2000 as envisaged. To that end, Directors recommended cutting subsidies and transfers, increasing customs duty rates, and containing the wage bill by slowing down new public sector employment. The authorities would also need to move aggressively to further rationalize expenditures and strengthen the domestic tax base and tax administration.

Directors noted the return of private sector confidence in the financial system, as indicated by the repatriation of capital, growth in domestic and foreign currency deposits, the narrowing of the Kuwaiti dinar–U.S. dollar interest differential, and the surge in stock market volume and prices. They called for strict implementation of the Debt Collection Program, together with a strengthening of the regulatory and supervisory regime, to further bolster confidence.

Directors emphasized that structural reform measures could minimize the impact on the non-oil sector of government expenditure reduction. They therefore welcomed the intensification of the privatization and deregulation program. Directors also stressed that the flexibility and functioning of the labor market should be improved by reducing market distortions, including by eliminating the salary and benefits differential favoring government over private sector employment, in order to promote private sector activity.

Directors commended the authorities for maintaining an open trade and payments system, capital account convertibility, and a generous foreign assistance program. They also encouraged the authorities to place greater priority on improving the statistical system and the flow of information between government agencies.

## *Malaysia*

The Board concluded the Article IV consultation with Malaysia in August 1996. The economy had continued to perform strongly in 1995, with real GDP growing by 9½ percent for the year as a whole, driven by buoyant investment and exports, as well as by a pickup in private consumption (Table 33). The risks of overheating had increased as demand pressures continued to mount during the second half of 1995. Real domestic demand growth reached 14½ percent for the year as a whole, capacity utilization rose, the output gap widened, and the labor market tightened further. As consumer price inflation declined slightly to 3½ percent—owing to lower import prices in ringgit terms, the tightening of monetary conditions, policies to address supply constraints and improve the distribution network, and administrative measures—demand pressures were vented largely through the current account deficit, which rose by 2½ percent of GDP, to 8¼ percent of GDP in 1995.

Monetary policy was tightened between October 1995 and May 1996, through increases in reserve requirements and interbank rates and through restrictions on automobile and property loans. The general government surplus declined by 2¾ percent of GDP, to 1 percent of GDP for 1995 as a whole. Long-term capital inflows increased, but reserves declined by $1.5 billion, to $25 billion. The exchange rate, in both nominal and real effective terms, remained broadly constant during 1995, although it appreciated by about 3½ percent during the first five months of 1996.

During the Sixth Plan (1991–95), most macroeconomic objectives were met or exceeded, the exceptions being the targeted increase in the private saving rate and—associated with this—a reduction in the current account deficit. Because the current account deficit was largely financed by foreign direct investiment, and owing to continued rapid growth of GDP and exports, debt and debt-service indicators declined slightly throughout the period and remained low by international standards. The incidence of poverty was reduced from 17 percent in 1990 to 9½ percent in 1995. In the area of structural reforms, basic education was being gradually extended from 9 to 11 years, and other structural measures—including labor market, tax, trade, and financial sector reforms—were implemented.

In their discussion, Directors commended the authorities for Malaysia's continued impressive economic performance, which had been marked by robust, outward-oriented growth, low inflation, and remarkable social progress in reducing poverty and improving income distribution. Sustained prudent macroeconomic management and wide-ranging structural reforms underpinned these achievements. The authorities were faced with the challenge of managing rapid growth to preserve the macroeconomic stability essential for sustainable growth.

Directors viewed pressures in factor markets and the widening current account deficit as signs of continued strong demand pressures. Although the national saving rate was high by international standards and the current account deficit largely stemmed from increased investment, Directors considered that the size of the deficit and the increased reliance on debt-creating flows gave rise to risks. The Board, therefore, urged the authorities to take early action to attenuate overheating and to place the deficit on a clear downward path. Given the constraints of monetary policy with large capital inflows, fiscal policy would have to play a key role in the needed policy mix. Directors urged the

Table 33
**Malaysia: Selected Economic Indicators**
*(Data as of Board discussion in August 1996)*[1]

| | 1993 | 1994 | 1995 | 1996 Projections at time of Board discussion | 1996 Outturn[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 8.3 | 9.2 | 9.5 | 8.8 | 8.2 |
| Unemployment rate | 3.0 | 2.9 | 2.8 | 2.8 | 2.6 |
| Change in consumer prices (end of period)[2] | 3.5 | 3.7 | 3.4 | 4.0 | 3.5 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b.[2] | 46.0 | 56.6 | 71.3 | 81.0 | 76.6 |
| Imports, f.o.b.[2] | 42.8 | 54.9 | 71.0 | 81.0 | 73.1 |
| Current account balance[2] | –2.9 | –4.2 | –7.0 | –7.8 | –5.2 |
| Private long-term capital, net[2] | 3.2 | 3.6 | 2.5 | 2.7 | 4.5 |
| Capital account balance[2] | 10.8 | 1.5 | 6.4 | 11.2 | 9.2 |
| Gross official reserves (end of year) | 28.3 | 26.7 | 25.1 | 28.4 | 27.7 |
| Current account balance (in percent of GDP) | –4.6 | –5.9 | –8.3 | –8.2 | –5.2 |
| External debt (in percent of GDP) | 42.8 | 37.5 | 37.5 | 41.5 | 38.1 |
| Debt service (in percent of exports of goods and services) | 7.3 | 5.8 | 7.1 | 7.4 | 5.7 |
| Change in real effective exchange rate (annual average; in percent) | –0.4 | –3.2 | 0.4 | . . . | 4.2 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| Consolidated public sector balance[2] | –4.7 | 1.3 | 0.6 | –1.0 | 1.2 |
| Gross national saving[2] | 30.5 | 32.7 | 32.4 | 32.0 | 36.0 |
| Gross national investment[2] | 35.1 | 38.7 | 40.7 | 40.1 | 41.2 |
| Change in total liquidity (M3; end of year; in percent) | 23.8 | 15.8 | 18.2 | 22.0 | 23.7 |
| Three-month interbank rate (annual average; in percent) | 7.2 | 5.1 | 6.1 | 7.2[3] | 7.2 |

[1]Unless otherwise noted.
[2]Official data provided subsequent to the Board discussion. Official data for 1993–95 were as follows: change in consumer prices—3.6 (1993); exports—71.6 (1995); imports—71.5 (1995); current account balance— –3.1 (1993), –4.6 (1994), –7.5 (1995); private long-term capital, net—5.0 (1993), 4.3 (1994), 4.1 (1995); capital account balance—1.3 (1994), 7.4 (1995); consolidated public sector balance— –2.2 (1993), 3.5 (1994), 2.9 (1995); gross national saving—33.0 (1993), 34.0 (1994), 34.7 (1995); gross national investment—37.8 (1993), 40.4 (1994), 43.2 (1995).
[3]First quarter.

authorities to limit the deterioration of the overall public sector balance projected in 1996 and to restore fiscal surplus in 1997. They welcomed the authorities' intention to consider proposals for expenditure-reducing and revenue-enhancing measures, including rescheduling lower-priority public investment projects, further cuts in investment incentives, and an early introduction of a value-added tax.

In view of the continued rapid money and credit growth, several Directors favored further tightening of monetary policy, and Directors noted that the authorities' readiness to allow greater exchange rate flexibility should help to increase the effectiveness of monetary policy. But the difficulty of significantly reducing the current account deficit through higher private saving, particularly in the short run, underscored the need for greater reliance on fiscal policy to increase public saving.

Directors observed that Malaysia's high level of investment and rapid total factor productivity growth augured well for sustainable growth in the future, provided that the momentum of liberalization and structural reform was sustained. The Board supported measures to strengthen the services sector, including through tax reforms. Directors also urged labor market reforms, including a more flexible, productivity-based wage system, and strengthening of education and training. A continuation of financial reform was also important, such as deregulation to promote development of the bond market and greater reliance on indirect monetary instruments. Continued strong emphasis on prudential supervision of commercial banks and other financial institutions would facilitate further financial liberalization. Directors also urged further trade and tariff reform and the elimination of controlled and administered prices.

## *Mexico*

The Board concluded the Article IV consultation with Mexico in August 1996. Although the lingering effects of the 1994 financial crisis had led output to contract by around 6.2 percent in 1995, real GDP expanded by 2.8 percent during the first quarter of 1996 relative to the last quarter of 1995. Reflecting the recovery, the open unemployment rate fell from 7.4 percent in the third quarter of 1995 to 5.4 percent in May 1996. Meanwhile, the 12-month rate of inflation declined from 52 percent in December 1995 to 32 percent by June 1996.

Fiscal performance during 1995 was better than programmed, largely owing to lower wage payments and revenue sharing to the states, and a shortfall in planned investment expenditures. The fiscal outturn in the first quarter of 1996 was considerably stronger than expected, largely because of the impact of higher-than-expected international oil prices and lower-than-programmed expenditures. The restrictions faced by monetary policy in early 1995, when delays in the disbursement of external loans led to an increase in net domestic assets and a decline in net international reserves, were alleviated by mid-March as external financing became available. In October and November, a second round of financial market turbulence led the authorities to tighten the monetary stance. By the first quarter of 1996, larger-than-programmed external borrowing by the government boosted international reserves and was responsible for a sizable decline in net domestic assets.

Mexico's main financial indicators improved steadily during the first half of 1996. The stock market index rose by about 15 percent. The interest rate on 28-day treasury bills fell from around 50 percent to 28 percent, and the peso appreciated slightly. Mexico registered a trade surplus in the first five months of 1996: merchandise exports increased 22 percent, and merchandise imports rose by 20 percent.

Directors noted with satisfaction the recovery in economic activity and employment, the sharp decline in inflation in 1996, and the strengthening of the balance of payments. They observed that the firm implementation of monetary policy aimed at lowering inflation had contributed to the decline in interest rates in the context of relative exchange rate stability. That in turn had reinforced investor confidence, leading to increased private capital flows.

Notwithstanding the improved economic performance, Directors stressed that areas of concern remained. In particular, the banking system remained fragile, and banks' nonperforming portfolios had continued to increase, albeit at a slower rate, creating the need for various support programs. They were concerned at the high fiscal costs associated with those programs and the potential moral hazard they created; they welcomed the government's intention not to provide further direct relief through new programs to bank debtors.

The Board stressed that the authorities should continue to resist pressures to relax policies and should be ready to take compensatory action as needed to achieve the main objectives of the program. A sustained tight

Table 34

## Mexico: Selected Economic Indicators

*(Data as of Board discussion in August 1996)*[1]

| | 1993 | 1994 | 1995 | 1996 Projections at time of Board discussion | 1996 Outturn[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| GDP (annual change) | 2.0 | 4.4 | –6.2 | 3.6 | 5.1 |
| Unemployment rate (average) | 3.4 | 3.7 | 6.3 | 5.5 | 5.5 |
| Inflation rate (end of period) | 8.0 | 7.1 | 52.0 | 25.0 | 27.7 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports[3] | 51.9 | 60.9 | 79.5 | . . . | 96.0 |
| Imports[3] | –65.4 | –79.3 | –72.5 | . . . | –89.5 |
| Current account balance | –23.4 | –29.7 | –1.6 | –3.4 | –1.9 |
| Direct investment | 4.4 | 11.0 | 9.5 | 6.3 | 7.6 |
| Portfolio investment[4] | 28.9 | 8.2 | –9.7 | . . . | 14.2 |
| Capital account balance[5] | 32.5 | 14.6 | 15.4 | . . . | 3.3 |
| Gross official reserves | 25.3 | 6.5 | 17.1 | 16.6 | 19.5 |
| Current account balance (in percent of GDP) | –5.8 | –7.0 | –0.5 | –1.2 | –0.6 |
| External debt (in percent of GDP) | 32.7 | 33.8 | 59.3 | 56.6 | 49.3 |
| Debt service (in percent of exports of goods and nonfactor services and transfers) | 26.2 | 27.7 | 24.7 | . . . | 28.0 |
| Change in real effective exchange rate[6] | 6.4 | 14.0 | 95.9 | . . . | –9.9 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| General government balance[7] | 0.7 | –0.1 | 0.0 | — | –0.1 |
| Gross national saving | 15.2 | 14.7 | 19.2 | 17.8 | 20.3 |
| Gross domestic investment | 21.0 | 21.7 | 19.7 | 19.0 | 20.9 |
| Change in broad money (M4; in percent) | 26.5 | 24.1 | 20.7 | . . . | 30.1 |
| Nominal interest rate (in percent)[8] | 15.0 | 14.1 | 48.4 | 29.0 | 31.4 |

[1]Unless otherwise noted.
[2]Updated Fund staff estimates.
[3]Includes in-bond industry.
[4]Comprises equity investments, private and public bond placements in international markets, and purchases by foreigners of government securities.
[5]Includes liabilities to the Fund, as well as all the financial support provided to Mexico in 1995 by other creditors.
[6]End of period real exchange rate based on relative unit labor costs in the manufacturing industry; a positive sign indicates a depreciation of the peso.
[7]Data for the general government do not exist. Figures shown are overall nonfinancial public sector (central government plus enterprises).
[8]On one-month treasury bills (average of primary auction).

monetary policy would be required to reduce inflation, which remained higher than expected.

Directors noted that Mexico faced several key challenges over the next few years. Foremost was the urgent need to improve its economic growth performance to raise the living standards of the population. Further tax and expenditure reform would be required to maintain fiscal discipline over the medium term. Restoring and preserving macroeconomic stability was critical in strengthening investor confidence and facilitating Mexico's access to long-term foreign financial assistance, particularly in light of the anticipated "hump" of external debt-service payments in 1998–2000. That needed to be accompanied by an increase in domestic saving to keep the external current account deficit at sustainable levels. Directors welcomed the authorities' intention to formulate a comprehensive medium-term program to consolidate ongoing stabilization and structural reform efforts and viewed positively the government's intention to seek Fund support for that program, which they considered should focus on structural measures.

Since the Board discussion, the economic recovery has become more entrenched. Real GDP grew by 5.1 percent in 1996, compared with an earlier projection (made prior to the Board discussion) of 3.6 percent (Table 34). The 12-month rate of inflation declined to 27.7 percent by year-end, compared with 52 percent in December 1995. By the end of 1996, the unemployment rate had fallen to levels close to those observed before the crisis. The external current account deficit in 1996 was estimated at about half (0.5 percent of GDP) the earlier projection (1.2 percent of GDP), contributing to an increase in net international reserves of $5.8 billion, more than quadruple the program target of $1.4 billion. Mainly reflecting stronger-than-expected oil prices, the overall public sector balance registered a small surplus of 0.2 percent of GDP, compared with a program target of balance. Reflecting the continued strengthening of confidence, capital inflows had remained strong, contributing to a real effective exchange rate appreciation of 9.9 percent in 1996, after a real depreciation of 95.9 percent in 1995. The capital inflows also permitted a restructuring of external debt to longer maturities at more favorable interest rates. In January 1997, the Mexican authorities liquidated all outstanding obligations under the U.S. Exchange Stabilization Fund ($3.5 billion) and, in the first quarter of 1997, made advance repurchases to the Fund totaling $2.3 billion.

### *South Africa*

The Board concluded the Article IV consultation with South Africa in May 1996. In 1995, for the third successive year, South Africa had made steady progress, successfully weathering the economic squalls that accompanied its political transition. Among its successes were a reduction in the 12-month rate of consumer price inflation (to 5.5 percent in April 1996 from 11 percent in April 1995), a 1½ percentage point of GDP increase in real net investment, and a 3.3 percent rise in real GDP (Table 35). Throughout this three-year period, the authorities maintained tight monetary and fiscal policies.

Despite the abolition of exchange controls on nonresidents in March 1995, and the increase in the external current account deficit in 1995 to 2.6 percent of GDP (from 0.5 percent of GDP in 1994), the rand remained strong through 1995, reflecting a substantial improvement in foreign investor sentiment toward South Africa. This newfound confidence underlay a strengthening of longer-term capital inflows in the second half of 1995 and into 1996—these soared to $6 billion in 1995 compared with $1.5 billion in 1994. However, in mid-February 1996 and again in late March, the rand weakened amid political uncertainties and speculation that exchange controls on residents would be abolished wholesale. In response, the authorities reiterated their intention of liberalizing exchange controls on residents gradually and of persisting with the "market-friendly" policies that had been pursued since the 1994 election.

In late 1994, open unemployment stood at 32 percent of the total labor force and at more than 40 percent of the black labor force. Since then, private nonagricultural employment has grown by less than 1 percent, while the labor force has grown by more than 2½ percent. In part at least, the unemployment situation reflected the persistence of competitiveness problems.

In their discussion, Directors commended the authorities for pursuing prudent policies, which included reducing the fiscal deficit in 1995/96, tightening monetary policy in response to the emergence of inflationary pressures in late 1994, liberalizing trade and capital controls, and enacting new legislation on labor relations. They noted that these actions had been crucial in improving market confidence, but Directors underscored that a further tightening of monetary policy was key to restoring financial stability and to containing inflation. At the same time, Directors recognized that the authorities faced competing demands to respond to the population's urgent social needs. In this regard, they welcomed the priority that the authorities attached to boosting growth and employment.

Directors took the view that the recent depreciation of the rand was appropriate, but that further policy action was needed to contain the inflationary impulse that had already resulted from the depreciation and to restore confidence in the foreign exchange markets. They cautioned that progress in these areas was necessary to prevent increased inflation from eroding the contribution of the depreciation to competitiveness. Although Directors welcomed the abolition of foreign exchange controls on nonresidents in March 1995, they noted that this action had exposed the economy more directly to shifts in investor sentiment and that financial policies therefore needed to respond accordingly. In that light, Directors endorsed the increase in the bank rate at the end of April 1996 and the authorities' commitment to step-by-step liberalization of the exchange controls on residents.

Directors emphasized that investor confidence would be bolstered by the announcement of a medium-term structural reform package that would address high unemployment and low growth. Such a program should aim to increase the demand for unskilled labor and improve the overall competitiveness of South African industry. The important role of further trade liberalization in improving economic efficiency and growth was stressed in this context. Monetary policy should focus on maintaining control of inflation, exchange rate policy should support trade liberalization, and fiscal policy should be designed to strengthen domestic saving.

Subsequent to the Board discussion, in June 1996, the Minister of Finance presented the authorities' growth, employment, and redistribution strategy, designed to raise medium-term economic growth and employment. It included commitments to more rapid fiscal consolidation and to exchange control reform, which were fully reflected in the budget for 1997/98, as well as further structural reform measures. In early 1997, the rand appreciated, reflecting renewed confidence in the policy framework and a strengthening in the external current balance.

Table 35
**South Africa: Selected Economic Indicators**
*(Data as of Board discussion in May 1996)*[1]

| | | | | 1996 | |
|---|---|---|---|---|---|
| | 1993 | 1994 | 1995 | Projections at time of Board discussion | Outturn[2] |
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 1.3 | 2.7 | 3.3 | 4.0 | 3.1 |
| Unemployment rate | . . . | . . . | 32.0 | . . . | . . . |
| Change in consumer prices (period average) | 9.7 | 9.0 | 8.6 | 7.5 | 7.4 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports | 24.1 | 24.7 | 27.9 | 31.1 | 29.1 |
| Imports, f.o.b. | –18.3 | –21.5 | –27.1 | –29.5 | –27.1 |
| Current account balance | 1.7 | –0.6 | –3.5 | –3.4 | –2.0 |
| Direct investment | –0.3 | 0.5 | 0.4 | 0.5 | 0.6 |
| Portfolio investment | 1.0 | 0.3 | 2.0 | 1.5 | 0.5 |
| Capital account balance | –4.5 | 1.5 | 6.0 | 3.0 | 3.4 |
| Gross official reserves | 2.7 | 3.1 | 4.3 | 2.2 | 2.2 |
| Current account balance (in percent of GDP) | 1.5 | –0.5 | –2.6 | –2.5 | –2.0 |
| External debt (in percent of GDP) | 14.8 | 15.3 | 15.5 | 17.0 | 19.0 |
| Debt service (in percent of exports of goods and services) | 10.3 | 10.8 | 13.8 | 17.4 | 16.6 |
| Change in real effective exchange rate (in percent) | –4.4 | –3.1 | — | . . . | –8.1 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| General government balance[3] | –6.0 | –5.7 | –5.5 | –5.1 | –5.1 |
| Gross national saving | 17.2 | 17.2 | 16.7 | 17.3 | 16.5 |
| Gross national investment | 15.7 | 17.7 | 19.3 | 19.8 | 18.0 |
| Change in broad money (in percent) | 7.0 | 15.7 | 15.1 | 12.0 | 13.6 |
| Interest rate (in percent)[4] | 12.0 | 13.0 | 15.0 | . . . | 17.0 |

[1]Unless otherwise noted.
[2]Updated Fund staff estimates.
[3]Central government; fiscal-year basis (April–March).
[4]Bank rate; end of period.

## *Tanzania*

The Board concluded the Article IV consultation with Tanzania in November 1996. Compared with an average of about 3.7 percent in the three preceding years, real GDP growth, led by agriculture, increased to an estimated 4.5 percent in 1995/96 (Table 36). Although manufacturing activity continued to decline, owing especially to inefficiencies in the parastatal sector, newly privatized enterprises expanded robustly. Slower monetary expansion and improved agricultural production led to a fall in the inflation rate on a year-end basis to 22.7 percent in June 1996 and to 18 percent in August 1996 from a peak of 38 percent for the year ended February 1995.

The new government, elected in November 1995, faced major deficiencies in budgetary and financial institution management. In the fiscal area, these deficiencies were reflected in weak tax administration, exacerbated by widespread tax exemptions and evasion, with the result that revenue collection remained below potential. Weakness in expenditure control also ener-

Table 36
### Tanzania: Selected Economic Indicators[1]
*(Data as of Board discussion in November 1996)*

| | 1993/94[2] | 1994/95[2] | 1995/96[2] |
|---|---|---|---|
| | *In percent* | | |
| **Domestic economy** | | | |
| Change in real GDP | 3.5 | 3.8 | 4.5 |
| Change in consumer prices (period average) | 30.2 | 34.0 | 25.7 |
| | *In millions of U.S. dollars*[3] | | |
| **External economy** | | | |
| Exports, f.o.b. | 485.9 | 592.9 | 659.1 |
| Imports, c.i.f. | –1,590.5 | –1,509.7 | –1,538.9 |
| Current account balance[4] | –1,075.8 | –861.7 | –835.9 |
| Direct investment[5] | 63.0 | 67.3 | 105.6 |
| Capital account balance | 256.6 | 113.9 | 118.8 |
| Change in gross official reserves (increase –) | –11.7 | 51.2 | 15.0 |
| Current account balance (in percent of GDP)[5] | –30.5 | –20.6 | –16.2 |
| External debt (in percent of GDP) | 194.7 | 171.8 | 143.7 |
| Debt service (in percent of exports of goods and services)[6] | 59.9 | 41.6 | 38.4 |
| Change in real effective exchange rate (in percent; end of period) | –3.5 | –3.8 | 22.2 |
| | *In percent of GDP*[3] | | |
| **Financial variables** | | | |
| Central government balance[4] | –7.9 | –6.9 | –4.9 |
| Gross national saving | 6.8 | 9.9 | 11.7 |
| Gross national investment[7] | 29.4 | 26.6 | 27.7 |
| Change in broad money (in percent) | 35.0 | 37.7 | 15.0 |
| Interest rate (in percent)[8] | 38.2 | 51.5 | 22.0 |

[1]Data are for fiscal years (July–June).
[2]Data provided by the Tanzanian authorities, and Fund staff estimates.
[3]Unless otherwise noted.
[4]Excluding grants.
[5]$32 million of privatization proceeds is included in 1995/96.
[6]Excluding Fund; before rescheduling.
[7]Based on national accounts data, which are not fully consistent with the balance of payments data.
[8]Discount rate of the Bank of Tanzania, end of period.

vated budgetary management. The dominance of a wide range of allowances in the government wage bill and an inability to eliminate low-priority activities contributed to expenditure overruns. In the financial sector, institutional weaknesses have compromised the effectiveness of indirect monetary instruments in promoting greater efficiency in providing financial services.

To address the budgetary weakness during the first half of fiscal year 1995/96 (July–June), the government adopted a mini-budget that included both revenue measures and expenditure cuts. As a result, for 1995/96 as a whole, the government's overall deficit amounted to 3.3 percent of GDP, compared with a deficit of 5.8 percent of GDP in 1994/95. The fiscal improvement in 1995/96 contributed critically to the decline in the rate of broad money growth to 15 percent in the year ended June 1996, compared with 38 percent a year earlier. A credit ceiling on state-owned banks and sales of foreign exchange by the Bank of Tanzania also contributed to the slower pace of monetary expansion. During the second half of 1995/96, the government also adopted several structural measures designed to remove the institutional deficiencies indicated above.

Despite a modest deterioration in the terms of trade, the external position strengthened in 1995/96. Import volume declined owing to tighter customs control and the uncertainties of an election year. The external current account deficit, excluding grants, declined to 16.2 percent of GDP in 1995/96, compared with 20.6 percent of GDP in 1994/95. Gross official reserves declined from the equivalent of 8.8 weeks of imports at end-June 1995 to 8.1 weeks of imports at end-June 1996, but they recovered to 10.0 weeks of imports at end-August 1996 owing to purchases of foreign exchange by the Bank of Tanzania during the traditional export season.

Although Directors welcomed the marked improvement in Tanzania's macroeconomic performance, they emphasized in their discussion that the financial situation remained fragile. In this light, they stressed the importance of strong financial policies and structural reforms—particularly fiscal consolidation and financial sector reform—in order to stabilize the economy, sustain more broadly based growth, and improve living standards.

Directors applauded the new government's initiatives to address persistent fiscal imbalances and structural impediments that hindered sound financial management. They welcomed the pay reform in the civil service, the establishment of the Tanzania Revenue Authority, and the strengthened expenditure control and budgetary processes. Some Directors, noting the government's determination to increase transparency and accountability by public officials, encouraged the authorities to intensify their efforts in the fight against corruption. Directors regretted the delay in introducing the value-added tax and noted the importance of improving tax administration and widening the tax base. In particular, extension of the Tanzania Revenue Authority to include Zanzibar, together with the programmed harmonization of import taxes, would eliminate an important source of tax evasion. They stressed that Tanzania should try to meet fiscal goals without accumulating domestic arrears.

In the area of structural reform, Directors welcomed the progress made to date, but they stressed the importance of intensifying the parastatal reform and deepening financial sector reform. Directors expressed concern about the risks to macroeconomic stability and the central bank's ability to implement an effective monetary policy posed by the serious problems of the state-owned banks, particularly the National Bank of Commerce, for which many Directors thought privatization would be necessary. They urged the authorities to address these problems without delay and to introduce more competition in the banking system.

Directors commended the authorities for their success in liberalizing the exchange and trade system, which allowed Tanzania to accept the obligations of Article VIII of the Fund's Articles of Agreement in July 1996. Directors urged the authorities to clear external payments arrears as quickly as possible. Observing that Tanzania's economy remained vulnerable to external shocks, Directors indicated that sustained commitment to the medium-term program and its full implementation would be needed for continued donor support.

Data available subsequent to the consultation show that the improvement in the fiscal position during July–December 1996 was greater than expected. Strong revenue performance and tight expenditure control allowed the government to generate savings equivalent to 1.4 percent of annual GDP. Government net repayments to the banking system kept broad money growth at 9 percent by end-December 1996, contributing to a decline in inflation to 14 percent by end-January 1997. The external position strengthened substantially, mostly reflecting an improvement in the current account, with gross official reserves of the Bank of Tanzania reaching the equivalent of 16 weeks of imports by end-December 1996.

### *Thailand*

The Board concluded the Article IV consultation with Thailand in July 1996. In response to the global economic recovery, overheating reemerged in Thailand during 1995 and the first quarter of 1996. For 1995 as a whole, demand remained strong, as GDP—driven by investment and exports—expanded by nearly 9 percent (Table 37). As a result, factor markets tightened further, with the unemployment rate falling slightly, to 2½ percent. Average inflation rose to 5.8 percent in 1995—the highest since 1991—and remained high in the first quarter of 1996, as a result of higher world commodity prices as well as the strength of demand, increases in wages, and the effect of floods.

Monetary policy was progressively tightened, and the overall public sector surplus increased. Nevertheless, the current account deficit rose to 8 percent of GDP but was more than covered by capital inflows. These inflows continued at a high level in early 1996, resulting in some downward pressure on interest rates. The slow progress in reducing the external current account deficit was in part due to the increase in private saving being inadequate to keep up with investment. External debt, about half of which was short term, rose from about 39 percent of GDP in 1991 to 49.5 percent of GDP in 1995.

In structural developments, poverty had been reduced substantially in recent years, but rural-urban income disparities continued to grow, and income distribution deteriorated. Infrastructural developments to alleviate bottlenecks were temporarily delayed because of a change in government. Measures had been taken to improve education and training, including by increasing the transition rate from primary to secondary schooling, but shortages of skilled labor remained.

Directors strongly praised Thailand's remarkable economic performance and the authorities' consistent record of sound macroeconomic policies. They noted that financial policies had been tightened in 1995 in response to the widening of the external current account deficit and the pickup in inflation, and this had begun to bear results, but they cautioned that there was no room for complacency.

Directors supported the authorities' intention to maintain a tight monetary stance. The authorities had, however, sought to address the growing openness of the capital account and the large and volatile capital inflows through a combination of monetary and prudential measures, supported most recently by price-based controls on short-term inflows. Directors considered that these were not an effective substitute for more fundamental policies over the medium term.

The stability of the baht had served the Thai economy well in the past, but Directors recommended a greater degree of exchange rate flexibility to improve monetary autonomy and to reduce the incentive for short-term capital inflows. The increased flexibility should be supported by development of additional indirect monetary instruments and reduced reliance on the credit plan.

The recent increase in the current account deficit had increased Thailand's vulnerability to economic shocks and adverse shifts in market sentiment. On the one hand, Directors noted, economic fundamentals remained generally very strong, characterized by high saving and investment, a public sector surplus, strong export growth in recent years, and manageable debt

Table 37
**Thailand: Selected Economic Indicators**
*(Data as of Board discussion in July 1996)*[1]

| | 1993 | 1994 | 1995[2] | 1996 Projections at time of Board discussion | 1996 Outturn[3] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 8.3 | 8.8 | 8.7 | 8.3 | 6.7 |
| Unemployment rate | 2.6 | 2.6 | 2.5 | . . . | 2.0 |
| Change in consumer prices (period average) | 3.3 | 5.0 | 5.8 | 6.0 | 5.9 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 36.6 | 44.6 | 56.0 | 63.9 | 54.7 |
| Imports, c.i.f. | 45.1 | 53.4 | 70.9 | 80.5 | 70.8 |
| Current account balance | –6.1 | –7.8 | –13.1 | –14.5 | –14.4 |
| Direct investment, net | 1.4 | 0.9 | 1.3 | 1.4 | 17.1 |
| Portfolio investment, net | 3.9 | 1.2 | 3.2 | . . . | 1.1 |
| Capital account balance | 10.5 | 12.2 | 22.0 | 20.5 | 18.0 |
| Gross official reserves | 25.4 | 30.3 | 37.0 | 43.0 | 38.7 |
| Current account balance (in percent of GDP) | –5.4 | –5.6 | –8.1 | –7.9 | –8.0 |
| External debt (in percent of GDP) | 41.7 | 45.3 | 49.5 | 52.4 | 49.9 |
| Debt service (in percent of exports of goods and services) | 10.9 | 11.4 | 11.0 | 12.4 | 11.4 |
| Change in real effective exchange rate (in percent) | 0.9 | –0.5 | –0.9 | . . . | 6.6 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| Overall public sector[4] | 0.9 | 1.6 | 2.5 | 2.5 | 2.2 |
| Gross domestic saving | 35.0 | 35.6 | 35.0 | 35.7 | 34.5 |
| Gross national investment | 40.4 | 41.2 | 43.1 | 43.6 | 42.5 |
| Change in broad money (in percent) | 18.4 | 12.9 | 17.0 | 17.3 | 12.6 |
| Interbank lending rate (in percent; end of period)[5] | 4.38 | 7.22 | . . . | . . . | 12.1 |

[1]Unless otherwise noted.
[2]Fund staff estimates.
[3]Updated Fund staff estimates.
[4]Fiscal years ending September 30.
[5]Weighted average.

and debt-service returns. On the other hand, the level of short-term capital inflows and short-term debt were somewhat high. Also, the limitations of present policy instruments constrained the authorities' ability to manage shocks. Caution in the use of foreign savings was warranted, Directors observed, and early action was required to reduce the current account deficit. While fiscal policy could play a role in the short term, over the medium term the emphasis should be on measures to increase private saving.

Directors noted that Thailand's remarkable growth performance owed much to structural policies that fostered strong total factor productivity growth. They encouraged the authorities to maintain and strengthen the momentum of reform, particularly in the financial and trade sectors, and recommended a further strengthening of supervision of the banking sector. Much progress had been made in reducing poverty, but the deterioration in distribution was a serious concern, and the authorities could improve their efforts in this regard. Directors welcomed measures to improve education. Directors encouraged the authorities to strengthen their efforts to improve the statistical base.

## *Uruguay*

The Board concluded the Article IV consultation with Uruguay in July 1996, together with a first review under the Stand-By Arrangement approved in March 1996. In 1995 real GDP had declined by about 2.0 percent, and unemployment rose significantly. The decline in output continued during early 1996 in construction, commerce, and industry, but agricultural output rose. The 12-month rate of inflation fell from 44 percent during 1994 to 30 percent in May 1996.

The combined public sector deficit was reduced in 1995 to 1.75 percent of GDP, from 3 percent in 1994. The central administration wage bill and outlays on goods and services were restrained, and investment spending was scaled back relative to GDP. Social outlays increased, however, as inflation declined. Although the net revenue effect of the tax package implemented in May 1995 was positive, tax revenue fell relative to GDP in 1995, reflecting a sharp fall in domestic demand.

The expansion of currency in circulation slowed from 43 percent in 1994 to about 31 percent in the year ended May 1996, and the growth of broad money and credit to the private sector also declined. The interest rate on short-term treasury bills also declined significantly during that period, as did the prime lending rate.

Uruguay's external position strengthened during 1995 and early 1996, with the external current account deficit narrowing from 2 percent of GDP in 1995 to

1.8 percent of GDP by March 1996 (Table 38). Nevertheless, export growth slowed during this same period, reflecting declining demand from Argentina and Brazil. The monthly rate of depreciation of the exchange rate band vis-à-vis the U.S. dollar, which had remained unchanged at 2 percent since 1992, was lowered to 1.8 percent in April 1996. In real effective terms, the Uruguayan peso appreciated by 3½ percent from early 1995 to April 1996, and in April 1996 it was appreciated by about 14 percent relative to its average level in 1990–95.

During their meeting, Directors commended the authorities on the progress made over the past year in fiscal consolidation and implementing structural reforms, which had helped to reduce Uruguay's external vulnerability to declining demand from its main trading partners during the period. They were concerned, however, that inflation remained high, output had declined substantially, and unemployment had risen. To sustain rapid output and employment growth in the medium term, saving and investment needed to be increased.

The Board stressed that it was urgent to reduce inflation. To that end, further fiscal adjustment would be needed during 1996. Measures to broaden the tax base and improve the administration of taxes and social security contributions, together with close monitoring of the financial performance of public enterprises, were also needed.

Table 38

**Uruguay: Selected Economic Indicators**

*(Data as of Board discussion in July 1996)*[1]

| | 1993 | 1994 | 1995 | 1996: Projections at time of Board discussion | 1996: Outturn[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real GDP | 3.0 | 6.8 | –2.4 | — | 4.9 |
| Unemployment rate (end of period) | 7.6 | 9.9 | 11.1 | . . . | 11.9 |
| Change in consumer prices (end of period) | 52.9 | 44.1 | 35.4 | 23.6 | 24.3 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 1.6 | 1.9 | 2.1 | 2.3 | 2.4 |
| Imports, c.i.f. | –2.3 | –2.7 | –2.8 | –2.9 | –3.3 |
| Current account balance | –0.3 | –0.4 | –0.3 | –0.3 | –0.3 |
| Capital account balance | 0.6 | 0.7 | 0.6 | 0.3 | 0.4 |
| Gross official reserves | 1.4 | 1.7 | 1.8 | 1.9 | . . . |
| Current account balance (in percent of GDP) | –2.6 | –2.7 | –2.0 | –1.7 | –1.5 |
| External debt (in percent of GDP) | 38.5 | 35.5 | 34.0 | 34.3 | 33.8 |
| Debt service (in percent of exports of goods and services) | 23.0 | 23.5 | 28.3 | 25.4 | 19.4 |
| Change in real effective exchange rate (in percent; end of period) | 15.5 | –1.6 | 3.2 | . . . | 2.6 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| Consolidated public sector balance | –1.9 | –3.1 | –1.7 | –1.3 | –1.7 |
| Gross national saving | 12.0 | 12.0 | 12.1 | 11.4 | 11.7 |
| Gross domestic investment | 14.6 | 14.6 | 14.1 | 13.1 | 13.2 |
| Change in broad money (in percent) | 36.0 | 37.3 | 31.6 | 23.2 | 36.9 |
| Interest rate (in percent)[3] | 48.2 | 44.7 | 39.4 | . . . | 29.2 |

[1]Unless otherwise noted.

[2]Updated Fund staff estimates.

[3]For 1993, the rate is for central bank treasury bills; thereafter the rate is for treasury bills with a maturity of up to 63 days.

Directors urged the authorities to continue and not delay their plan to slow the depreciation of the exchange rate band, in line with targeted inflation and supported by appropriately restrained financial and wage policies. At the same time, to improve external competitiveness and increase productivity, Directors urged the authorities to accelerate tax changes and structural reforms. In particular, it was extremely important to undertake a fiscal package that included reducing social security contribution rates paid by employers, lengthening the adjustment period of wages, and removing backward wage indexation arrangements, as well as other measures to help deliver the programmed narrowing of the fiscal deficit in 1996 and its further decline in 1997.

Directors emphasized that credit policy should continue to be restrained until signs were clear that fiscal adjustment was taking place and inflation was declining as planned. In that context, Directors welcomed the authorities' intention to restrain credit expansion by the state banks.

Directors commended the authorities on the implementation of the reform of the main social security system and encouraged them to press for prompt passage of legislation for reforming the other social security plans. They welcomed the ongoing effort to implement the reform of the central administration. Those efforts, as well as institutional changes and other steps to

Table 39
**Republic of Yemen: Selected Economic Indicators**
*(Data as of Board discussion in July 1996)*[1]

| | 1993 | 1994 | 1995 | 1996 Projections at time of Board discussion | 1996 Outturn[2] |
|---|---|---|---|---|---|
| | | | *In percent* | | |
| **Domestic economy** | | | | | |
| Change in real non-oil GDP | 3.7 | –4.5 | 7.5 | 4.0 | 4.0 |
| Change in core inflation (period averages) | . . . | 71.3 | 48.0 | 20.0 | 11.1 |
| | | | *In billions of U.S. dollars*[1] | | |
| **External economy** | | | | | |
| Exports, f.o.b. | 1.2 | 1.8 | 1.9 | 2.1 | 2.2 |
| Imports | 2.1 | 1.7 | 2.0 | 2.4 | 2.3 |
| Own current account (excluding oil company transactions) | –0.5 | 0.2 | –0.1 | –0.5 | –0.3 |
| Overall balance | –0.4 | –0.7 | –0.5 | –0.9 | –0.3 |
| Own gross official reserves (in months of imports, excluding oil company transactions) | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 |
| Own current account (in percent of GDP, excluding oil company transactions) | –12.1 | 3.5 | –1.8 | –9.1 | –5.0 |
| External debt (in percent of GDP) | 209.1 | 200.6 | 188.1 | 171.8 | 167.0 |
| Debt service (commitment basis; in percent of current account receipts, excluding oil company transactions) | 59.3 | 40.7 | 36.7 | 30.8 | 30.2 |
| Change in real effective exchange rate (parallel / free market rate; in percent) | . . . | –14.7 | –6.2 | . . . | 21.6 |
| | | | *In percent of GDP*[1] | | |
| **Financial variables** | | | | | |
| Central government balance (cash basis) | –16.5 | –16.5 | –5.9 | –3.1 | –2.5 |
| Gross national saving | –10.6 | 17.6 | 21.4 | 13.7 | 20.1 |
| Gross national investment | 15.0 | 9.6 | 15.1 | 15.5 | 19.1 |
| Change in broad money (in percent) | 46 | 34 | 20 | 14 | 11 |
| Effective deposit rate (in percent) | 3–5 | 3–5 | 20–22 | 25–27 | 20–22 |

[1]Unless otherwise noted.
[2]Provisional actual data and updated Fund staff estimates.

strengthen tax administration, would be instrumental in making room in the public finances for reducing producer taxes further in the medium term. Directors encouraged the authorities to develop further the private sector by deepening deregulation and privatization and accelerating the planned restructuring of the state banks to enhance economic efficiency and raise private investment. Directors considered that the authorities should also seek a deepening of trade liberalization.

### *Republic of Yemen*

In July 1996, the Board concluded the Article IV consultation with the Republic of Yemen and completed the first review under the Stand-By Arrangement approved on March 20, 1996. To reverse the disappointing macroeconomic and policy performance over 1990–94, the authorities had launched in 1995, and strengthened in 1996 under the Stand-By Arrangement, a financial adjustment and structural reform program. The program was comprehensive and entailed substantial fiscal adjustment; the elimination of domestic bank borrowing for the budget; a supportive, tight monetary stance directed at realizing positive real interest rates; and far-reaching structural reforms. These reforms encompassed a broadening of the excise tax base, excise tax harmonization, and introduction of government debt instruments; the freeing of interest rates and basic monetary management reforms; the freeing of exchange markets, unification of the exchange system, and adoption of a floating-rate regime; and full one-step tariff reform, elimination of import licensing, and removal of virtually all import prohibitions for economic reasons.

Real non-oil GDP recovered strongly in 1995—following the civil-war-induced contraction in 1994—rising on a net basis by 3 percent, and growth was expected to accelerate to 4 percent in 1996 (Table 39). The core inflation rate, moreover, was declining sharply as a result of the continued tight financial policies and the appreciation of the free market exchange rate. Over February–May 1996, the annualized rate was about 20 percent, compared with 48 percent in 1995 and 71 percent in 1994.

The overall cash budget deficit, which had declined to 6 percent of GDP in 1995 from 17 percent in 1994, was forecast to narrow further to 3 percent. This improvement reflected the benefits to oil revenues deriving from the depreciation of the official exchange rate and to a large increase in non-oil revenues deriving from the tax and tariff reforms and improved administration. On the expenditure side, the GDP ratios for the wage, subsidy, and defense bills were all targeted to decline to allow for increased outlays for public investment and civil service reform.

With no bank borrowing, broad money growth was targeted to slow from 20 percent in 1995 to 14 percent. Nominal deposit interest rates had been raised to 25–27 percent in early 1996; with the core inflation rate of 20 percent, real rates had become positive. In those circumstances, the composition of broad money began to shift toward quasi-money, and the government treasury bill auctions continued to experience successful outcomes.

The tightened fiscal and monetary conditions of 1995–96 and the integration of the freed commercial bank and money-changer exchange markets helped to stabilize the floating free market exchange rate after late October 1995, indicating restored confidence in the currency and the economy.

Directors in their discussion commended the authorities for demonstrating a strong sense of ownership of the comprehensive financial adjustment and structural reform program, and for its successful implementation. They were encouraged by the deceleration in the core inflation rate, the stabilization of the free market exchange rate, and the increase in gross foreign exchange reserves to near the end-year target despite a shortfall in external financing.

Directors welcomed the marked strengthening of fiscal policy in 1995–96, which had led to substantial reductions in the budget deficit and the rate of monetary expansion. They urged the authorities to continue the fiscal consolidation by further reducing subsidies through front-loaded increases in administered prices for wheat, flour, and energy, and they endorsed the adoption of a general sales tax. Directors considered it essential to establish a well-designed social safety net to mitigate the impact of the reform program on the more vulnerable segments of the population.

Directors welcomed the authorities' increased reliance on interest rate policy and recommended that interest rates be reduced only when inflation had clearly receded. Because the goal of high growth depended on more active intermediation by the banking system to ensure the extension of credit to the private sector, Directors stressed the need for legal reforms to address loan contract enforcement.

## Countries in Transition

### *Armenia*

The Board concluded the Article IV consultation with Armenia in September 1996 and conducted the midterm review of Armenia's first annual ESAF arrangement. Following a period of steep decline in GDP and of high inflation, Armenia had stabilized its economy (Table 40). Real GDP increased by 6.9 percent in 1995, and by 4.3 percent during the first half of 1996, compared with 5.4 percent in 1994. In 1995, end-of-period inflation fell to 32 percent, from 1,885 percent in the previous year. However, at the end of 1996, regional instability and the blockade of Armenia's transportation routes through Azerbaijan and Turkey continued to pose a threat to sustained growth.

The accrual budget deficit was reduced from 16.4 percent of GDP in 1994 to under 10 percent in 1995 and to 6.8 percent for the first six months of 1996, through a combination of tax measures and expenditure restraint. However, the repayment of substantial expenditure arrears led to a cash deficit amounting to 8.4 percent of GDP during the first half of 1996. The most important budgetary problem was weak revenue performance stemming from gaps in the tax base (notably the failure to capture the emerging private sector) and tax arrears.

The government continued its program of fiscal institution building in 1996. It established a treasury department as well as a debt-management unit and large-taxpayer unit within the Ministry of Finance and set up 40 field treasuries. It targeted the social safety net better, facilitating an increase in benefits, and enacted a new pension law raising the retirement age and bringing the Pension and Employment Fund into balance.

Reserve and broad money expanded rapidly during the second half of 1995, declined in the first quarter of 1996, and increased slightly during the second quarter. The central bank's refinance rate was constant at 52 percent between October 1995 and August 1996, whereas lending and deposit interest rates varied substantially. The nominal exchange rate remained stable through May 1996 before undergoing a slight depreciation, while the real effective exchange rate depreciated by 5 percent during the first six months of 1996.

As a result of high import levels and slow export growth, the ratio of the current account deficit (excluding official transfers) to GDP increased from 36 percent in 1994 to 38 percent in 1995.

At the time of the consultation, privatization was practically complete in the agriculture and housing sectors and on track for small-scale enterprises. Although privatization of medium- and large-scale enterprises had slowed in early 1996 and fallen behind schedule, it had subsequently begun to accelerate. Most prices had been liberalized, and electricity prices were raised 40 percent between October 1995 and April 1996. Progress had also been made with legal reform, particularly in the banking sector, with the passage in 1996 of the Central Bank Law establishing the central bank's independence, the Law on Banks and Banking, and the Law on Banking Insolvency.

Directors complimented the authorities on the economic growth and low inflation achieved under the ESAF-supported program and welcomed progress in systemic reforms across all sectors. However, major problems remained to be addressed, notably with regard to fiscal policy, financial sector reform, and privatization.