



International Monetary and Financial Committee

Thirty-Seventh Meeting
April 20–21, 2018

Statement No. 37-4

**Statement by Mr. Velarde
Peru**

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

**Statement by Governor Julio Velarde, President of the Central Bank of Peru
On behalf of the Southern Cone Constituency
(Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay)**

Global Developments

The global economy continues to strengthen almost everywhere without inflationary pressures. Global GDP growth accelerated in 2017 and there have been consecutive upward revisions for 2018 and 2019. The WEO notes that accommodative financial conditions and the domestic and international repercussions of expansionary fiscal policy in the U.S. support forecasts of benign development over the next couple of years.

The world economy is moving towards an expansionary economic cycle (for example, in the case of the U.S. and Germany, GDP growth exceeded potential economic growth in 2017) after several years of economic growth based on closing out-put gaps and falling unemployment rates. As a result, the trend of increasing international interest rates and more tightened financial conditions will continue on the near horizon or could even accelerate as a natural policy mix with an expansionary fiscal stance in the U.S.

Latin America is recovering from the fall of commodity prices (2013-2015) as these prices had partially recovered (2016-2017) and international financial conditions became more favorable, although economic growth in 2017 (1.0 percent) was still below potential and inflation is falling. Among the reasons behind the slow recovery are labor market conditions (Brazil and Chile), fiscal consolidation process (Brazil, Colombia, and Mexico), uncertainty about international trade rules (Mexico), and presidential elections. The WEO has reviewed Latam GDP upwards (0.1 percent) for 2018 (2.0 percent) and 2019 (2.7 percent). Inflation is below target in Brazil and Peru (in the latter case mainly due to a reversal of supply shocks) and within the target in Colombia and Chile. One important exception is Venezuela, which has seen a collapse in its economic system (double-digit negative growth rates for three consecutive years and hyperinflation since 2017) resulting in a severe humanitarian and political crisis with massive migration.

Global risks remain skewed to the downside, marked by recent international trade disputes and financial market volatility. Since the 2008 financial crisis there has been an increase in different forms of protectionism, but the proximity of protectionist conflicts in a more perceptible way have been seen in recent months with some concrete actions. There are no winners in a trade war, as a worldwide establishment of trade barriers diminishes the efficiency of the global trade market. Trade conflicts lead to more expensive products, more limited choices, less competition, and prevent trade from boosting productivity and spreading new technologies. Globalization of trade and capital has contributed significantly to income convergence by taking millions out of poverty and allowing major access to goods and services. Policy makers should work to promote an open and rules-based multilateral trade system and an efficient global financial system.

Financial risks remain varied with stretched valuations, rising leverage, and rapid innovation. U.S. dollar balance sheets are also a concern for the banking system. Even though banks have strengthened their consolidated balance sheets, they are increasingly

relying on short-term wholesale dollar funding, and thus vulnerable to liquidity risk. Demand for U.S. dollar-denominated assets from outside the U.S. continues to grow rapidly, with corporates in emerging markets being an important driver. Commodity producers could be further affected by monetary tightening if it goes along with a weakening of commodity prices. Countries with limited space are more vulnerable, in particular those with a high level of indebtedness (public and private). Drawing general conclusions on how a possible tightening of financial conditions can affect Emerging Market and Developing Countries (EMDCs) is not straightforward. There are important differences among EMDCs in terms of official reserves, depth, and liquidity of capital markets, and the ability to hedge credit and currency risk, among other factors. Hence, accessibility to external financing and credit conditions vary widely and we should refrain from putting all EMDCs into a similar risk category.

International Collaboration and IMF Policies

Global policy makers need to steer clear of protectionism, guard against financial risk, and continue efforts to secure the recovery and improve medium-term prospects.

At the country level, flexible macroeconomic policy frameworks, including sustainable fiscal policies, flexible exchange rate regimes, an adequate level of international reserves and inflation targeting, complemented by sound regulation, supervision, and the appropriate use of macro prudential policies, have proven to be critical for reaping the benefits of global integration. We agree with the Fund on helping member countries to calibrate an appropriate policy mix tailored to country circumstances. Also, further research and debates about spillover effects from systematic importance countries are welcome.

We support the Managing Director's Global Policy Agenda in emphasizing that the momentum behind the cyclical global expansion remains strong and policy makers need to tackle significant structural reforms to increase productivity and potential growth. In addition, reforms should aim not only at reaching higher sustainable economic growth, but the dynamic of growth should also be inclusive. Economic recovery in advanced economies does not seem to reverse the increasing trend of inequality, which probably is the main reason for political and social resistance to migration and free-trade. The WEO addresses certain topics to better understand this unfortunate phenomenon and, more importantly, provides valuable information for the design of public policies aimed at inclusive economic growth. More research on these topics is needed.

Social safety nets remain important to protect those adversely affected by technological progress and other structural transformations. Improving the quality and access to education and health is key to reducing inequality and enhancing social mobility over time. The increasing trend of female participation in the labor market is very welcome as an aging population will limit potential GDP growth. Efforts to raise potential output should be prioritized based on country-specific initial conditions, including upgrading skills and human capital, investing in infrastructure, and lowering product and labor market distortions.

Strengthening institutions and governance is of paramount importance to increase potential growth. We welcome the debates at the Fund on governance and corruption

issues given their crucial impact on economic growth and social welfare. Also, we support the Fund's engagement in the international tax debate, in particular, on corporate taxation. We reiterate that critical elements of a strong governance policy include better frameworks for public financial management aimed at more effective and efficient public spending, combating tax evasion and tax avoidance, regulating markets appropriately to promote competition, and fighting corruption, money laundering, and the financing of terrorism.

A strong global financial safety net (GFSN) is critical for crisis prevention and to help countries adjust to economic shocks. We support the IMF's plans to continue exploring ways to enhance the GFSN, including strengthening collaboration with regional financing arrangements and maintaining precautionary lending for the broad membership. The review of Fund-supported programs and conditionality would provide an ideal opportunity to discuss possible ways to reduce the stigma associated with IMF lending.

IMF Governance

We remain committed to a strong, quota-based, and adequately resourced IMF at the center of the International Monetary System and the GFSN, in line with statements by the IMFC. Our view is that an increase in quotas is needed to improve the balance of permanent to borrowed resources, which remains low. It is essential that the Fund has sufficient resources available ex-ante to respond to financing needs of members and to help mitigate the impact of crises. This is important at a time when the global economy is more vulnerable to tail risk events. We trust that we can find a solution and conclude the 15th General Review of Quotas no later than the Annual Meetings in 2019.

Argentina

Argentina's administration continues making considerable progress in implementing its ambitious policy agenda. Efforts have been focused on laying the groundwork for inclusive and sustainable growth. Aiming at this objective, the government has been working to establish sound macroeconomic policies, restore credibility, improve efficiency and productivity, and increase trade openness through new trade agreements. The results of the decisive policy actions adopted have been very encouraging.

Economic activity has been expanding since the second half of 2016 and growth reached 2.9 percent in 2017, in line with the government's projections. The current upswing has been steady, with the quarterly growth rate increasing to 4.2 percent yoy in the last quarter of 2017. Investment has led the recovery, growing 11 percent last year, and industrial exports recovered with similar growth rates. Private consumption also contributed to the strong expansion, growing at 3.6 percent in 2017 driven by the strengthening of the labor market. The unemployment rate declined to 7.2 percent of the labor force in the fourth quarter of 2017, with more than 400,000 new jobs created last year. Meanwhile, real wages have increased and the poverty rate decreased to 25.7 percent in the second half of 2017, from 30.3 percent in the second half of 2016.

Inflation is on a downward trend, in spite of significant adjustments in utility rates. Inflation finished 2017 at 24.8 percent, almost 15 percentage points below that of 2016, with regulated prices (utilities, transport) growing close to 40 percent (due to the policy of gradual reduction in untargeted subsidies) and core inflation slowing to 21.1 percent. This reduction in inflation is taking place without causing an overvaluation of the real exchange rate, which depreciated around 30 percent since the new administration took office.

The primary deficit of the federal government declined to 3.9 percent of GDP in 2017, an overperformance with respect to the announced target of 4.2 percent of GDP. The primary deficit is declining due to a significant reduction in public spending. A key element in this reduction has been the decline in subsidies on utilities and transportation. Tariffs are increasing to be aligned with production costs and subsidies have been reduced and oriented towards those in need. The magnitude of the reduction in the deficit underrepresents the actual fiscal effort as, at the same time, the government is reducing the tax pressure. Between 2015 and 2017, tax pressure dropped by 1.6 points of GDP.

While the current account remains negative, this is mainly reflecting the strong performance of investment. Imports of capital goods explain a large share of the trade deficit. On the other hand, there are improvements on the financing side. Foreign direct investment accumulated around USD 11.9 billion in 2017, equivalent to almost 2 percent of GDP. Meanwhile, the Central Bank of Argentina (BCRA) has built reserves accommodating strong capital inflows. Reserves increased to more than USD 61 billion, or 10 percent of GDP.

Banks remain robust with adequate levels of capital and liquidity. Domestic credit availability is increasing, with total bank credit to the private sector growing above 25 percent in real terms over the last 12 months, amid a decline in interest rates, particularly for mortgages, which are at historical lows. The implementation of indexation of long-term loans (mortgages) was a key factor in explaining the decrease in interest rates.

Strong social policies remain in place. Income transfer programs continue to be an essential tool for combating poverty, ensuring a minimum income for those who need it most. The Universal Child Allowance is an ongoing program that has been enlarged and enhanced reaching 3.9 million children (7 percent more than in 2015). Moreover, 4.2 million children were reached by the Family Income Policy framework, of which 1.2 million were incorporated in 2017. The National Plan for Early Childhood was launched at the beginning of 2016 to eradicate malnutrition in children under the age of four. In education, the public system has, for the first time, covered all children over the age of three, benefiting more than 638,000 children.

Building on this success, the authorities are continuing to address the top medium-term government priorities. Higher levels of investment are needed to sustain rapid growth and employment to sustainably reduce poverty, the overarching objective of the administration. The economy is expected to grow close to 3 percent in 2018, as a current drought is expected to affect agriculture. The goal over the medium term is to grow at an annual rate of 3-3.5 percent, supported by lower taxes and productivity-enhancing reforms.

Following October's mid-term elections, which resulted in strong support for the administration, Congress enacted reforms that underpin the fiscal strategy, including a fiscal responsibility law to maintain real primary expenditure constant, a fiscal pact with subnational governments that solved litigations between provinces and the federal government and cap public spending, and a tax reform to reduce the overall tax burden and the most distortive taxes. Notably, the reform reduces the corporate income tax rate from 35 percent to 25 percent (when profits are reinvested) and significantly reduce the subnational distortive taxes.

The authorities expect consolidated public spending to decline from 40 percent of GDP in 2017 to 33 percent of GDP in 2023 (assuming the economy grows at 3.5 percent per year). For the federal government, the primary deficit will decline to 3.2 percent of GDP in 2018, with primary spending falling to 22 percent of GDP. The debt of the federal government with the private sector and international organizations will increase to 31 percent of GDP in 2018, among the lowest in the region, and is expected to stabilize at 37 percent of GDP by 2020 as the reduction of the primary deficit continues at a pace of 1 percent of GDP per year.

In the monetary area, the BCRA will continue operating an inflation-targeting regime, with the objective of reducing inflation to 15 percent in 2018, 10 percent in 2019, and 5 percent over the medium term. As part of the announcement that changed the inflation target to these levels last December, the government also committed to reduce the financing of the BCRA to the Treasury significantly in 2019, and to only the monetary seigniorage thereafter. Given the current level of inflation, monetary policy is expected to maintain its contractionary stance.

At the same time, the government is strongly committed to strengthening institutions and modernizing the State, enhancing the social safety net, and expanding investment in infrastructure.

Modernization of the State. Administrative simplification will help reduce the regulatory burden of the State on the private sector and increase productivity. The main elements of this program include the elimination of redundant requirements for businesses to operate, the possibility of filling these requirements online, the unification of registries across public offices, and the implementation of e-files in the public sector. Online procurement systems have been launched to increase transparency and competition. Procedures for setting up small businesses have been streamlined and it is now possible to register a business in 24 hours. To facilitate international trade, a one-stop online system is being built and currently 80 percent of export and import requirements can be filled online.

Social spending. The authorities will adjust electricity, gas, and transport rates, aimed at achieving cost-recovery ratios between 80-90 percent by end 2018 and near 100 percent in 2019. Social tariffs for electricity and gas will remain in place to protect lower-income households. A fundamental analysis of the pension system and a proposal for reform—addressing sustainability and equity considerations—are expected to be concluded in a couple of years.

Rebuilding infrastructure. While much progress has been achieved with better prioritization and efficiency of investment projects undertaken by the public sector, infrastructure needs remain very high. The new law for public-private partnerships approved in 2016 allows for new investment carried out by the private sector with limited fiscal risks and high transparency standards. About 60 projects have been identified (in transport; energy; communications and technology; water, sewage and housing; and health, justice, and education) and included in the 2018 budget to be undertaken under PPPs, resulting in additional investment of about 1 percent of GDP per year in the next three years. Successive budget laws will include clear information about the degree of advancement of each project and the fiscal impact through public spending commitments and public guarantees.

The administration remains committed to sustain a process of gradual integration to the world economy. One of the key priorities in this area is to pursue a free trade agreement between Mercosur and the European Union. The government eliminated tariffs on more than 200 products, among which are notebooks and PCs, and enacted a simplified system for exporting and a unified framework for trade.

Bolivia

Last year the Bolivian economy maintained a strong and sustainable growth based on adequate and timely fiscal, monetary, and exchange rate policies implemented since 2006. These policies have improved the living conditions for the population and, once again, Bolivia's growth and stability are among the best performers in the region.

Nevertheless, the Bolivian authorities expect a higher GDP growth rate for 2018, on target at 4.7 percent, fueled by greater dynamism in the extractive sectors, the recovery of regional economic growth, and the non-extractive sector, principally, electricity and water, construction and public works, public administration services, financial establishments, and agriculture, forestry, hunting, and fishing. Similarly, the expansion of GDP on the expenditure side will boost the performance of domestic demand which continues to support growth.

Fiscal accounts remained with a deficit in 2017, mainly due to capital expenditure. This deficit was financed by domestic savings and international borrowing; therefore, macroeconomic stability was preserved. Fortunately, the significant fiscal surpluses achieved before the international crisis are allowing the authorities room to retain the level of public spending and maintain social programs, which are crucial for protecting the poor and improving social indicators.

The fiscal authorities are also envisaging a deficit for 2018, as public investment projects will continue in accordance with the Economic and Social Development Plan 2016-2020 (PDES). This deficit can be mostly explained by capital expenditure in investment projects, such as infrastructure development, investment in state-owned enterprises (energy, electricity and natural gas), and strengthening the dynamism of the economy. All of this has been made possible through greater productivity, closing gaps in physical infrastructure, and industrialization (adding value to hydrocarbon and mineral production).

The government, with its fiscal policy, is going to continue its role as income redistributor, through social programs. For the last ten years, the authorities have been applying policies to improve income redistribution through granting conditional and non-conditional cash transfers, along with other measures to support the most vulnerable of the population. The continuity of these programs is crucial to avoid reversing the progress achieved in poverty reduction. Moderate poverty levels in the country reduced from 59.6 percent in 2005 to 36.5 percent in 2017, while extreme poverty decreased from 36.7 percent to 17.1 percent in a similar period, which mostly impacted rural areas.

In 2017, monetary policy led by the Central Bank of Bolivia was accommodative and, in the second quarter, additional policy actions were introduced in light of an exceptional liquidity decrease. The expected inflation pressures did not arise and the inflation rate ended up at 2.7 percent, the second lowest rate in the last 12 years, and it is projected that this trend will be maintained in 2018.

International reserves at the end of 2017 increased and were equivalent to 27 percent of GDP and 11 months of imports, reflecting the country's external strength, which stands out in the region and throughout the world. The current exchange rate policy is serving the country well, keeping inflation at bay without hurting the economy's competitiveness, supporting price stability, and promoting the de-dollarization of the financial sector and the economy at large to support both public and private investment.

The financial and credit policies applied by the authorities are continuing to grow notably and the loans were mainly dedicated to the productive sector and to fund social interest housing. The financial system remains stable, healthy, and well capitalized. The rate of non-performing loans is still at very low levels (1.7 percent at the end of last year). Financial de-dollarization of credits and savings continue to deepen with levels close to 100 percent of participation of domestic currency. This is a remarkable result that no other country in the region with partial de-dollarization has achieved in such a short time.

In the first quarter of 2018, GDP growth increased by more than 4 percent. This great economic performance is based on outstanding domestic demand, supported mainly by public investment and household consumption. Moreover, the external demand also presented a positive impact on economic growth unlike previous years. Therefore, the principal sectors that contributed to economic growth are the agriculture, financial establishments, manufacturing, transport, and communications sectors. However, after three years of contraction, the hydrocarbons sector will show a favorable performance, thanks to the improvement in the terms of trade.

In the framework of the government's PDES and the Patriotic Agenda 2025, as well as the objectives provided in the annual budget 2018, the implementation of public policies will continue to be focused on the prioritized sectors, the use and generation of surpluses, income redistribution, the reduction of poverty and inequality, the creation of opportunities, strengthening the productive sector, and consolidating industrialization.

Chile

The Chilean economy grew 1.5 percent during 2017, explained by a stronger dynamism of the non-mining sector during the second half of the year, after a poor performance of the mining sector during the first quarter—due to a prolonged strike. In addition, growth was favored by an external sector showing the highest world's growth of the last two years. In particular, China's growth was larger than expected and commodity prices hovered above past-year levels. During 2018, the baseline Central Bank forecast scenario assumes that the external sector growth, along with improved private expectations and favorable financial conditions, supports growth in the range of 3 to 4 percent; above potential growth. In 2019 growth is estimated in a range of 3.25 to 4.25 percent, and in 2020, 3 to 4 percent.

During the last year, inflation has been around 2 percent. Convergence towards 3 percent target will occur as the output gap narrows and the real exchange rate returns to its long-run level. The monetary policy remains expansionary keeping the policy rate at 2.5 percent during the last 11 months. In the baseline scenario, it is expected to stay at this level and be reduced as soon as macroeconomic conditions are in line with inflation converging towards 3 percent.

Several changes to the monetary policy scheme have been introduced. Since January 2018, the number of monetary policy meetings was reduced from twelve to eight per year, four of them coinciding with the publication of the Monetary Policy Report each quarter, following international best practices in this matter. The length of meetings increased from one to two days, the voting outcome is now released jointly with background information 11 days after the meeting, and communiqués detail more on the discussion on the domestic and international economic situation, macroeconomic forecasts, and monetary policy options.

Structural fiscal deficit in 2017 was revised to 2 percent of GDP. Public debt is still at a low level (23.6 percent of GDP) with a net debtor position of 13.3 percent given the strong foreign asset position (USD 30,000 million in sovereign funds). The country risk premium continues to be the lowest among emerging markets and around historical lows. In March 2018 a new administration took office. Two main economic plans have been announced. The first is a tax simplification of the previous tax reform to abridge its operations towards collection efficiency. Secondly, the government announced an immediately effective operational fiscal austerity program to commit to fiscal consolidation, plus the development of an eight-year horizon plan to totally dissipate the structural fiscal deficit. Further policy challenges include improving the fiscal rule and its institutional support, to stabilize the gross public debt as a percentage of GDP and create the conditions to recover the country's risk classification.

A relevant issue beyond the economic juncture is the need for the economy to recover the buffers that allowed macroeconomic policy to operate countercyclically. Chile's macroeconomic policy framework proved especially effective in the current business cycle. An example is that monetary policy was able to accommodate a relevant rise in inflation caused by a depreciation of the Peso, strongly suggesting a reduction in interest rates.

Now, this has been possible because of an economic policy framework that was built on the basis of a low level of public indebtedness; a high degree of capitalization of financial

institutions; the financial solvency of firms and households; the credibility of fiscal and monetary policy, and an adequate level of international reserves. However, the low growth of the economy over the last few years has been partly consuming the mentioned buffers. The level of public debt has increased, banks have reduced their capital gaps, household debt has risen and employment, based on greater self-employed, has less room to sustain without an increase in average productivity. It is important that as it is returning to higher growth rates, the economy should recover these buffers in order to be well prepared for eventual future shocks.

Paraguay

In 2017, the Paraguayan economy maintained the momentum and the greater diversification observed in recent years. According to the latest revision, GDP closed the year with an annual variation of 4.3 percent, slightly higher than the previous estimate (4.2 percent). On the supply side, this expansion was mainly driven by the tertiary sector (commerce) and manufacturing, while on the demand side, consumption and investment were the main drivers. On the other hand, the first growth forecast for 2018 stands at 4.5 percent, in which again the tertiary (commerce and other services) and secondary (manufacturing, construction and electricity) sectors would be the main factors that would explain the product expansion. On the demand side, the positive performance of private consumption and investment (domestic demand) is expected to continue, while external demand would have a slightly negative impact. The first data observed in 2018 show a consistent evolution with these projections.

Regarding prices, inflation in 2017 was 4.5 percent, above the 4 percent target, but within the tolerance range of +/- 2 percentage points, mainly due to the increase in prices of fruit and vegetable products in the last quarter. However, core inflation measures remained relatively low during the year. At the beginning of 2018, although there were increases in some administered prices, the reversion of fruit and vegetable prices and of other food items contributed to mitigating the effect on total inflation, which closed the first quarter around the target. On the other hand, inflation trend measures have continued to show an evolution consistent with the convergence of inflation to the medium-term objective. In this context, in meetings earlier this year, the Central Bank of Paraguay (BCP) considered it appropriate to continue maintaining the monetary policy stance, with a reference rate of 5.25 percent annually.

The exchange rate has remained stable, in line with the market fundamentals and with the behavior observed in the region. In 2017, the guaraní appreciated around 2.8 percent, the Peruvian sol 4.5 percent, the Chilean peso 4.5 percent, the Colombian peso 0.7 percent, and the Brazilian real 1.8 percent, among other currencies. In this context, the participation of the BCP in the foreign exchange market has been limited almost entirely to compensatory sales, which refer to those gradual and programmed sales that are made by the monetary authority as a counterpart to foreign currency purchases made by the Ministry of Finance. It is necessary to highlight that, in 2017, Paraguay reached USD 8 billion of International Reserves (27 percent of GDP), which represents a significant buffer of liquidity to face possible volatility of the exchange rate and continues to place Paraguay in a solid external position.

In line with the greater dynamism of economic activity, tax collection has also shown a favorable evolution. In 2017, the tax revenues of the Central Administration grew 11.6 percent (7.7 percent in 2016), with which the tax pressure stood at 13.1 percent of GDP. On the other hand, current spending grew at a rate of 7.6 percent, below the average of the last ten years (13.3 percent). This lower expansion of current spending allowed an increase in public investment in infrastructure, which went up to 18.6 percent in 2017, above the average observed in the last decade (12.8 percent). With these data, a fiscal deficit of 1.4 percent of GDP was registered, slightly lower than the limit established in the Fiscal Responsibility Law (FRL).

The financial system remains stable with capital adequacy indicators that easily exceed the minimum requirements at the local and international level. In turn, credit quality, liquidity and profitability indicators are at adequate levels. Concerning the evolution of credit, the recovery which started at the beginning of 2017 continues to consolidate. With regard to the legal framework, the proposals for legal reforms necessary to advance in the implementation of international best practices of financial regulation are still being studied by Parliament. In this regard, at the end of 2016 the reform of the Banking Law was approved, whose regulations are in the process of being completed. Among the pending measures to be approved are the modification of the Charter Act of the Central Bank of Paraguay, the creation of a Pension Superintendence, and a Guarantee Fund for cooperatives.

Peru

After expanding by 4.0 percent in 2016, economic activity in Peru decelerated to 2.5 percent in 2017, mainly due to a weaker contribution from net exports. The latter is explained by lower mining export growth, and higher imports associated with a recovery in domestic demand. In 2017 the economy also faced the impact of the El Niño Phenomenon, which affected the performance of several industries and caused considerable infrastructure destruction, especially in northern Peru. However, during the second half of the year there was a recovery in private investment, particularly in the mining sector, and in public expenditure, which contributed to higher domestic demand growth. This in turn translated into an improved performance of the construction sector, with positive growth rates after a two-year fall.

Going forward, growth is expected to rebound to 4.0 percent in 2018–19, closer to potential, on the back of higher public investment (reconstruction works in the wake of the El Niño Phenomenon) and a recovery in private investment and consumption resulting from improved terms of trade. It should be noted that, given current metal prices and cash costs below USD per 1/lb in copper projects, investment in exploration has begun to accelerate. The latter, together with new projects entering investment phase, is expected to add momentum to domestic demand in the coming years.

In 2017 inflation fell back into the target range (1-3 percent) and closed the year at 1.36 percent, the lowest since 2009, mainly due to the correction of food prices resulting from the reversal of El Niño supply shocks. Core inflation (excluding food and energy) fell close

to the center of the target range, reflecting the appreciation of the domestic currency relative to the USD and the low point of the business cycle. Twelve-month inflation expectations lie within the target range since March 2017. In this context, the Central Reserve Bank of Peru (BCRP) recently cut the reference rate twice (January and March 2018) to 2.75 percent, in addition to four cuts during 2017. The real interest rate thus maintains an expansionary stance. The BCRP stands ready to modify its monetary policy, should it be necessary, in light of any new inflation developments. Going forward, inflation is expected to decrease temporarily below the center of the target range (2 percent) during the first half of 2018 and then gradually converge again towards it.

Credit to the private sector accelerated from 6.6 percent yoy in December 2017 to 7.3 percent yoy in February 2018, mainly in response to a better performance in corporate and personal credit in a context of recovering private sector demand.

High growth and sound public financial policies have led to a reduction in public debt from 47 percent to 25 percent of GDP in 2001-2017, among the lowest in the region. The fiscal deficit will be temporarily higher in 2018 (3.5 percent of GDP), mainly due to reconstruction works, but fiscal consolidation will result in lower deficits thereafter, to 1 percent of GDP by 2021.

The current account deficit continued to decrease as a percentage of GDP, from 2.7 percent in 2016 to 1.3 percent in 2017. It is expected to remain at that level in light of improved terms of trade, higher growth in trade partners, and the aforementioned recovery in domestic demand. The current account deficit will likely continue to be covered by long-term capital flows, which are expected to stabilize at around 4.4 percent of GDP in 2018-19. Finally, the BCRP keeps an international reserve buffer equal to 30 percent of GDP.

Uruguay

Uruguay continues to exhibit positive developments, although, admittedly, its outlook is not exempt from some challenges. A relevant development is related to one of the authorities' key objectives which is inclusive growth.

In 2017, Uruguay recorded its fifteenth consecutive year of positive growth rates. This is a record-setting spell of growth for the country, not only due to its length and the much higher average rate compared to the country's previous records, but also because, in some part of the period, it coincided with traumatic episodes at global levels and, more recently, with profound downturns in Uruguay's main regional neighbors. Uruguay's decoupling from its neighbors' business cycles has been underscored by many analyses in publications worldwide, and it seems clear that the pillars of this performance are related to prudent policies, structural transformations, and sound institutions. The country's determination to diversify its economy in terms of products and markets constitutes a key factor in explaining the above-referred behavior, and the authorities intend to redouble efforts aimed at further integrating the country into the world economy. Uruguay's differentiation is well reflected, among others, in its robust financial buffers, namely, the country's international reserves as well as the healthy profile of its public debt, with regard to its composition in terms of currencies, interest rates, and the average time to maturity (it is worth underlining

that, a few days ago, Uruguay issued a 2055-dollar bond, which is its longest duration ever).

For a long time, the combat against inflation was mentioned as a key priority for the country, and it continues to be, although it is worth mentioning Uruguay's significant progress in this regard. After reaching 11 percent in 2016, the Central Bank of Uruguay (BCU) adopted an even tighter monetary stance and, along with consistent fiscal and income policies, it helped put inflation on a downward trend, until it reverted within the BCU's target range. Inflationary expectations significantly declined, generating a virtuous circle to the extent that they create a benign environment for the forthcoming round of wage agreements, on which the authorities have underlined the importance of maintaining flexibility, job-creation, and enhancing workers' training programs.

As empirical evidence shows, growth by itself is not enough to improve the welfare of society as a whole. Policies must actively contribute to make sure that growth and improvements in social conditions go hand in hand. As noted, inclusive growth is essential and, although much remains to be done in this area, social indicators clearly ratify that policies have been making steady progress. Poverty rates have exhibited a steep decline, from 32.5 percent in 2006 to 7.9 percent in 2017 (having dropped 1.5 points compared to the previous year). Meanwhile, income inequality also decreased from 0.455 to 0.38 in the above-referred period (bucking a trend seen in many places around the world).

Looking forward, potential growth must be boosted and, in this regard, education and infrastructure appear to be key factors that need to be addressed. The authorities have repeatedly mentioned the importance of increasing investment rates, having recently announced policies and incentives aimed at heightening them. Employment has not accompanied the country's growth dynamic, which is a matter of concern, and, in this respect, the authorities have underlined their firm willingness to tackle this issue. Furthermore, the fiscal consolidation process has shown some progress, and fiscal policies will intensify efforts to attain the government's targets, which are consistent with a sustainable debt dynamic and, of course, with the government's priorities. In summary, the authorities are fully committed to continue implementing the needed policies and structural transformations aimed at further improving the current and future welfare of Uruguayan society as a whole.