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IMFC Statement by Rosanna Costa
President of the Central Bank
Chile

On behalf of

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

Statement by Governor Rosanna Costa, President of the Central Bank of Chile

On behalf of the Southern Cone Constituency

(Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay)

We join the international community in deploring Russia's aggression against Ukraine, which has resulted in massive humanitarian consequences, and a heavy toll to the global economy. We urge for a speedy and peaceful resolution of the conflict in full respect of international law.

Global outlook and economic policies

The stakes are high for the world economy amid a confluence of negative shocks, heightened debt vulnerabilities, and growing geopolitical fragmentation. Multi-decade highs in inflation, Russia's war on Ukraine, high food and energy prices, tight global financial conditions, market volatility, and persistent COVID-curbs create a highly challenging environment for the membership. Global activity is headed for a significant slowdown in the near term, while international inflation will decline only gradually, and global imbalances are projected to widen. Risks to the global outlook are unusually large and tilted to the downside.

Countries need to implement appropriate domestic policies to support macroeconomic and financial stability, boost potential growth, strengthen social cohesion, and build resilience in a more shock-prone world. It is critical that monetary and fiscal policy work hand in hand. Central banks must stay the course until restoring price stability and anchor inflation expectations, with clear communications and due consideration for cross-border spillovers and spillbacks from their actions. Fiscal policy must support the monetary tightening and put public debt on a sustainable path, while providing targeted assistance to the most vulnerable. An adequate policy mix is critical to achieve a well-balanced adjustment and limit the negative effects of high interest rates on real investment, trade imbalances, capital flows, and the stability of the international financial system. Structural transformations towards higher, greener, and more inclusive growth must remain at the center of the policy response to the current economic, financial, social, and institutional challenges.

Global cooperation is critical to face shared challenges, help the most vulnerable members, and overcome rising geopolitical fragmentation. Multilateral action is critical to overcome the food crisis, keep agricultural markets open in a rules-based trading system, and address emergency needs. A strong and responsive global financial safety net (GFSN) is needed to provide timely and adequate support to vulnerable countries facing a complex global landscape. Broad collaboration between official creditors and constructive engagement with the private sector are required to strengthen the debt resolution framework. In addition, global cooperation is the only way to meet the long-term challenges associated with climate change, pandemic management, and digitalization.

IMF priorities

The IMF must continue playing a leading role in advising and helping members to get through these challenging times, while supporting the structural shift towards a more resilient future. In the aftermath of the pandemic, the energy and food shock, and now tighter global financial conditions, many emerging and developing economies are moving through a narrow policy path. The world economy needs an agile and well-resourced Fund to provide real-time support to its members through tailored policy advice, catalytic financial support, and integrated capacity development.

Surveillance

We welcome the Fund's focus on the most pressing policy issues, including inflation and the 'cost-of-living' crisis, food insecurity, emerging macro-financial vulnerabilities, and the use of multiple policy tools to address the confluence of economic and financial shocks. The Integrated Policy Framework will provide operational guidance on the adequate mix of policies, without losing sight of the long-term benefits of financial integration and exchange rate flexibility, in line with the Institutional View. The Fund's policy advice needs to be tailored, granular, and prioritize contingency planning to address and preempt macroeconomic and financial risks. We support the continuation of the foundational and surveillance work on the macro-critical aspects of cross-cutting issues, such as climate change, digitalization, inequality, fragility, and gender, in collaboration with other international organizations.

We support the emphasis on multilateral surveillance and analytical work on inflation, monetary-fiscal policy interactions, and risks to financial stability. A clearly communicated and well-balanced policy adjustment across systemically important economies will help to limit negative spillovers across the world economy and the financial system. We encourage staff to continue working on the medium- and long-term perspectives for real interest rates in the world and their important consequences for monetary policy, fiscal sustainability, and financial stability. We support monitoring the implications of geopolitical fragmentation and supply-chain disruptions for the global economy, international trade, the international monetary system, and the global financial safety net.

Lending and debt

The Fund, at the core of the global financial safety net, must continue adapting and expanding its lending toolkit to ensure a stable international monetary system and world economy.

We support stepping up the Fund's provision of financial support at a time of heightened uncertainty. The upper-credit tranche quality programs, when possible, should remain the primary tool to help members adjust and restore external viability. The newly established *Resiliency and Sustainability Trust (RST)* will provide an additional tool to help members cope with the balance-of-payment requirements of structural and long-term challenges, such as climate change and pandemic management. Over time, we expect the RST to cover a broader range of structural issues.

We welcome the recent establishment of the temporary food shock window to help vulnerable countries cope with urgent balance-of-payment needs related to the global food shock. We encourage the Fund to continue working on other initiatives to reach a broader group of countries affected by the consequences of Russia's war against Ukraine. Looking forward, we support a broad, ambitious, and holistic medium-term review of the Fund's lending toolkit and policies to help countries deal with global shocks, including a comprehensive review of precautionary instruments and their complementarity.

There is a growing number of countries facing debt distress. The roll-out of the new Sovereign Risk and Debt Sustainability Framework has provided valuable information to identify debt fragility problems and guide debt sustainability assessments. We support the emphasis on strengthening and speeding up the implementation of the common framework for debt resolution, as well as other initiatives, to increase debt transparency and improve the contractual approach for debt restructuring.

Capacity development

We support strengthening the integration of capacity development (CD) with conditionality in lending programs and policy advice in Article IV consultations. The focus should be on building strong macroeconomic and financial policy institutions to ensure sustainable and resilient policies that support prosperity in the long term. We look forward to the CD strategy review and the implementation of the Independent Evaluation Office recommendations.

IMF resources

We look forward to a timely and successful completion of the 16th General Review of Quotas. At this time of unprecedented challenges and risks of global fragmentation, we need a representative, well-resourced, and quota-based IMF at the center of the international financial safety net. Under plausible stress scenarios, the lending capacity of the Fund may be insufficient to ensure a stable global financial system. We see as a priority to move forward with an increase in the Fund's lending capacity and rebalancing the role of quotas and borrowed resources. The Fund must remain adequately resourced and at the center of the GFSN.

We welcome the strengthening of the Fund's *Enterprise Risk Management* (ERM) framework. The Fund needs to take risks to fulfill its unique mandate in the international monetary system. The ERM framework is a critical element to strengthen the management of these risks supporting and complementing the existing risk management processes embedded in the current policies and practices of the Fund. We look forward to the implementations of the recommendations of the *Institutional Safeguards Review*.

ARGENTINA

Argentina's 2022 IMF´s Extended Fund Facility has gone through the 1st and 2nd Reviews

Background of the new program

The negative consequences of the 2018 SBA have been established in the 2021 IMF's Ex-Post Program Evaluation (EPE) and, as recognized by the EPE, the program failed. Even though Argentina passed the four IMF Board Reviews and met all the fiscal targets, none of the objectives of the program were achieved. The 2018 SBA allowed the service of unsustainable debt and the acquisition of foreign exchange at convenient rates by the private sector, but confidence and market access were never restored, output contracted sharply amidst inflation increases, and public debt rose substantially as a fraction of GDP.

The new program builds on the lessons learned from the flaws of the failed 2018 SBA.

On March 25, 2022, the IMF Executive Board unanimously approved an Extended Fund Facility (EFF) program for Argentina. This new program was carefully calibrated to meet Argentina's specific circumstances, notably to address large balance-of-payment needs—which mostly reflect the schedule of payments of the 2018 SBA—, and to address the challenging economic and social situation caused by a two-year recession in 2018-2019 and the economic impact of the COVID-19 pandemic.

The EFF program represents a stepping-stone towards long-term sustainable growth needs—conciliating a gradual fiscal consolidation based on the genuine growth of economic activity, and the need to protect the most vulnerable sectors of the population and counts on broad support from the Argentine society. For the first time, an agreement between Argentina and IMF staff was endorsed by the National Congress, providing greater ownership and legitimacy, in a context of massive political and social support from province governors, civil society representatives, the private sector, trade unions, social movements, entrepreneurs, and banks associations. The 1st and 2nd quarterly reviews were approved by the IMF Executive Board and the program remains well on track, despite the challenging international context.

Economic outlook and risks

A new economic team took office in early August, amid a global and local context of uncertainty. This team brought about a greater sense of ownership and enhanced implementation capabilities. This is due to, on the one hand, a greater concentration of areas, coupled with a more in-depth coordination with the central bank, and on the other hand, by a greater political unity of purpose regarding the key policies of the Program.

The new team's vision for the future can be captured in four basic pillars: fiscal sustainability, reserve accumulation, promotion of exports (in particular, value-added exports), and continued growth with social inclusion. In that vein, our authorities also envision, while fostering and preserving general growth, the furthering of key economic sectors such as: the knowledge economy, energy, mining, and agro-industry. Regarding fiscal sustainability, our authorities would also like to emphasize and underscore the importance of tax information exchanges and international cooperation for combating tax evasion and improving fiscal performance; not just in our case, but even more broadly for EMDCs.

Argentina´s economic team is convinced that the EFF Program´s policies are an anchor in themselves, not merely performance criteria to be met. They are needed as a key element of Argentina's prosperity.

So much so that, despite slippages and an increasingly difficult global context, it redoubled efforts and faced challenges that allowed Argentina to stabilize the situation within the framework of the Program.

Notwithstanding an increasingly complex global backdrop, following a period of market turbulence, multi-decade high peaks in inflation, the war in Ukraine, high food and energy prices, and tighter global financial conditions, our authorities are taking bold steps to avoid disorderly adjustment and restore stability, ensure program implementation, and continue tackling Argentina's challenges. More importantly, despite all the mentioned difficulties and against all odds, the Argentine economy continues to recover, and the program is well on track. There are significant challenges ahead, but our authorities are confident they will be able to take the necessary steps to avoid disorderly adjustments, minimize turbulent market fluctuations, and continue to rebuild a strong and resilient economy.

Corrective actions allowed our country to meet the relevant performance criteria of the IMF program, including the primary balance of the federal government and the ceiling on the central bank financing of the fiscal deficit. Moreover, had there been no war, we estimate our stock of net international reserve would have been around US$ 4.9 billion larger. All end-June indicative targets were also met, and our authorities made steady progress in meeting structural benchmarks, although revisions to the timeline will be required. It's important to note that all through even September, all Performance Criteria will be met; the monetary PC was met already, as well as the reserve accumulation PC. As for the fiscal PC, available preliminary data show that it will also be met. We are, thus, on an auspicious path regarding the tasks going forward.

Our authorities have taken critical steps to restore fiscal order through improved budget management, including a combination of stricter expenditure controls, enhanced targeting of subsidies, and strengthened revenue compliance. In this regard, pushing for enhanced tax cooperation and information exchange is crucial to generate further fiscal space by tackling tax evasion, tax elusion, and profit shifting. Argentina will continue to enhance the progressivity of taxes. Payments of income taxes from companies with extraordinary profits related to the global commodity price shock were recently advanced, and we are also intensifying efforts to improve property tax collection (aligning real estate valuations with their market prices) and to strengthen tax and customs administration, drawing on ongoing IMF Technical Assistance.

On the other hand, our authorities have reinforced the implementation of monetary policy, by limiting monetary financing of the fiscal deficit below program levels, while continuing to mobilize domestic and external financing and increasing roll over rates. In September, we built a resilient base of international reserves, through targeted actions aimed at improving the trade balance and catalyzing external support from private and official sources.

These initial actions have been complemented by a more consistent and forceful application of the monetary policy framework to ensure sufficiently positive real interest rates. The 2023 Budget, presented to Congress on September 15, represents a key stone for macroeconomic stability, the recomposition of the purchasing power of income, and the strengthening of the economy. Our authorities will continue to take the necessary actions to address underlying imbalances and secure more sustainable and inclusive growth.

Finally, our authorities reaffirm their strengthened commitment to the policies and objectives of the economic program supported by the IMF, the EFF, and to meeting the program's targets for the remainder of 2022 and next year. The updated macroeconomic framework takes into account the more difficult global situation, recent domestic developments, and the conviction that growth and resilient policies and public capital spending, to develop infrastructure to pave the way to private investment in the real economy, are as essential as the implementation of the agreed policy actions, program targets, and structural benchmarks that have been adjusted to reflect the new macroeconomic framework and policy priorities.

BOLIVIA

Amid an adverse international context, with high uncertainty, growing pressures on food and fuel prices, tighter financial conditions, and the threat of a global recession, the Bolivian economy remains robust this year, showing important growth and price stability. The policies applied to preserve the economic recovery and protect the population's well-being were critical in this outcome.

Continuity of the recovery process

The Bolivian economy continues to be dynamic in 2022. During the first quarter, GDP grew by 4.0 percent, mainly driven by the strength of transportation, agriculture, and financial establishment activities. Similarly, electricity, gas and water generation, and construction reported a significant expansion. On the expenditure side, domestic demand continued to be the factor that most stimulated the economy. Foreign demand also contributed to growth, despite the complex external scenario.

One of the concerning variables at the current global juncture is inflation, which remains low in Bolivia. As of August, accumulated inflation was 1.6 percent, the lowest in South America and one of the smallest in the world, on the back of the favorable agricultural activity performance and the fuel and food subsidies scheme. The productive sector's supportive policies and subsidies have been applied in the country for the last decade and a half, within the framework of strengthening productive capacity and guaranteeing Bolivian food security and sovereignty. Exchange rate stability also played an important role in containing imported inflationary pressures.

External sector indicators are continuing their recovery trend. Exports grew by 36 percent as of July 2022 compared to the same period in 2021, with a notable rise in sales of the manufacturing industry. Imports also rose, mainly due to the increase of capital goods, raw materials, and input purchases. As a result, the trade balance reached a surplus of US$1,287 million as of July, a positive balance for the second consecutive year, after six years of deficit. This balance will contribute to the result of the current account, which also recorded a surplus in 2021. Furthermore, international reserves are at around US$4.3 billion, above international thresholds in terms of months of imports.

The financial system remains strong. As of August 2022, deposits grew by 6 percent y-o-y and loans by 8 percent y-o-y. The greater vitality of loans stands out in relation to that observed in 2021, which reflects the dynamism of activity and at the same time contributes to better economic prospects. Moreover, the sector presented a low rate of non-performing loans, less than 2 percent, and among the lowest in the region.

As a result of the economic activity dynamism, tax collections rose by 24 percent y-o-y as of August. Regarding public expenditure, control of current spending remains within the framework of the austerity policy, while public investment continues to grow. Hence, the fiscal balance recorded a surplus in the first half of the year, and it is expected to end 2022 with a lower deficit than that observed in 2021. External public debt stood at 28.9 percent of GDP as of June, below the ratio reached last year and lower than international reference levels.

The progress in the previously mentioned macroeconomic variables was joined with the improvement in the labor market and social indicators. The unemployment rate declined to 4.6 percent in July 2022, well below the peak of 11.6 percent recorded in the same month of 2020 and having returned to pre-pandemic levels. Significant growth in employment was also observed and the consumption of basic services by households showed a notable recovery as of July. Poverty and inequality reduced in 2021 and this path is expected to continue in 2022. According to ECLAC, Bolivia would be the country with the greatest reduction in extreme poverty in the South American region this year.

Economic and social policy to continue the recovery

In 2022 the Bolivian government continues applying policies to consolidate the recovery and reconstruction of the economy, in line with the country's Economic Social Communitarian Productive Model, with more focus on facing the challenges of the complex international environment, protecting the economic recovery and the population's welfare, and promoting the import substitution strategy. Therefore, domestic demand continues to be boosted, especially through public investment.

Furthermore, policies to strengthen the productive sector remain a priority. Productive loans are still promoted through portfolio limits and preferential interest rates. The SIBOLIVIA program also stands out, which grants loans on favorable conditions to producers that substitute imports. This fund was recently expanded to continue to support the sector. VAT exemption for the importation and sale of capital goods, which is improving the Bolivian production capacity, was extended for one year. Moreover, greater resource allocation towards producers, through the Productive Development Bank (BDP), was determined a few weeks ago. It also highlights the progress of state-owned companies, such as the urea plant, which already operates at 100 percent of its capacity and is a relevant component to face the current context of increasing prices and global shortage of fertilizers.

Finally, regarding the pandemic, significant progress was made in the country's capacity to face the threat of new waves, with close coordination between the central level and local governments. The country overcame the fifth wave positively, with a decrease in the mortality rate from 6.2 percent in the first wave to 0.1 percent in the last one. Sufficient vaccines are available to immunize the whole target population, and progress has been recorded in the vaccination drive.

Economic outlook

The Bolivian economy will continue to show a positive performance throughout the rest of the year. GDP growth is expected to end 2022 at around 5 percent and inflation at 3.3 percent. The government will continue to make the necessary efforts to consolidate the process of economic recovery and the restoration of the population's welfare, especially protecting the most vulnerable households. The import substitution policy, within the framework of the Economic and Social Development Plan (PDES) 2021-2025, will be a key element to guarantee sustained growth with income redistribution in Bolivia.

CHILE

The Chilean economy is facing significant challenges due to the overheating that developed in the wake of the pandemic, combined with the recent deterioration in the global outlook. Economic activity rebounded vigorously in 2021, driven by generous fiscal and financial support to households that overcompensated their loss of labor income. The flip side was an increase in inflation and the current account deficit. Since April, the confluence of adverse external shocks from Russia's war against Ukraine, stubborn inflation, and tighter financial conditions, have aggravated the pressures on Chile's inflation and external balance. In the near term, tight monetary and fiscal policies are necessary to safeguard macroeconomic stability, while structural reforms are introduced to improve growth prospects and strengthen fiscal, social, and financial resilience.

Macroeconomic projections

The Chilean economy is expected to grow below potential in 2022-23. After the extraordinary expansion of domestic demand in 2021, a significant slowdown was necessary to close the output gap and restore the level of expenditure to a sustainable level. Recent data shows that the economy has entered an adjustment process. GDP is expected to grow between 1.75 and 2.25 percent in 2022, and contract between 0.5 and 1.5 percent in 2023. Private consumption is expected to decline as high inflation curtails household purchasing power, extraordinary liquidity balances accumulated during the pandemic vanish, and credit conditions become tighter. Towards 2024, once macroeconomic imbalances are resolved, expectations are that activity will resume growth rates in line with its potential, that is, between 2.25 and 3.25 percent. After reaching 6.6 percent of GDP in 2021, the current account deficit is projected to moderate gradually over the next two years to reach 3.3 percent of GDP by 2024, reflecting the decline of domestic demand and the depreciation of the real exchange rate.

Monetary policy and inflation

The Central Bank of Chile (CBC) has rapidly tightened monetary policy to restore price stability, anchor inflation expectations, and correct the excessive level of absorption. In recent months, inflation has continued to rise on the back of global food and energy shocks, the sharp depreciation of the exchange rate, and second-round effects through higher inflation expectations and backward indexation. It is expected that headline CPI inflation will close at 12 percent by year end and will descend gradually to the 3 percent target within the two-year horizon. The monetary policy rate currently stands above neutral levels. Future movements of the benchmark rate will depend on the evolution of the macroeconomic scenario and its implications for the convergence of inflation to the target. CBC will be especially vigilant of the upward risks for inflation considering its already high level, and above-target two-year inflation expectations.

The exchange rate has flexibly adjusted to the fall in terms of trade and the tightening of global financial conditions. However, the currency has been subject to unusual bouts of volatility, which threatened to distort the transmission of monetary policy and the normal functioning of financial markets. In response to these developments, the CBC announced a temporary and transparent program of foreign exchange intervention and preemptive provision of US dollar liquidity. After the launch of the FXI program, price formation conditions in the foreign exchange market improved and exchange rate volatility subsided. The FXI program ended in September, as planned.

Fiscal policy and public debt

The authorities remain fully committed to fiscal responsibility and macroeconomic stability. The government is implementing a multi-year fiscal consolidation plan to achieve a close-to-balance structural fiscal position by 2026 (-0.3 percent of GDP) and ensure that public debt remains below a prudent ceiling of 45 percent of GDP. The fiscal adjustment in 2022 has been bold and ambitious. The extraordinary support programs implemented during the pandemic have been wound down while targeted support has been provided to lagged sectors and the most vulnerable to cushion the increase in the cost of living. The overall headline fiscal position and the structural balance are projected to close in surplus in 2022 (1.6 percent of GDP and 0.9 percent of GDP, respectively), a consolidation near 10 percent points of GDP in the headline balance. Gross public debt is projected to reach 36 percent of GDP by the end of 2022. To strengthen the fiscal framework, the government introduced a bill to improve the Fiscal Responsibility Law and incorporate lessons learned from Chile's experience with the fiscal rule, including a well-defined debt ceiling, escape clauses, and convergence paths, as well as an insurance framework against natural disasters.

PARAGUAY

The current GDP growth projection for 2022 stands at 0.2 percent. However, it must be noted that the initial GDP growth forecast for this year was 3.7 percent. The considerable downward adjustment of the projection takes place in the context of a severe drought—registered between the end of 2021 and beginning of 2022—which has significantly affected agriculture, causing important losses in the harvest of soybeans and other farm crops. On the expenditure side, in spite of this downward revision of economic activity, a rebound in domestic demand (private consumption and investment) continues to be foreseen, although at a lower growth rate than previously expected, while net external demand will have a significant negative incidence.

In the second quarter of 2022, GDP registered an inter-annual variation of -3.4 percent, explained mainly by the negative performance of the agriculture sector, and to a lesser extent, the construction and manufacturing sectors. Favorable results were registered for the electricity and water, livestock production, and services sectors. On the expenditure side, the negative contributions of government consumption and net exports stood out, while private consumption and gross capital formation registered positive variations. In accumulated terms, GDP contracted 2.2 percent in the first quarter of the year, while GDP (excluding agriculture and the hydro electrical bi-national entities) grew by 1.6 percent. Better results are expected for economic activity in the upcoming months, taking into account the beginning of the 2022/2023 soybean campaign and the spillover effects that agriculture exerts on other sectors of the economy.

As regards the labor market, the results for employment and unemployment indicators have been more favorable in the second quarter. In the reference period, employment grew by 47,239 positions as compared to the same period in 2021, representing an increase of 1.4 percent y-o-y. By economic sector, the percentage of the population employed within the tertiary sector (particularly trade, restaurants, and hotels) increased, while an inter-annual reduction was observed in the primary and secondary sectors. By occupational category, there was an improvement in the number of wage-earning workers, although this was offset by the decrease in self-employment. On the other hand, the number of unemployed persons decreased by 69,001 and the unemployment rate dropped from 8.6 percent in the second quarter of 2021 to 6.7 percent in the second quarter of 2022.

Total inflation continued to increase during the first months of 2022, due to the persistence of external pressures on commodity prices. However, the pressures on external prices have moderated recently which, together with the lower dynamism of domestic demand, have contributed to contain inflationary pressures. Between January and April 2022, average monthly inflation was 1.3 percent, while between May and August, the rate decreased to 0.4 percent. Likewise, the inter-annual rate decreased from 11.8 percent in April to 10.5 percent in August. As for inflation forecasts, a rate of 8.8 percent is foreseen for 2022, decreasing to 4.1 percent for 2023.

Regarding monetary policy, the Central Bank of Paraguay (BCP) continued with the process of upward adjustments of its reference rate, although at a slower pace within the last few months, given the deceleration of inflation and the potentially lower pressures stemming from the external scenario, mainly those derived from commodity prices. Between March and June 2022, the Monetary Policy Rate (MPR) was revised upward by 200 basis points, while in the period July to September it increased 75 basis points, to stand at 8.50 percent annually. The latest decisions have been based mainly on the fact that inflation expectations for the monetary policy horizon are still slightly above the 4 percent target, although they have stabilized. In addition, some second-round effects on certain service prices have continued to be observed.

Total bank loans and other forms of credit have continued to show favorable dynamism, boosted largely by the accelerated growth that loans extended in foreign currency have been experiencing. Loans in U.S. dollars expanded 25.2 percent inter-annually in August 2022, while loans granted in Paraguayan guaranies registered a growth rate of 7.8 percent y-o-y. The financial soundness indicators of the financial system remain at satisfactory levels. In this vein, the solvency ratios continue well above the minimum required levels and the profitability indexes have started to increase in recent months, as compared to the reductions registered since the beginning of 2020. As regards the quality of loans, the nonperforming loans ratio remains low (3.4 percent in August 2022).

The payments system has performed normally, in a fluid and efficient manner. In May 2022, the production of the Instant Payments System (SPI) was launched. This system will allow for the availability of 24 hours a day seven days a week (24x7) inter-bank transfer services for all citizens, thereby constituting a qualitative leap of immense relevance for the country’s payments system. This new module of the Paraguayan Payment System (SIPAP) is being successfully developed in stages, with the gradual incorporation of financial institutions.

PERU

In the first half of 2022, year-on-year growth was 3.5 percent, mainly led by the momentum in private consumption and the recovery in exports. The normalization of spending habits and stronger activity in service industries will continue to support employment and domestic demand for the rest of the year. Additionally, mining production is expected to recover in 2023 due to the launching of new projects and the resumption of activities that had been temporarily suspended. At the same time, business and household confidence remains subdued, which can bear on investment and consumption decisions, in turn affecting production plans. Furthermore, public investment growth is expected to be zero in 2023 due to a contraction in investment at the subnational level (a usual pattern after regional elections). Overall, GDP is expected to grow by 3.0 percent in 2022 and 2023, close to its potential level.

Inflation in Peru has been one of the lowest and less volatile in LAC since 2001 (2.7 percent on average in 2001-2021). In a context of global price increases, inflation reached 8.4 percent in August due to supply-side factors affecting food and fuel prices. Twelve-month inflation expectations reached 5.10 percent, above the 1 percent -3 percent target band of the Central Reserve Bank of Peru (BCRP). Inflation is expected to be back within the target band during the second half of 2023, assuming a reversal of food and fuel price pressures, in a scenario where inflation expectations return within the target band and growth remains close to potential.

Credit to the private sector increased 6.4 percent year-on-year as of August 2022, mainly due to higher household loans. After a significant increase in the credit-to-GDP ratio in 2020 (mainly due the Government Loan Guarantee Program known as *Reactiva Peru*), growth in the demand for credit is expected to moderate to 5.5 percent in 2022.

The fiscal deficit is expected to decrease from 2.5 percent in 2021 to 1.9 percent in 2022, mainly due to higher government revenues in a context of domestic recovery. Public debt as of end-2022 is expected to reach 33.8 percent of GDP. Going forward, fiscal consolidation will continue, as the economy gradually recovers from the negative COVID-19 shock.

The current account deficit is forecast at 3.8 percent of GDP due to lower-than-expected terms of trade, an increase in imports, greater profits from FDI in Peru, and a higher services account deficit due to increased transportation costs. However, the balance of payments will continue to be sustainable and financed by long-term capital inflows; and is expected to decrease to 1.8 percent in 2023.

Starting in August 2021, the BCRP began to normalize of its monetary stance by raising its policy rate from a historical low of 0.25 percent in July 2021 to 6.75 percent in September 2022 (14 rate hikes). The real policy rate is 1.65 percent as of September 2022 (close to the estimated neutral real interest rate).

Additionally, the BCRP maintains an FX buffer of around six times the country's short-term obligations and 35 percent of GDP due to a precautionary accumulation of international reserves. Peru also has access to contingent funds, notably USD 5.2 billion from a successor Flexible Credit Line arrangement with the International Monetary Fund. With sound fundamentals and high FX reserves, Peru's external position is one of the strongest among emerging market economies. This enables the authorities to considerably limit the risks from exogenous financial shocks.

Peru's strong and coordinated fiscal and monetary response under the pandemic was possible due to solid macroeconomic fundamentals, including low debt ratios, one the largest fiscal spaces in LAC, and significant external buffers. In a context of unprecedented challenges, the country's solid policy management over the past three decades is being validated.

URUGUAY

The Uruguayan economy has been on a recovery path since the COVID-19 shock. After contracting 6.1 percent in 2020 and growing 4.4 percent in 2021, economic activity has continued to strengthen buttressed by external demand, some large investment projects, timely and effective policies, and the normalization of health conditions in the country. In the second quarter of 2022, GDP increased by 7.7 percent in relation to the same quarter of 2021. For 2022, the authorities foresee a 4.8 percent increase in real GDP.

The recovery has been accompanied by the strengthening of the labor market as almost all the jobs lost during 2020 were recovered in 2021. In August 2022, the unemployment rate stood at 7.9 percent, down 1.6 percentage points from the same month of last year.

In a global context of rising inflationary pressures and a strengthening of domestic economic activity, the Monetary Policy Committee of the Central Bank of Uruguay (BCU) increased the policy rate from 9.75 percentage points to 10.25 percentage points in August, the ninth consecutive hike since August 2021. The rate increase deepened the contractive phase of monetary policy aiming to tame continued high inflation and the persistent rigidity of inflation expectations. Inflation in August reached 9.53 percent year-on-year. The monetary authorities also anticipated continuing with the increase in rates to achieve the convergence of inflation expectations towards the inflation target (3-6 percent).

The financial sector remains sound and resilient with a capital buffer that reached 1.8 times the minimum regulatory requirement. Regarding liquidity risk of the banking system, the ratio of liquid assets to total assets remained at a healthy 59.6 percent. The profitability of banks (measured in nominal pesos) represented a return on assets of 0.9 percent and a return on equity of 14 percent as of March 2022. The general delinquency of credit stood at 1.5 percent, remaining stable from the previous quarter. Besides, it recorded a sustained improvement from the peak of 3.4 percent reached after the COVID-19 outbreak, in April 2020. Stress tests of the banking system carried out by the Superintendence of Financial Services (SFS) of the Central Bank, showed that the banking system would withstand a severe recession scenario, and the regulatory capital of the banking system would remain above the minimum requirement.

On the fiscal front, Uruguay has continued taking a multi-pronged approach to face the current surge in food and energy prices while healing the scars from the pandemic with timely and well-targeted measures. The government deployed targeted and time-bound cash transfers to mute the recent impact of inflationary pressures on low-income households. On real wages, the government advanced the adjustment in public wages, agreed in the past wage negotiation, that would have taken place in 2023. In addition, import tariffs on key staple goods were lowered and transparently muted the passthrough of international oil prices on domestic fuel prices.

Over the last two years, the government secured the necessary public savings to mitigate the impact of the pandemic shock while prudently balancing fiscal sustainability objectives. This allowed meeting all three pillars of the new fiscal rule for two years in a row—that is, the structural balance target, the real spending growth cap, and the legal limit on net indebtedness—restoring fiscal credibility in the midst of a global pandemic. According to available projections, the central government deficit is projected at 3.1 percent in of GDP 2022 (excluding the positive effect of inflows to the Social Security Trust Fund), down from 4.3 percent in 2021. Most of the consolidation would come from cuts in extraordinary spending and containment of structural expenses in line with potential GDP growth.

The government continues to move forward in the integration of sustainable finance within the debt management strategy so as to harness Uruguay's strength and progress in environmental, social and governance (ESG) factors, and climate change policies. The recently published Sovereign Sustainability-Linked Bond (SSLB) Framework seeks to pioneer an alternative approach for sustainability-linked debt financing through implementing a two-way pricing structure, linking the country's cost of capital to the achievement of its climate and nature-based goals under the Paris Agreement. Through this mechanism, Uruguay intends to align its national financing strategy with its sustainability efforts, creating an innovative tool that binds borrowers and investors together in the effort to protect the planet.