



International Monetary and Financial Committee

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**IMFC Statement by Mario Marcel
President of the Central Bank of Chile**

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

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

Outlook and Current Macroeconomic Issues

Since our last October meeting, global growth prospects have strengthened in the near term, especially in advanced economies (AEs). Recent activity data and expectations in these economies have been more upbeat, marked by a better-than-expected performance by the manufacturing sector and a more positive outlook following years of relative stagnation. Growth seems firmer in the U.S. and prospects are also improving in Eurozone countries and Japan. In turn, deflationary risks seem to have dissipated. In the U.S., the Federal Reserve Board has continued to normalize monetary policy, and monetary authorities in the Eurozone and Japan appear to have set aside the possibility of additional stimulus measures. Markets have incorporated these changes in their expectations without disruptions. We believe these developments prove that policies undertaken by AEs in the aftermath of the Great Recession were broadly sound.

Along with better signs in AEs, China's outlook remains positive on the back of continued policy support. In Latin America (LatAm), the growth outlook continues to be marked by the adjustment processes in several larger economies. The observed moderation of external imbalances and progress toward fiscal consolidation should provide the foundations for firmer growth. Similarly, the pick-up of commodity prices has improved the external conditions faced by commodity exporting countries. In sum, we can argue that LatAm may finally be on the edge of a more sustained recovery, on the back of domestic policies, more favorable commodity prices, and external financial conditions that overall have remained favorable, notwithstanding the new monetary policy cycle which has started in the U.S.

It is noteworthy that recent developments have continued to sustain higher valuations of riskier assets. This can be seen in high stock market valuations, reduced sovereign risk premiums, and capital flows that are returning to emerging markets (EMs). This has also been apparent in a relative strengthening of exchange rates in several EMs, particularly in LatAm, where this has helped to quickly dissipate inflationary pressures, even though it may pose some challenges for growth in the short term. Nevertheless, the risk of inward policy measures and protectionism in major AEs has increased. This could cause negative spillovers and compromise medium-term prospects for small and medium-sized open economies that have relied on the well-known gains from free trade opportunities for their development strategies. This scenario cannot be ruled out and we believe it should be of the highest concern for the global community.

On risks to the global outlook, we share the view that they are tilted to the downside. We also note that, at present, some sources of uncertainty are especially relevant, yet given their nature,

are difficult to quantify. These include political-economic uncertainty in upcoming elections in Europe, the realization of Brexit, and a potential retreat to protectionism. In the case of the U.S., the expected fiscal stimulus and its tax reform is itself a source of uncertainty, not only in terms of its effective materialization, but also due to possible monetary policy implications and potential negative spillovers to EMs. China remains a source of concern, although its authorities appear to have successfully managed a gradual deceleration without a major disruption thus far. On the upside, we observe that recent favorable trends in the global and market sentiment may enter a virtuous cycle, leading to a better-than-expected global economic recovery and/or higher commodity prices.

In sum, the global economy seems to be better placed for a stronger recovery in the short term, but substantial challenges remain, including the need to safeguard the current multilateral and rules-based framework in the long run. As relatively small emerging market economies, our constituency supports an open global economy and considers that cooperative efforts are essential to avoid potential setbacks on economic integration and financial regulation, which would both dampen the long-awaited global recovery and put global financial stability at risk. Flexible macroeconomic policy frameworks, including flexible exchange rate regimes, fiscal rules, and inflation targeting, complemented by sound regulation, supervision, and the appropriate use of macro prudential policies, have proven to be a positive combination for dealing with these risks in the short run.

Considering the current global conjuncture and associated downside risks, we support the Global Policy Agenda's three-pronged approach, with monetary, fiscal, and structural reforms, geared to strengthen growth and secure resilience. On the macroeconomic front, monetary policy should remain accommodative where output gaps are still negative and inflation remains subdued. In addition, a better mix of fiscal versus monetary policy appears to be appropriate, particularly in the Eurozone, where fiscal consolidation has proceeded apace, and where the need for an ultra-loose monetary stance appears less necessary. In turn, fiscal and structural reforms geared towards lifting potential output and inclusive growth need to be adapted to specific country realities, carefully implemented, and financed.

We believe that national authorities have sufficient leeway at their disposal to use domestic policies to deal with domestic challenges. The lack of opportunities in local labor markets or specific sectors, overall economic inequality, the adequate provision of social services to the most vulnerable segments of the population, among other aspects, are all within the grasp of national authorities, particularly AEs, without compromising a commitment to a cooperative and well-functioning multilateral system based on free trade.

In this regard, we welcome the recent analysis by the Fund on the determinants for the global productivity slowdown observed across advanced, emerging, and low-income economies. We particularly underscore the importance of trade and financial openness, as well as domestic policies to unlock productivity, including reforms that expand innovation and the capacity of

workers to reap the benefits of integration through human capital accumulation, retraining and on-the-job training matched to new labor market demands. We look forward to having more granular and member-tailored policy recommendations on this crucial challenge in the context of bilateral surveillance.

The lifting of potential growth rates must be complemented by inclusiveness and the expansion of opportunities for all, a crucial objective that has framed policies followed by all the countries in our constituency. Globalization of trade and capital has contributed to income convergence by raising incomes, boosting millions out of poverty, and allowing major access to goods and services. Against the background of voices of discontentment with globalization, the effects of technological change and trade integration on income distribution need to be carefully disentangled. In this vein, we welcome the Fund's recent work on the drivers behind the observed trends in the income labor share, which identifies technological progress as the main cause for declining income shares in AEs. At the same time, we encourage further work to identify member-tailored policy advice to tackle inequality, being mindful that in these endeavors, the Fund's policy advice may be largely enhanced by collaboration with other specialized institutions.

In sum, we believe that the best environment for national authorities aimed at enhancing equity and inclusiveness is an open world economy that fosters growth and an international financial architecture that is capable of leveling the playing field and supporting sound institutions.

IMF Institutional Issues

We consider that the cornerstone of a well-functioning International Monetary System (IMS) remains to be members' observance of sound economic policies within adequate macroeconomic frameworks. The IMS is strengthened by macroeconomic discipline and financial stability in each member country of the system, which reduces their likelihood of requiring Fund or Global Financial Safety Net Resources. In turn, the Fund may greatly contribute to having a better IMS through enhanced bilateral and multilateral surveillance, in both advanced and emerging economies, by adapting its financing tool kit and strengthening its technical assistance and capacity-building functions.

The IMS needs to continue progressing to accommodate observed trends in the global economy within a collaborative framework. These include China's rebalancing transition and larger influence in financial markets, global current account imbalances, and potential financial spillovers in the context of a more positive global economy outlook. We welcome future Fund recommendations to promote a healthy rebalancing of current account imbalances, based on its independent and technical assessments. We also encourage an effective and consistent implementation of the Fund's Institutional View on Capital Flows across the membership and further analysis on the interaction of capital flow measures and macroprudential policies to increase financial sector resilience to volatile capital flows.

Finally, considering the current global economic conjuncture and associated risks of protectionism, we strongly encourage the Fund's efforts to raise awareness of the benefits of rules-based multilateral trade and to keep an active participation on multilateral efforts to strengthen the global financial regulatory reform agenda. We encourage coordination with the World Trade Organization, the Organization for Economic Cooperation and Development, as well as an active involvement with the Financial Stability Board and Bank of International Settlements.

Quota and Governance Reform

We support working expeditiously toward the completion of the 15th General Review of Quotas, including a new quota formula, by the 2019 Spring Meetings. A successful review will be a crucial step toward ensuring that members' quota shares reflect their positions in the world economy and that the Fund remains a quota-based institution. Our constituency considers that borrowed resources from NAB and BAB reflect a strong compromise by countries to support the adequacy of Fund resources but should continue being considered as transitional arrangements.

Argentina

When the new government took office in December 2015, the economic situation in Argentina was in disarray. Economic activity had stagnated since 2011, with growth rates below population growth, and the country had entered a recession by mid-2015. Inflation, fueled by the financing of government operations by the central bank, had been high for many years, reaching annual peaks of about 40 percent. Unemployment was high, with approximately 1.2 million workers unemployed and almost 4 million workers in the informal sector, both factors contributing to a high poverty rate of 32.2 percent in the first half of 2016. The external sector exhibited clear signs of imbalances, with exports declining, widespread import controls, and low international reserves, which had motivated pervasive restrictions in the foreign-exchange market. The situation of public finances was dismal with large deficits, despite high tax pressure, and no access to voluntary external financing. The size of financial intermediation had reached historic lows. Economic statistics suffered from an absolute lack of credibility.

The efforts of the new government over the past sixteen months have been focused on establishing sound macroeconomic policies, restoring credibility, and laying the groundwork for inclusive, balanced, and sustainable growth. The initial priorities included removing restrictions in the foreign-exchange market and excessive taxes on exports, settling a long-standing dispute with private foreign creditors, reducing costly subsidies in the provision of public services, and designing a coherent disinflation strategy. In parallel, the government put in place an immediate plan to rebuild the official statistics office (INDEC).

These decisive actions by the government have paid off. The economy turned around in the second half of 2016 and is expected to grow 3 percent in 2017, led by higher exports and investment. A strong agricultural output is expected, including a record harvest of wheat. Employment creation has been positive and real wages have increased since July 2016. Inflation has declined dramatically since the second half of 2016 and is set to close at the upper end of the central bank target in 2017. On the external front, all exchange controls have been dismantled, import controls have been lifted, international reserves are growing, and the public and private sectors have regained access to international capital markets amid a sustained decline in government financing costs. On the fiscal front, in 2016, and for the first time since 2002, the tax-to-GDP ratio declined and real public expenditures remained constant. Utility tariffs have been increased to be better aligned with production costs and subsidies have been reduced and oriented towards those in need.

Building on this success, the authorities continue working towards addressing the top medium-term government priority, which is the elimination of poverty. The government is strongly committed to enhancing the social safety net and ensuring that social expenditures reach those who need them most. Tax policy changes have been introduced to alleviate the burden on low-income households and pensioners by introducing a 15-percentage-point VAT refund. The minimum wage has also been increased. The “Plan Nacional de Primera Infancia” (National Plan for Early Childhood) was launched at the beginning of 2016 to eradicate malnutrition in children under the age of four. The “Asignación Universal por Hijo” (Universal Child Allowance), a former program that reaches 3.8 million children, has been enlarged and enhanced, aiming to reach an additional million infants with increased benefits. In education, for the first time, the public system will include all children over the age of three in 2017, benefiting more than 638,000 children, and 3,000 new kindergartens will be built before 2019. Public pensions have been increased through the “Reparación Histórica a Jubilados”, a piece of legislation that brought pensions to the levels mandated by law, which were not met by previous administrations, benefitting more than two million pensioners. Other redistributive programs will also continue, such as “Argentina Trabaja” and “Ellas Hacen”, and important programs on housing, water, transport, and health are underway. All in all, Social Services will account for 64 percent of total public expenditure in 2017, or 15 percent of GDP.

Substantive progress has been achieved and continues on other fronts. The asset disclosure program launched in 2016 far exceeded expectations, with taxpayers revealing more than US\$ 116.8 billion in assets. The program required from taxpayers a 5 to 15 percent one-off payment on the amount of disclosed assets. The tax collection from this program reached 1.8 percent of GDP, a record high when compared with similar programs launched by other nations, and the assets disclosed meant a five-fold increase in private external assets. The tax revenue from the program will be earmarked to the public social security fund (ANSES), to help finance the regularization of pensions mentioned above. More broadly, the success of this program reveals strong confidence in the new direction of economic policies and would result in higher investment and tax collections over the medium term.

Sector programs have been negotiated with the private sector to increase investment, employment, and output. In the oil sector, a tripartite agreement among government, corporations, and labor unions will unlock investment for US\$5 billion in the region of Vaca Muerta, the 3rd largest shale oil field in the world. A similar agreement with the auto sector would allow another US\$5 billion in investment and create 30,000 jobs, aimed at increasing production to 1 million units by 2023, increasing the local content in production—benefiting small and medium-sized enterprises (SMEs)—and the diversification of export markets.

Spending on infrastructure has accelerated. More infrastructure for development and growth is under construction, with capital outlays representing 13 percent of the 2017 budget. Our goals include the expansion of the supply of drinking water to 100 percent of households and the coverage of the sewer system to 75 percent in urban areas, by 2019. We also seek to increase the participation of rail and ships in the freight transport network to reduce costs and improve regional logistics to boost regional value chains; for urban transport, a network of regional express trains will enhance mobility.

New loans will lead to higher credit growth, at lower rates and longer maturities. In a coordinated effort by the largest banks and government, a new 30-year mortgage line will finance access to housing for 150,000 middle-income families. Public funds will be used to facilitate household access to these new loans. In addition, public banks will expand the use of inflation-adjusted mortgages.

Policies to assist SMEs have been launched. Dedicated credit lines for this segment of enterprises have been expanded, while the administrative burden has been eased, and more flexible terms for payment of taxes, particularly VAT, have been granted. Other incentives for investment and increasing financing opportunities are being analyzed by Congress. A new law for *Entrepreneurs* was approved to speed up the process to set up new ventures, provide fiscal incentives for investors in new enterprises, and credit to impulse projects in their initial stages.

Amid the ongoing recovery, government policies will focus on continuing reducing inflation and the fiscal deficit, and deepening work on structural areas to strengthen competitiveness.

- The central bank will conduct monetary policy to achieve its announced targets for inflation:

Inflation - Targets	2017	2018	2019
	12%-17%	8%-12%	3,5%-6,5%

- In parallel, the central bank will work towards achieving stability and the sound expansion of the financial sector, promoting the use of local-currency saving instruments to finance credit expansion in local-currency at longer maturities and lower rates. In this context, priorities

include increasing access to bank services by all segments of society and promoting the use of electronic payments, contributing to the formalization of economic activity.

- Fiscal policy will be geared to achieve a sustained and gradual reduction of the deficit of the public sector. Targets for the federal government budget have been announced and will imply a reduction of the primary deficit from 4.2 percent of GDP in 2017, to 3.2 percent of GDP in 2018, and 2.2 percent of GDP in 2019. The deficit reduction strategy is anchored in the continuation of our policy to reduce subsidies and a recent agreement between the federal government and subnational governments, aimed at maintaining primary spending constant in real terms, reducing tax distortions and the overall tax pressure, and building fiscal savings funds. A draft law including these objectives will be sent to Congress in the coming months.
- Important efforts are underway to increase productivity and continue intensifying private investments. Building on the progress made, the authorities are laying the groundwork for growth, with the expansion of infrastructure—road networks, ports, water and sanitation, power generation, and airports, all areas where the stock of capital depreciated dramatically in recent years. To this end, a new Public-Private Partnership law was passed by Congress in November 2016.

Argentina is now strongly committed to multilateralism. The authorities re-initiated annual consultations with the International Monetary Fund, which had not taken place since 2006. The 2016 Article IV consultation was concluded by the Executive Board in November 2016, amid fruitful deliberations.¹ The authorities appreciated that, after the reconstruction of the INDEC and the elaboration of new and credible statistics on consumer prices and GDP, the Executive Board lifted the “Declaration of Censure” adopted in February 2013, when Argentina was found to be in breach of its obligations with the Fund.² The authorities have also resumed meaningful relations within the G20 and preparations are underway to take the presidency of the group later this year.

Bolivia

Despite the adverse external conditions for Bolivia in 2016, the country was able to sustain growth, albeit at a slower pace. In fact, GDP growth was 4.3 percent, half a percentage point lower than in 2015; nevertheless, Bolivia is still among the best performers in growth in the region. In 2016, policies were implemented through timely measures to mitigate the negative effects coming from the global economic cycle and to improve the living conditions for Bolivians. In 2016 public investment reached 15.1 percent of GDP compared to 14.7 percent in 2015. Priority was given to industrial projects and physical infrastructure, which combined represented 72.8 percent of 2016 public investment (36.8 and 36 percent respectively).

¹ <http://www.imf.org/external/pubs/cat/longres.aspx?sk=44386.0>.

² <http://www.imf.org/en/News/Articles/2016/11/09/PR16497-Argentina-IMF-Executive-Board-Removes-Declaration-of-Censure>.

The Bolivian authorities expect a higher GDP growth rate for 2017 (4.7 percent) due to greater dynamism in construction (8.1 percent), water and electricity (7.6 percent), public administration services (7.1 percent), and financial services (6.1 percent). For 2017, international organizations are envisaging slight hikes in commodity prices and rises in global and regional growth.

However, the Bolivian authorities consider that there are risks stemming from changes in the international environment that could lead to possible protectionist policies, like in the USA. Even though Bolivia does not have strong trade linkages with the USA, there could be indirect effects through spillovers to Bolivia's trade partners. Therefore, fiscal and monetary policies will be oriented to counter the cyclical effects, as in recent years, seeking to maintain the dynamism of the economy and preserve social protection programs.

Fiscal accounts registered a deficit of 6.7 percent in 2016, mainly because of capital expenditure. This deficit was financed by domestic savings and international borrowing; therefore, macroeconomic stability was preserved. Fortunately, the significant fiscal surpluses achieved before 2015 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. Bolivia is well positioned in international financial markets given the success achieved in issuance of the recent sovereign bond of US\$ 1 billion (March 2017) which priced with an interest rate of 4.5 percent, lower than in 2012 and 2013, when the country returned to international financial markets. Even though Bolivia has increased its borrowing, its external debt ratio is at a moderate level, 20 percent of GDP.

The fiscal authorities are also envisaging a deficit for 2017, as public investment projects will continue to be developed, in accordance with the 2016-20 National Development Plan. Focus will be put on infrastructure development and investment in state-owned enterprises (particularly energy, both electricity and natural gas). Maintaining the dynamism of the economy through public investment is paramount to the expansion of the output base, greater productivity, closing gaps in physical infrastructure, and industrialization (to add value to hydrocarbon and mineral production).

Fiscal policy is going to continue in its role as income redistributor, through social programs. Since 2007, 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. The continuation of these programs is crucial to avoid reversing the progress achieved in poverty reduction in the last 10 years. Moderate poverty levels in the country reduced from 60.6 percent in 2005 to 48.5 percent in 2011, while extreme poverty decreased from 38.2 percent to 24.3 percent in a similar period, which mostly impacted rural areas.

In 2016, monetary policy was still accommodative as the Central Bank of Bolivia gradually injected liquidity into the economy as part of the counter cyclical policies aimed to support domestic demand in the economy. However, inflation pressures did not arise and the inflation

rate ended up at 4 percent in 2016, within the range envisaged by the authorities. In 2017, the monetary policy will continue to be counter cyclical and it will be in tandem with the exchange rate policy, which aims to preserve stability. The current exchange rate policy is serving the country well, keeping inflation at bay without hurting the competitiveness of the economy. Inflation for end 2017 is projected to be at 5 percent. In 2017, monetary and financial policies will continue to support price stability and promote 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 in 2016 led to credit increases in the production and housing sectors, substantially helping domestic demand. It is expected that the same trend will be observed in 2017, while preserving financial system stability and mitigating the effects of external shocks. The financial system remains stable, healthy, and well capitalized. The rate of non-performing loans is still at very low levels (1.6 percent at the end of 2016).

The current account registered a deficit of 5.6 percent in 2016 mostly explained by falls in terms of trade, while export volumes did not experience a significant decline. The authorities project a smaller percentage for 2017. However, international reserves are still more than adequate for any metric. At the end of 2016, they were at 38 percent of GDP and the authorities project they will be higher at the end of this year.

Chile

The Chilean economy grew 1.6 percent in 2016 and exhibited a deceleration that has persisted into the start of 2017, influenced by a prolonged strike that took place in the mining sector. Subdued growth continues to be explained by weak mining investment associated with the end of the commodity super cycle, low growth in trading partners, and a delayed recovery in non-mining investment. In contrast, private consumption has continued supporting growth, in line with an unemployment rate that is still low by historical standards, notwithstanding signs of deterioration in the labor market. Central bank forecasts indicate that GDP will accelerate throughout 2017 and grow, on average, within a range between 1.0 and 2.0 percent this year, and between 2.25 percent and 3.25 percent in 2018. Several elements will support the economy as it recovers higher growth rates, including the absence of relevant macroeconomic imbalances, a smaller negative impact from the adjustment in mining-related investment, an improvement in the global outlook and monetary policy that will remain expansionary.

Annual CPI inflation has continued to decline and in the short term is expected to reach a level around 2.5 percent. In addition, medium-term inflationary pressures have been reduced by a somewhat larger output gap as a consequence of a higher-than-expected deceleration in activity. In this context, the central bank has reduced the monetary policy rate by 75 basis points during this year, anticipating additional rates cuts to what was previously expected. According to the last monetary policy report, the board will consider a slightly greater monetary policy impulse if required to ensure that projected inflation stands at 3 percent over the policy horizon.

The fiscal authorities remain committed to a gradual fiscal consolidation to reach a structural balanced budget position over the medium term, while allowing automatic stabilizers to operate. Accordingly, policy makers seek to gradually reduce the structural deficit by approximately 0.25 percentage points per year, which in 2016 reached 1.6 percent of GDP, according to preliminary estimations. The 2017 Public Budget approved by Congress is in line with the medium-term consolidation objective. Reflecting the macroeconomic soundness of the economy, the country's risk premium continues to be among the lowest in emerging markets and around historical lows.

The government has progressed in implementing its agenda oriented to improve the quality of Chile's human capital and secure inclusive medium-term growth. Reforms to strengthen primary and secondary public education and careers in teaching continue to be implemented gradually, while a new legislation for improving post-secondary education is currently under discussion in Parliament. Finally, several developments which are under way may help improve productivity and efficiency in the near term. These include a new energy policy, prompting record investment in unconventional renewable energy projects, a more diversified energy matrix and lower energy costs; legal amendments broadening the portfolios of institutional investors, deepening long-term capital markets; reforms on payments systems to increase financial inclusion and foster competition in supportive transaction infrastructures; a forthcoming banking bill to adopt Basel III capital regulations; the creation of an Infrastructure Fund; and an overhaul of governance arrangements to foster public-private partnerships.

Paraguay

Amid the complex international scenario, Paraguay's growth estimate for 2016 is 4 percent. Despite a moderate expansion during the first quarter, economic activity bounced back in the following months, supported by the recovery of non-traditional sectors (specifically manufacturing and construction). For this year, current output growth estimates stand at 3.7 percent, mainly driven by the secondary and tertiary sectors on the supply side and by domestic demand on the expenditure side.

Inflation has remained within the target range. After the reversal of some supply shocks and lower exchange rate pressures, there was a moderation in both headline and core inflation throughout 2016. As a result, consumer prices grew 3.9 percent. These lower inflationary pressures provided sufficient space to adopt a more accommodative monetary policy stance to support the recovery of some sectors of the economy. In this scenario, the monetary policy rate was reduced (25 basis points in May and July, respectively) to 5.50 percent.

During the implementation of the inflation-targeting (IT) regime, inflation has remained low and on target. Thus, in early 2017, the Central Bank of Paraguay (BCP) decided to reduce the inflation target by 50 basis points (from 4.5 percent to 4 percent per year), with a tolerance range of +/- 2 percentage points (pp). In addition, during the period of the IT monetary policy regime,

the BCP initially reduced the tolerance bands from +/- 2.5 pp to +/- 2 pp in 2014 and afterwards the inflation target from 5 percent to 4.5 percent in 2015.

The exchange rate is consistent with fundamentals, as well as with the dynamics of other currencies in the region. In most of 2016, pressures on the exchange rate had moderated, in line with the continuous postponements of the Federal Reserve benchmark rate. However, in the latter part of the year, after stronger US macroeconomic data and consequently higher probabilities of a rate hike, the region's currencies weakened against the US dollar. In this context, BCP interventions in the foreign exchange market were minimal and only to smooth out abrupt exchange rate volatilities, in line with its legal framework.

In the fiscal area, tax collection was more efficient and grew above the economic activity. Tax revenues grew 7.7 percent, higher than in 2015 (3.4 percent). Indeed, fiscal policy has played an important role, reducing the fiscal deficit to 1.4 percent of GDP in 2016, below the limit of the Fiscal Responsibility Law (FRL), and has moved towards a change in the composition of spending. In 2016, the burden of current expenditure was reduced to 1 percent of GDP, which is explained by a drop of 0.8 percent of public wages. Meanwhile, public investment grew in real terms by more than 16 percent, reaching a level close to 3 percent of GDP. The Ministry of Finance continues to work on strengthening the FRL and joint efforts are being made to move towards international best practices, with the creation of the Advisory Fiscal Council. This step will contribute to the discussion, analysis, and generation of opinions on fiscal policy by independent professionals with vast experience in macroeconomic and fiscal issues.

The financial system remains stable with indicators of solvency, liquidity, profitability, and a non-performing loans ratio that continues to be at adequate levels. Throughout 2016, a slowdown in credit growth was observed, partly due to the less favorable external conditions for export commodities prices and the consequent lower investment in the agricultural sector. Also, the moderation in consumption partly explains this behavior, mainly in local currency loans.

Regarding the modernization of the legal framework, the recent reform approval of the Banking Law and the National Development Bank will consolidate risk-based supervision and advance in the implementation of international financial regulation best practices. Moreover, a set of reform proposals includes the charter of the BCP and the creation of a Superintendence of Pensions.

Peru

GDP was recovering momentum in 2016 with a growth of 3.9 percent driven mainly by the mining exports' dynamism and a sustained consumption growth. Higher rates of growth were expected this year taking into account the recovery of the world economy and better terms of trade of around 5 percent.

However, two short-term shocks have impacted our forecasts: one is the deferral of main infrastructure investment projects by large Brazilian companies and their affiliates that are being investigated by what is already considered to be one of the biggest corruption scandals of our time. The second shock was the presence of an abnormal El Niño event with devastating floods and mudslides that affected northern fishing and agriculture, road infrastructure, and sanitation and electricity services.

While the Peruvian government is still evaluating the total impact of this event, a fund of US\$770 million has been set up to help victims and begin reconstruction with a stimulus package of 5.5 billion soles (US\$1.7 billion) focusing on building infrastructure. In this scenario and depending upon how fast the reconstruction activities are enforced, we expect a 3.5 percent GDP growth for this year.

As to our main macroeconomic forecasts, after declining from 4.9 to 2.8 of GDP between 2015 and 2016, consistent with growing mining exports, mainly copper, the current account deficit is projected to decline even more in the coming years. Long-term financing from private sources will continue exceeding the current account gap and foreign direct investment will continue to be the main component. At the same time, trade surplus would continue increasing to around US\$ 4 billion because of exports growth in terms of volume and price after reaching a surplus of US\$ 1.7 billion in 2016 from a deficit of US\$ 3.2 billion in 2015.

Fiscal deficit will probably be temporarily higher than in previous years due to reconstruction costs but still below 3 percent of GDP. In 2016 it increased from 2.1 to 2.6 percent of GDP, because of the decline in fiscal revenues, which could have been higher if the new government had not taken any fiscal consolidation measures, which implied significant expenditure adjustments. The net fiscal debt is less than 10 percent of GDP, which gives the economy enough fiscal space to deal with the reconstruction cost.

The inflation rate was 3.2 percent at the end of 2016 and in recent months has picked up close to 4 percent reflecting temporary price increases in some perishable food products, because of the El Niño event. However, inflation expectations and core inflation remain within the target range of 1-3 percent. Given the transitory nature of restrictions affecting the food supply, inflation is projected to converge to the target range in the second half of 2017, consistent with a still negative output gap.

In this context, monetary policy has remained accommodative with a policy interest rate at 4.25 percent, which implies 1.3 percent in real terms. The Central Bank of Peru stands ready to ease the monetary policy stance as soon as they confirm the reversal of supply shocks and no impact on other inflation determinants. It has already reduced the reserve requirements to domestic and foreign currency deposits to preserve the financial conditions in a context of raising interest rates abroad and to provide enough liquidity to the financial institutions to attend the demand for credit.

On top of recent measures, the government has launched a set of structural reforms to improve the business environment, facilitate private and public investment, reduce red tape, and increase productivity aimed at recovering higher rates of growth in the medium term.

Uruguay

The past two years were characterized by strong turbulence and uncertainties at global and regional levels, where the Uruguayan authorities fully ratified their main policy orientations. Particularly in times of uncertainty, policies and institutions that instill certainty and confidence reap fruits.

In 2016, Uruguay recorded its fourteenth consecutive year of growth. Beyond the exceptional fact that this is the longest period of economic expansion in the country's history, there are two relevant developments worth underlining: amidst a complex global scenario, as well as recessions in the country's two main partners in the region, Uruguay has shown a very unusual performance: albeit at lower rates, the country has continued to grow. The latter clearly indicates a decoupling process that became more evident over the last five years, on the back of a critical process of structural transformations which are still ongoing. The second relevant issue is that after a noticeable deceleration, the last quarter of 2016 exhibits an economy that is on the rebound: this pickup in momentum is fully consistent with other indicators of domestic and external demand, as well as indicators associated with consumer and investor confidence, suggesting that Uruguay's economy is rapidly heading to a new phase of higher growth rates compared with the past two years.

A sustainable and robust period of growth requires macroeconomic prudence and consistency among policies and objectives, and this is what the country has exhibited in terms of fiscal, monetary, and income policies. In May 2016, annual inflation had reached 11 percent; after a declining trend, the latest data displayed that in March 2017 the inflation rate was 6.7 percent, within the central bank's target range. Albeit throughout an economic deceleration period over the past two years, unemployment showed relatively low levels, while real wages displayed a positive and stable path. Admittedly, the fiscal deficit is higher than desirable; the authorities have ratified the target of 2.5 percent of GDP for 2019 which, under the government's fiscal plan, is fully reachable.

Prudence and consistency have buttressed the confidence of international investors on the country's sovereign credit, underpinned by a resilient debt structure (in terms of currency, rates, residual maturity, and instruments) and the government's ample liquidity buffers. Uruguay's public debt management has been highlighted by many well-respected reports, including the Fund's, for its operational efficiency, institutional quality, and long-term policy objectives. It is worth noting that a few days ago, the country signed a "south-south" cooperation agreement with Paraguay, with the objective of sharing knowledge and experiences from Uruguay's positive

practice. The considerable level of Uruguay's international reserves and the financial system's sound indicators are also a testament of the country's position of strength to face eventual external shocks. Uruguay's investment grade status reflects the country's efforts and achievements in terms of stability and building buffers.

Growth can and should be accompanied by boosting social conditions. Uruguay's macroeconomic stability and robust growth have been the indispensable conditions in attaining a substantial decline in poverty rates and significant progress regarding inequality. Nevertheless, much greater efforts, policies, and transformations were needed: the government's priority for attaining inclusive growth is mirrored in the very high portion of social expenditure in terms of the country's total public spending. In any case, much remains to be done in this area, especially to enhance the quality of spending, making it more consistent with its quantity. Improvements in education and infrastructure are critical for the country to keep progressing towards higher stages of social and economic developments. Regarding the government's objective of increasing opportunities for society as a whole, especially its most vulnerable sectors, it is worth underlining the critical progress the country has made regarding its financial inclusion reform.

As political uncertainty continues to be highlighted as a major risk for the global economy, policies and institutions that inspire certainty are essential. The Uruguayan authorities maintain their unambiguous view on the importance of stability, inclusiveness (in the whole sense of the word that includes total respect for everyone's rights and diversity), transparency, openness to the world (Mercosur should constitute a platform to reach agreements with other blocks), diversification, and robust institutions as singular and synergetic factors.