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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. We are appalled by the massive humanitarian crisis in Ukraine, with a growing number of victims and more than 10 million displaced people fleeing violence. We look forward to a speedy and peaceful resolution of the conflict in full respect of international law.

Global outlook and economic policies

In the aftermath of the pandemic, the invasion of Ukraine will hurt global growth, increase inflation pressures, and exacerbate existing vulnerabilities in the world economy. In addition to the direct impact of the war and sanctions on the economies of Ukraine and Russia respectively, the economic effects will be felt around the world through direct trade and financial linkages, and indirect spillovers through commodity and financial markets. These negative spillovers come as many emerging market and developing countries (EMDCs) have yet to fully recover from the pandemic, while many others are dealing with its legacies: high inflation and high debt.

So far, the surge in fuel and food prices has added to already high and widespread inflationary pressures. The tightening of external financial conditions has been limited and differentiated across regions and country groups, depending on their direct exposure to the conflict and commodity prices. The negative impact of the war on global growth is expected to be largely concentrated in Russia and Ukraine and, to a lesser extent, in Europe, while the effects in other regions will be milder and more mixed.

Risks to the global recovery are significant and tilted to the downside. Among the more prominent risks are an escalation of the war in Ukraine and related sanctions, a resurgence of the pandemic amid new variants, and a sharp tightening of monetary policy in the face of persistently high inflation and rising expectations. These risks are particularly important for highly indebted EMDCs with limited policy space.

In the long term, increased geopolitical tensions threaten the prospects for shared prosperity and stability. Strong global cooperation and multilateral action remains essential to expand economic integration and digitalization, address climate change and the transition to a low-carbon economy, improve pandemic management, tackle debt distress, and strengthen global liquidity and the international financial safety net.

Adequate macroeconomic and financial policies must be tailored to country-specific conditions, including health, social, and economic conditions, vulnerabilities, and policy space. Policymakers face difficult tradeoffs to balance concerns about economic growth, inflation, social vulnerability, and debt sustainability. In those countries where the economic recovery is well entrenched, monetary policy must be resolute in fighting inflation, supported by fiscal consolidation to stabilize public debt and restore buffers, and accompanied by well-targeted support to protect the most vulnerable. In other countries, where the recovery is lagging but policy space is limited, macroeconomic policies must strike a delicate balance between supporting growth and the most vulnerable, while ensuring their credibility and sustainability over time.

Longer-term structural transformations must not be lost amid the near-term policy challenges of the pandemic and the war in Ukraine. Policymakers must continue to strive for higher, more inclusive, and resilient growth, taking full advantage of the productivity opportunities of new digital work arrangements and the green economy.

IMF priorities

The IMF must play a leading role in advising and helping members to get through these challenging times, while supporting the structural shift towards a more resilient future. 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

In line with the Comprehensive Surveillance Review, the Fund's policy advice needs to be tailored, granular, contingent, and prioritized according to country-specific circumstances. EMDCs are facing difficult policy trade-offs with limited instruments. We welcome the Fund's prioritized focus on the most pressing policy issues, including inflation and monetary policy, corporate and financial fragilities, fiscal consolidation, and credible medium-term fiscal frameworks. The recently completed revision of the Institutional View informed by the Integrated Policy Framework will provide useful guidance on the appropriate mix of policies, without losing sight of the long-term benefits of financial integration and exchange rate flexibility. Recent advances on the new debt sustainability framework, and ongoing work on addressing debt vulnerability and transparency will strengthen the Fund's advice in this area. At the same time, we support strengthening the implementation of the Common Debt Treatment Framework.

We also welcome the emphasis of multilateral surveillance on the global spillover effects from the war in Ukraine and the tightening of monetary policy in advanced economies. A clearly communicated and well-balanced macro policy adjustment across systemically important economies will help to limit adverse ripple effects across the world economy and will provide useful insights for policy makers in EMDCs, which are particularly sensitive to the global financial cycle and commodity markets.

We support the scale up of the coverage of emerging topics, such as climate-change, digital currencies and crypto-assets, and inequality, in bilateral and multilateral surveillance. The Fund's work must continue to focus on critical macro issues, building on its comparative strengths and capabilities, while ensuring effective and efficient collaboration with other international organizations. At this initial stage, the priority should be foundational analytical work on climate change and transition policies, digitalization, gender, and inequality, while bilateral surveillance and capacity building should focus on the more pressing macroeconomic dimensions of these issues.

Lending

In the wake of the pandemic and the war in Ukraine, more countries will find it difficult to finance their external deficits. We call on the Fund to stand ready to provide additional support to these economies with timely and adequate resources through its lending and precautionary facilities. We also join calls to mobilize additional concessional resources for the PRGT and CCRT.

The new Resilience and Sustainability Trust will allow long-term financial resources to be channeled to address structural challenges with balance-of-payment implications. We

commend the IMF for intense work to establish this new trust initially aimed at challenges related to climate change and pandemic preparedness. Over time, we expect the RST to cover a broader range of structural issues that have long-term external balance implications.

Capacity development

We support the shift to strengthen the integration of capacity development 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 inclusive prosperity in the long term. Delivery should take full advantage of the lessons learned in the last two years of virtual interaction, without losing sight of the important benefits of personal contact and field presence. We support the priority of capacity development on cyber regulation and supervision.

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.

ARGENTINA

Argentina's new Extended Fund Facility

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

The new program not only 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–, but it also counts with broad support from the Argentine society. For the first time, an agreement between Argentina and the IMF Staff was endorsed by the Argentine Congress, providing greater ownership and legitimacy, in a context of massive political and social support from governors, civil society representatives, the private sector, trade unions, social movements, entrepreneurs, and banks associations.

Background of the new program

The negative consequences of the 2018 SBA have been established in the Ex-Post Program Evaluation (EPE) of 2021. As recognized by the EPE, the 2018 program failed. Even though Argentina passed the four IMF Board Reviews (October 2018, December 2018, April 2019, and July 2019) and met all the fiscal targets, none of the objectives of the program were achieved.

As recognized by the EPE, the 2018 SBA allowed the service of unsustainable debt and the acquisition of foreign exchange at convenient rates by the private sector using IMF resources, while confidence and market access were never restored, output contracted sharply amidst increasing inflation, and public debt rose substantially as a fraction of GDP, following the currency depreciation. Learning from the flaws of the 2018 SBA was the starting point of the new program.

Economic outlook and risks

After three consecutive years of economic contraction, the economy expanded by 10.3 percent in 2021, while showing improvements in key macroeconomic and social indicators. Government supported policies, including on the health front, coupled with favorable external conditions, contributed to the economic expansion. The positive dynamics of investment (up 32.9 percent y/y through 2021) and exports (up 9 percent in 2021) played a key role. Fiscal imbalances narrowed, while priority social and infrastructure spending were expanded. The federal primary fiscal balance fell from 6.4 percent of GDP in 2020 to 3 percent in 2021, compared to an original budget target of 4.5 percent of GDP. The domestic government bond market is being strengthened. Net domestic (peso) market financing has been over 2 percent of GDP in 2020 and 2021. This has allowed monetary financing of the deficit to fall sharply—from 7.4 percent of GDP in 2020 to 3.7 percent in 2021. The trade surplus reached a near-historic high of US$15 billion, although sizeable outflows in the financial account limited reserve accumulation.

Social conditions are also gradually improving: the labor market is recovering, with the unemployment rate falling to 7.0 percent in Q4:2021, after peaking 13.1 percent during Q2:2020. The labor force participation rate is also rising, formal employment is above pre-pandemic levels, real wages are beginning to recover, and poverty is declining, falling to just

37.3 percent of the population during the second half of 2021, and below the peak during the pandemic (42 percent).

Despite this progress, important economic and social challenges remain. Persistently high inflation, along with deep social and infrastructure gaps, still call for a solution. These are the issues that the policies of the 2022/2024 Program will seek to solve. Argentina's authorities remain committed to support an economic inclusive recovery by steadily addressing imbalances, while continuing to encourage net exports and FDI, to ease the external constraint on growth.

Medium-term policies of the new program

Fiscal Policies. Argentina will continue to pursue a growth-friendly fiscal policy to ensure stability, supporting the ongoing recovery and the sectors of the population in situation of vulnerability. To this end, a multi-year fiscal consolidation strategy has been developed to gradually reduce the fiscal deficit during the duration of the program. The fiscal path envisaged will help place public debt to GDP on a firm downward trajectory and support the gradual resumption of international market access starting in 2025. Additional external investment projects financing from Multilateral Development Banks (MDBs) will be used to scale up capital spending, including through higher and more efficient infrastructure and innovation spending, thereby helping to bolster economic growth and long-term development goals.

On the revenue front and on tax policy, Argentina will continue to mobilize and enhance the progressivity of taxes. Efforts will be focused on further reorienting spending towards public investment. These efforts are underpinned by a multipronged approach of reducing energy costs and increasing the pass-through of generation costs, while ensuring adequate protection for the most vulnerable. Argentina will adopt measures to strengthen the efficiency and sustainability of the energy sector, with the support of the World Bank and other international partners. Most importantly, energy subsidies are going to be reduced as a fraction of GDP—with the speed being to some extent dependent on the evolution of the ongoing geopolitical conflicts that affect the international energy situation. However, social assistance schemes and infrastructure investment will reinforce the process of growth with social inclusion. Social assistance coverage will be improved to best serve those most in need, focusing on addressing child poverty and reorienting support to promote labor market inclusion, particularly for women and individuals with low skills. In addition, spending on science and technology will be protected and enhanced to encourage innovation.

Financial Strategies. Argentina's government strategy for domestic financing remains focused on strengthening the local currency (peso) securities market. Coupled with efforts to mobilize external support, a strong domestic capital market will enable the unwinding of monetary financing of the deficit. Financial policies were designed with the long-term goal of macroeconomic stabilization, which in the case of Argentina requires a gradual process of de-dollarization. By developing the domestic capital market, Argentina seeks to avoid the flaws of past failed programs, which drastically reduced monetary financing by slashing public spending in critical areas.

Monetary and Exchange Rate Policies. As recognized by the IMF staff, persistent high inflation in Argentina is a multi-causal phenomenon and addressing it will require an integral approach. In the years 2018 and 2019 inflation reached 47 percent and 53.8 percent, respectively –amidst a context of output contraction–. Lowering inflation in Argentina requires a comprehensive set of economic policies. An important pillar will be achieving a sustainable fiscal and financial path that contributes to an early reduction in central bank budget financing. This will need to be complemented by prudent and pro-active monetary policy to support the demand for peso

assets and voluntary price and income policies to tackle challenges from strong inflation inertia and unanchored views on inflation dynamics. Meanwhile, the rate of crawl of the official exchange rate should also support external competitiveness, with a well-designed and calibrated capital flow management regime further supporting reserve accumulation.

Argentina's authorities, mindful of the deep economic and social costs of inflation, have taken steps to bring down inflation, anchoring views on its dynamics. Voluntary price-income policies are complementing macroeconomic policies to stabilize prices. Moving forward, income and price policies will be adjusted depending on evolving circumstances to tackle inertia and guide expectations on future inflation dynamics. The exchange rate management will be calibrated to ensure the medium-term competitiveness of the real effective exchange rate, and support reserve accumulation. To enhance exchange rate stability, since January the Central Bank raised the effective annual policy rate by 900 basis points and streamlined sterilization instruments to improve monetary policy transmission and signaling.

Growth and Resilience Enhancing Policies. Promoting strategic sectors is essential to boost the country´s net exports and address the long-standing vulnerabilities from external constraints to growth and to address informality. With the goal of increasing exports by around 30 percent by 2030, the Argentine authorities, in close collaboration with stakeholders, are moving forward to approve new legislation and regulations to promote investment and exports in strategic sectors, such as the knowledge-based economy, energy, mining, agriculture, and automotive. Various labor market initiatives to encourage formal employment and labor inclusion, especially of women and young adults with low skills, are moving forward. The competition framework will be strengthened to tackle excessive concentration, entry barriers, and market power, thus ensuring a level playing field. In the same vein, financial inclusion, the promotion of sustainable finance and the strengthening of financial resilience are being encouraged. Important social programs have been scaled up, to deepen the inclusion of the groups in situation of vulnerability in the labor market.

Gender Policies. A key goal of the government strategy is the reduction of the country's large gender gaps, which were further exacerbated during the pandemic. The multipronged approach emphasizes the strengthening of care support systems, including through expansion of key social protection programs that target women; increasing access to child-care facilities, housing, and other social infrastructure for mothers; and promoting labor market inclusion through programs that help to formalize domestic workers (thus far 33,000 domestic workers have been registered). Also, the presence of women in strategic male dominated jobs, such as industry, construction, technology, and others will be promoted. Adequate fiscal resources are oriented to addressing gender inequities by building on and enhancing the gender budgeting approach introduced for the fiscal year 2021.

Climate Adaptation. Argentina is developing environmental policies to strengthen preparedness and better address the challenges of climate change and ensure progress in achieving the country's commitments under the Paris Agreement. Key actions include: i) the preparation of a new bill to incentivize the production and use of renewable energy-powered vehicles; ii) the implementation of a *Green Productive Development Plan* aimed at promoting, investment in the knowledge economy, integration of circular economy processes, and environmental adaptation and efficiency in the use of resources; iii) the preparation of a new legislation and a regulatory framework to support investment in the *hydrogen sector,* and iv) a full-fledged climate tagging system in the 2023 Budget Preparation Manual.

Governance and Transparency. The Argentine authorities recognize the need to improve governance and transparency, in order to tackle tax avoidance and external assets formation, while improving the framework to combat money laundering and the financing of terrorism.

BOLIVIA

After a scenario of economic, political, social, and health crisis in 2020, the Bolivian economy showed a significant recovery during 2021, driven by different measures taken by the government of President Luis Arce Catacora, which undertook the challenge of rebuilding the Bolivian economy and guaranteeing its return to the path of sustained growth, macroeconomic stability, and the reestablishment of the population's living conditions that had been seriously affected by the crisis.

Economic Policy for Economy Reconstruction

Since November 2020, when the new government took office, a set of measures were designed to ensure the reconstruction and recovery of the Bolivian economy, within the framework of reestablishing the Economic Social Communitarian Productive Model, a model which has been applied in Bolivia since 2006 and that implied a deep transformation and advances in the country, mainly in the economic and social sphere.

One of the fundamental measures was the campaign to fight COVID-19. This was achieved through a strategic plan based on three pillars: early and massive diagnosis, massive vaccination, and coordination with subnational governments.

From the first days of its mandate, the national government began efforts to purchase coronavirus tests, having acquired more than 4 million by the end of 2021, and with free access to the population. Likewise, around 24 million doses of vaccines were effectively managed, enough to immunize the entire vaccinable Bolivian population. As of April 5th, 2022, 13.2 million vaccines have been administered in the country, among first and second doses, and the booster ones; reaching a vaccination coverage of 67 percent of the target population with a complete regimen, regardless of the doses applied to children and adolescents.

In this fight against COVID-19, between November 2020 and December 2021 the government allocated 4,486 million of Bolivianos (approx. USD 654 millions) to the purchase of vaccines, tests, medicines and medical supplies, as well as to hire health personnel and hospital equipment.

Regarding policies to promote the economic reconstruction, effective measures were defined to boost both demand and supply. Among the former, *Bono contra el Hambre* stood out, which consisted of a transfer of approximately USD 146 per eligible person aimed at mitigating the loss of income suffered by Bolivian households in 2020. The measure benefited more than 4 million of Bolivian men and women. Furthermore, it highlighted policies such as the rise in rents for retired population; the increase in the national minimum wage by 2 percent in 2021, after being halted in 2020 by the previous government; the items creation in education and health sectors; and the return of the contributions made to their retirement, to those Bolivians who requested it.

In the same way, within the Bolivian income redistribution policy framework, a cash reimbursement of Value Added Tax (Re-IVA, in Spanish) was determined, which consisted of 5 percent return on the amount presented in invoices to population with income less than or equal to 9,000 Bolivianos (approx. USD 1,312). A tax on large fortunes (IGF, in Spanish) was also established, which only reached to 0.002 percent of Bolivian population.

Policies to boost supply and promote the productive sector were essential for Bolivia's economic recovery in 2021. Among these important measures is the SIBOLIVIA credits program, which consisted of loans at a minimum interest rate (0.5 percent) to benefit the

productive sector that substitutes imports. It also highlighted the reestablishment of the impulse to productive and Social Interest Housing loans; and the 0 percent tax rate for import and sale of capital goods, which promotes the country's capital stock.

Results: Recovery of the Bolivian Economy

The economic policy measures applied since November 2020 were decisive for the recovery of the national economy. Thus, in 2021 Gross Domestic Product (GDP) grew by 6.1 percent, with a significant improvement in sectors such as transportation, mining, manufacturing, and construction; and a notable rebound in domestic demand, which contributed mainly on GDP expansion.

External sector variables also showed a favorable performance. For the first time in seven years, the country achieved a surplus in trade balance which totaled USD 1,462 million. On the one hand, exports rose to USD 11,080 million, a growth of 58 percent respect to 2020, with manufacturing sales reaching record levels. On the other hand, imports totaled USD 9,618 million, with a rise of 35 percent, explained mainly by purchases of capital goods, supplies, and raw materials.

The financial system resumed its dynamism in 2021. Deposits rose by 6 percent and loans by 4 percent, with a notable growth in productive and Social Interest Housing loans, 6 percent in both cases, and low levels of default (1.6 percent).

Similarly, it highlighted the contained inflation in 2021, 0.90 percent, the lowest inflation rate in South America. Likewise, so far in 2022 inflation continues controlled, reaching an accumulated of 0.39 percent as of March, despite external inflationary pressures in the current scenario of the war conflict between Russia and Ukraine.

Fiscal sector indicators also showed a positive performance. After reaching a deficit of 12.7 percent of GDP in 2020, a single-digit negative balance was recorded in 2021, 9.3 percent of GDP, below that programmed at the beginning of the year (9.7 percent of GDP). In line with the recovery of economic activity, tax collections rose to 49,018 million of Bolivianos (approx. USD 7,145 million), with a 15 percent growth respect to 2020.

Regarding financing, the country's return to international capital markets last February was notable, having secured USD 850 million from a sovereign bond swap operation of upcoming maturities bonds. This operation will allow the country to allocate the resources that otherwise would have been assigned to fulfill said financial obligations to public investment and, therefore, to consolidate the national economic recovery. It highlights as well that this process did not imply an increase in public debt as it corresponded to a liability management operation.

The advances in macroeconomic variables would not be complete if they were not reflected in the improvement of the living conditions of the Bolivian population. Indeed, after reaching high levels of urban unemployment during 2020, with a maximum level of 11.6 percent in July, this was reduced, ending 2021 at 5.2 percent. It highlighted the additional 1.2 million people employed between May 2020 and December 2021.

Furthermore, one of the main achievements of the year, in line with the reestablishment of social enhancements that had been observed during the period of the Economic Social Communitarian Productive Model, was the reduction of poverty and inequality. Thus, according to the National Institute of Statistics (INE), moderate poverty decreased from 39.0 percent in 2020 to 36.3 percent in 2021; extreme poverty, from 13.7 percent to 11.1 percent; and inequality, measured by the Gini Index, from 0.45 points to 0.42 points, in said period.

Bolivian Economic Outlook for 2022

The process of the Bolivian economic recovery continues so far in 2022, and it is expected to be consolidated throughout this year, with the contribution of important policies developed by the national government to promote economic strengthening, such as the estimated high level of public investment, USD 5,015 million, directed mainly to the productive sector, and a special emphasis on import substitution policy. In this framework, a growth of the economy of 5.1 percent, an inflation of 3.3 percent, and a single-digit fiscal deficit of 8.5 percent of GDP is projected for 2022.

Therefore, after the severe crisis suffered by the country in 2020, 2021 constituted the year of an important recovery of the national economy, which is expected to be consolidated during 2022, alongside the reestablishment of economic and social improvements that the country had shown in the last decade and a half prior to the pandemic, under the Economic Social Communitarian Productive Model.

CHILE

Macroeconomic projections

With a well-entrenched recovery, Chile’s monetary and fiscal policies are focused on closing macroeconomic imbalances accumulated during the pandemic, stabilizing inflation, and restoring buffers. Economic activity rebounded vigorously in 2021 driven by supportive macroeconomic policies plus early, rapid, and widespread vaccination, and favorable external conditions. Output expanded 11.7 percent last year propped up by very strong domestic demand and exceeded its pre-pandemic trend. The flip side saw a widening of the Current Account deficit and increased inflationary pressures, on the back of supply-demand imbalances, global supply chain disruptions, higher commodity prices, a weak exchange rate, and tight labor markets. The Central Bank of Chile (CBC) began tightening monetary policy in mid-2021 and has maintained a restrictive stance for some months. Fiscal authorities have withdrawn the extraordinary pandemic support and project a significant reduction of the fiscal impulse and public financing needs in 2022.

Consistent with a less favorable external scenario and the tightening of macroeconomic policies, the Chilean economy is expected to grow below potential in 2022-23. After the extraordinary expenditure growth in 2021, a slowdown of the Chilean economy is necessary to ensure the closing of the output gap and convergence of inflation within the monetary policy horizon, as well as a moderation of the current account deficit. Private consumption and fixed investment are expected to decline in 2022-2023 as pent-up demand fades, extraordinary liquidity balances built up during the pandemic shrink, credit and financial conditions become tighter, and lingering uncertainty remains.

GDP is expected to grow between 1.0 and 2.0 percent in 2022, and between -0.25 and +0.75 percent in 2023. Data for late 2021 and early 2022 suggest that the economy was already on a downward path from last year’s record high spending. 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.

Although the war in Ukraine is a negative shock for the Chilean economy, so far, its impact remains limited. The main spillover effects have been an increase in energy import costs, the expected slowdown in some of Chile's trading partners. The impact on external financial conditions has been muted so far.

Monetary policy and inflation

After the extraordinary boost of domestic spending in 2021, inflation has continued to rise, surpassing 9 percent annually according to March CPI, against a backdrop of broad-based demand and cost-push pressures, persistent global supply chain disruptions, a weak exchange rate, and labor market mismatches. Further increases in inflation are anticipated by mid-2022 heightened by recent commodity price shocks in the wake of the war and supply disruptions in China. Indexation dynamics and increased inflation expectations may prolong the inflationary shock.

Resolving the underlying imbalances that accumulated in the economy in recent quarters is vital to achieve inflation convergence. The CBC has rapidly adjusted the Monetary Policy Rate (MPR) to a restrictive level, tightening domestic financial and credit conditions. Further increases in the MPR are in the pipeline but would be smaller than those of recent quarters. Inflation is expected to start declining later in the year and to converge to the 3 percent target within the two-year horizon. The CBC will carefully monitor inflationary developments and risks, making sure that inflation converges to the target within the two-year monetary policy horizon.

Fiscal policy and public debt

Since the beginning of the pandemic, the government took bold actions to protect lives and livelihoods. It responded by delivering an unprecedented multi-year fiscal stimulus to safeguard health, protect jobs and household incomes, buttress the credit supply to SMEs, and boost a swift recovery from the crisis. As the recovery has become well entrenched and the health situation has improved, extraordinary support measures have been withdrawn, while temporary and targeted programs remain to protect and facilitate the transition of those sectors and groups most affected by the pandemic.

The headline fiscal deficit is expected to have a sharp decline in 2022, in line with the withdrawal of extraordinary pandemic programs, while revenues have bolstered higher copper prices. The structural deficit is expected to decline reflecting the turn towards a more neutral stance. Going forward, these extraordinary policies are expected to be phased out after, while the fiscal budget returns to a consolidation path that stabilizes gross public debt. The increases in social spending in the new government's program will be accompanied by tax reforms to mobilize additional resources.

PARAGUAY

In 2021, the Gross Domestic Product (GDP) grew 4.2 percent according to the Central Bank of Paraguay (BCP)’s Quarterly National Accounts data. On the supply side, this expansion was explained mainly by the services, manufacturing, construction, and livestock sectors. On the expenditures side, growth was basically due to the positive performance of investments and consumer expenditures, both private and public.

For 2022, the GDP growth projection presented in mid-December 2021 was 3.7 percent. However, after the publication of that official figure, the local weather conditions quickly deteriorated, thus leading to an important downward bias in the forecast, which will be updated and published in the Monetary Policy Report (IPoM) at the end of April.

Until mid-December 2021, a favorable development of soybean crops was observed, with expectations of high yields for harvests during the 2021/2022 campaign. However, the climatic conditions changed abruptly, resulting in a significant deficit of water resources due to heat

waves and the lack of rainfall. Both factors have harshly affected agricultural endeavors and have led to a scenario that is far different from the one previously anticipated.

Regarding prices, inflation accelerated since mid-2021, closing the year at 6.8 percent, explained largely by the increase in the prices of food items and fuels. The inflationary pressures stemmed mainly from external shocks caused by the successive increases in the international prices of commodities, as well as the important rise in beef exports that pushed local beef prices upwards. On the other hand, the inter-annual variation of the Consumer Price Index that excludes food items and energy (IPCSAE) was 2.7 percent, reflecting the high concentration of inflation in the two categories.

In this context of inflationary pressures and considering the recovery of economic activity that had been observed during 2021, the Monetary Policy Committee deemed it appropriate to raise the referential rate. The measure was intended to prevent external shocks from generating second-round effects on other products of the basic consumer basket and avoid a de-anchoring of the medium-term inflation expectations. Thus, adjustments were made in August (up 25 basis points), September (up 50 bps), October (up 125 bps), November (up 125 bps), and December (up 125 bps), resulting in an increase of 450 basis points, thus setting the monetary policy rate at 5.25 percent by the end of 2021.

At the beginning of 2022, inflation remained high. The monthly variation in January was 1.5 percent, while the inflation rate in February was 1.4 percent, explained largely by the increase of the prices of fresh vegetables, with incidences of 0.6 and 0.5 percentage points (pp), respectively. Given the high volatility of this component of the CPI, its incidence is expected to decrease in the upcoming months. Likewise, the hike in fuel prices continues to have repercussions on inflation (0.2 pp in January and 0.5 pp in February). More recently, the armed conflict between Russia and Ukraine has led to an increase of international crude oil quotes, generating new pressures on the domestic prices of fuels, and bearing an incidence on inflation expectations of economic agents. In this scenario, the CPM deemed it appropriate to continue with the cycle of monetary policy rate increases, with upward adjustments of 25 bps in both January and February and an increase of 50 bps in March.

According to available projections, inter-annual inflation is expected to remain above the upper limit of the target range during the first semester of 2022, due to the recent additional increases of the prices of petroleum and volatile categories affected by the drought. Notwithstanding, a gradual convergence to the target range is expected.

Paraguay’s financial system has remained sound, with solvency levels above regulatory requirements and with favorable credit quality indicators. Likewise, the profitability of the system has remained relatively stable, after showing a decrease in the first quarter of 2020 mainly due to the Covid-19 pandemic.

Credit continued to show favorable dynamism in recent months. Loans extended in Paraguayan guaranies registered a growth rate of 10.8 percent y-o-y in February 2022, whereas loans granted in foreign currency expanded with an inter-annual rate of 11.5 percent. Taking into consideration the adverse weather factor registered since the last months of 2021, the BCP issued a temporary regulation, in the first quarter of 2022, which is intended to alleviate the situation of the agriculture and livestock production sectors affected by the drought. This measure has the purpose of interrupting the calculation of late payment fees to preserve the risk profiles of customers, thus allowing them to continue as subjects of credit for loans provided through the financial system.

The payments system has performed with normality. Regulations were issued in January 2022 so that Paraguay's stock exchange the *Bolsa de Valores y Productos de Asunción S.A.* (BVPASA), associated with the Sustainable Stock Exchange Initiative, can interconnect with the Real-time Gross Settlement (RTGS) System and the Securities Depositary of Paraguay's Payment System (SIPAP). These measures were designed to foster greater deepening of the local public securities market and strengthen the mechanisms for the transmission of monetary policy. In addition, it is anticipated that by May 2022 instant inter-bank transactions will be in effect 24x7 – 24 hours a day seven days a week.

PERU

The Peruvian economy grew 13.3 percent in 2021 (0.8 percent relative to 2019), one of the highest rates in the LAC region, resulting from a relaxation of COVID-related restrictions and widespread vaccination rollout in a context of fiscal stimulus and expansionary monetary policy. At the same time, economic activity decelerated during the second half of the year due to a lower statistical effect and a deterioration of business expectations (associated with higher uncertainty, mainly affecting private investment).

Inflation in Peru has been one of the lowest and less volatile in LAC so far this century (2.7 percent on average in 2001-2021). However, in a context of global inflationary pressures, 12-month CPI inflation increased to 6.8 percent in March 2022 due to higher food and oil prices, whereas core inflation rose to 3.5 percent. Against this backdrop, 12-month inflation expectations reached 4.39 percent, above the 1-3 percent target range of the Central Reserve Bank of Peru (BCRP). Other inflation trend indicators are also above the target range. However, inflation is expected to return to the target range between the second and third quarters of 2023, as transitory supply-side effects revert, and economic activity remains below potential.

Credit to the private sector increased 6.5 percent year-on-year as of February 2022, with a strong recovery in consumer loans, as formal employment (which returned to pre-pandemic levels in August) remains on an upward trend.

As of February 2022, the fiscal deficit stood at 2.4 percent of GDP (one of the lowest in LAC), marking 12 consecutive months of decline after the mounting trend associated with COVID-related measures in 2020. The fiscal deficit is expected to decrease to 2.5 percent in 2022, mainly due to higher government revenues (amid economic recovery and improved terms of trade) and lower expenses (as the government phases out the extraordinary measures adopted in response to the health crisis). Public debt as of end-2021 was 36.1 percent of GDP. Going forward, fiscal consolidation will continue, and the deficit is expected to decrease as the economy gradually recovers from the COVID-19 shock.

The current account deficit increased to 2.7 percent of GDP in 2021, similar to the average of the last 40 years. The deficit is forecast to decrease to 1.6 percent of GDP in 2022 and will continue to be sustainable and financed by long-term capital inflows. The trade balance will continue to be in surplus in 2022 (6.7 percent of GDP).

Since August 2021, the BCRP began to increase its policy rate, in line with the normalization of its monetary stance, and has since introduced nine rate hikes, to 4.5 percent currently. The BCRP will continue to take the necessary steps to bring inflation back within the target range over the forecast horizon.

Additionally, the BCRP's FX buffer, built via precautionary accumulation of international reserves, amounts to 35 percent of GDP. Moreover, Peru has access to contingent funds like the USD 11.4-billion Flexible Credit Line agreed 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 policy response was possible as a result of 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 implementation over the past three decades is being validated.

URUGUAY

The Uruguayan economy has recovered rapidly from the COVID-19 shock, underpinned by a successful mass vaccination process—81 percent of the total population had received both doses and 64 percent a third booster shot as of end March 2022—and an effective and timely fiscal and monetary support. After a 5.9 percent contraction in 2020, growth in 2021 was 4.4 percent led by the greater dynamism of industry, agriculture, and commerce and strong growth in both exports and investment. For 2022, the authorities foresee a 3.8 percent increase in real GDP. That said, Uruguay is a small open economy exposed to downside external risks, including higher oil prices and a tightening of global financial conditions, which are considered when designing economic policy.

Economic recovery has been accompanied by the strengthening of the labor market as more than 80 percent of the jobs lost during 2020 were recovered in 2021. Moreover, the number of total unemployment insurance beneficiaries has decreased since May 2021. A new partial unemployment insurance was a very useful tool during the COVID-19 pandemic. It was devised at the onset of the pandemic to provide more flexibility to the unemployment benefit, thus allowing firms to place workers in part-time schedules, avoiding an outright dismissal and enabling them to return to their jobs once activity picks up. The unemployment rate reached 7 percent in December 2021, down 3.6 percent from December 2020 -the lowest since 2017.

As economic activity has recovered, and in a global context of inflationary pressures, the Central Bank has gradually started exiting the expansionary phase of monetary policy to anchor medium-term inflation expectations. The monetary policy rate was raised to 7.25 percent on February 16, the fifth consecutive rate hike since August 2021. Inflation in January 2022 reached 8.15 percent year-on-year. The monetary authorities also anticipated that they would continue with the gradual increase in rates to achieve the convergence of inflation expectations towards the inflation target. Of note, in September 2022 the target band will be narrowed to 3 percent-6 percent (from 3 percent-7 percent).

The financial sector remains sound and resilient. As of end September 2021, the capital structure of financial institutions almost doubled the minimum regulatory requirement. Regarding liquidity risk of the banking system, the ratio of liquid assets to total assets remained at a healthy 60.1 percent. The profitability of banks represented a return on assets of 1.4 percent and a return on equity of 14 percent in the third quarter of 2021. The general delinquency of credit continued to fall, reaching 1.8 percent. Stress tests of the banking system showed that it would withstand a severe recession scenario.

On the fiscal front, throughout 2021 the Government continued responding to the pandemic in a timely, targeted, and responsible way to ensure that measures remained sustainable during the duration of the pandemic. Many of the measures adopted to protect the most vulnerable population and contribute to the recovery of micro, small, and medium-sized enterprises have been extended recently.

At the same time, the authorities took decisive actions to strengthen public finances that had been steadily deteriorating in the years prior to the pandemic. Overall, for a second consecutive year, the three pillars of the fiscal rule were met, that is, the structural balance target, the real spending growth cap, and the legal limit on net indebtedness. Moreover, the fiscal deficit of the Central Government was 4.2 percent of GDP in 2021 (excluding the positive effect of inflows to the Social Security Trust Fund of 0.4 percent of GDP), 1.5 percentage points lower than in 2020, and over-performing the official projection of 4.9 percent. In turn, gross debt of the Central Government stood at 59.6 percent of GDP as of December 2021, while net debt was 55.1 percent of GDP, implying a reduction of 1.7 percent and 1.2 percent of GDP, respectively, from a year ago.

The authorities have continued pursuing a proactive financing strategy that has included disbursements of credit lines from multilateral institutions, as well as bond issuance in both domestic and international markets, mostly in local currency. More than 75 percent of total bond issuance in 2021 (in both domestic and external jurisdictions) was denominated in local currency. Of the total foreign currency bond issuance, approximately 43 percent was in yen and the rest in dollars. In May 2021, Uruguay successfully tapped international capital markets with a debt issuance equivalent to US$1.7 billion, of which almost US$1.2 billion correspond to a new global bond denominated in fixed-rate nominal pesos. More recently, in December 2021, Uruguay made another successful debt issuance, this time in the Japanese Samurai bond market for a total of 50 billion yen across three-to-fifteen-year maturity branches. The authorities remain committed to integrating sustainable finance within the debt management strategy, to harness Uruguay’s strength and progress in environmental, social, and governance (ESG) factors, and climate change policies.