



South America

Argentina

1. General trends

GDP continued to grow briskly during 2005 and the first few months of 2006. In 2005, economic activity was up by 9.2%, thereby surpassing its record 1998 rate. This represented a complete turnaround from the declines registered during the lengthy, deep recession of the late 1990s and early years of the present decade. Although all components of aggregate demand showed a considerable increase in 2005, the star performers were investment (with an investment-to-GDP ratio of 22.2% at current prices in the last quarter — the highest since the series began in 1993) and exports of goods and services. True to the pattern observable since 2003, aggregate consumption climbed significantly, although by less than GDP growth.

The upswing in economic activity continued to drive job creation. The employment rate was high in historical terms, while the unemployment rate fell once more, slipping to just below 10% in the final quarter. Wages in the public sector and informal private sector did no more than keep up with the rise in retail prices, but real wages in the formal private sector rose by 12% for the year as a whole, thereby comfortably regaining the levels reached at the end of 2001. The combination of employment and wage trends helped to lower the country's still high rates of poverty and indigence.

Against a backdrop of booming domestic demand and higher prices for some exportables that are heavily consumed in the domestic market, inflation rose to 12.3% over 2005 as a whole. Inflation trends became the subject of public debate, thereby prompting the government to negotiate price agreements with various production sectors. Measures directly aimed at influencing price formation were reinforced following a change of Minister at the end of 2005. The authorities also placed priority on supplying mass consumer goods to the local market as opposed to exports. As part of this effort, the government raised export duties on dairy products and, in 2006, suspended beef exports.

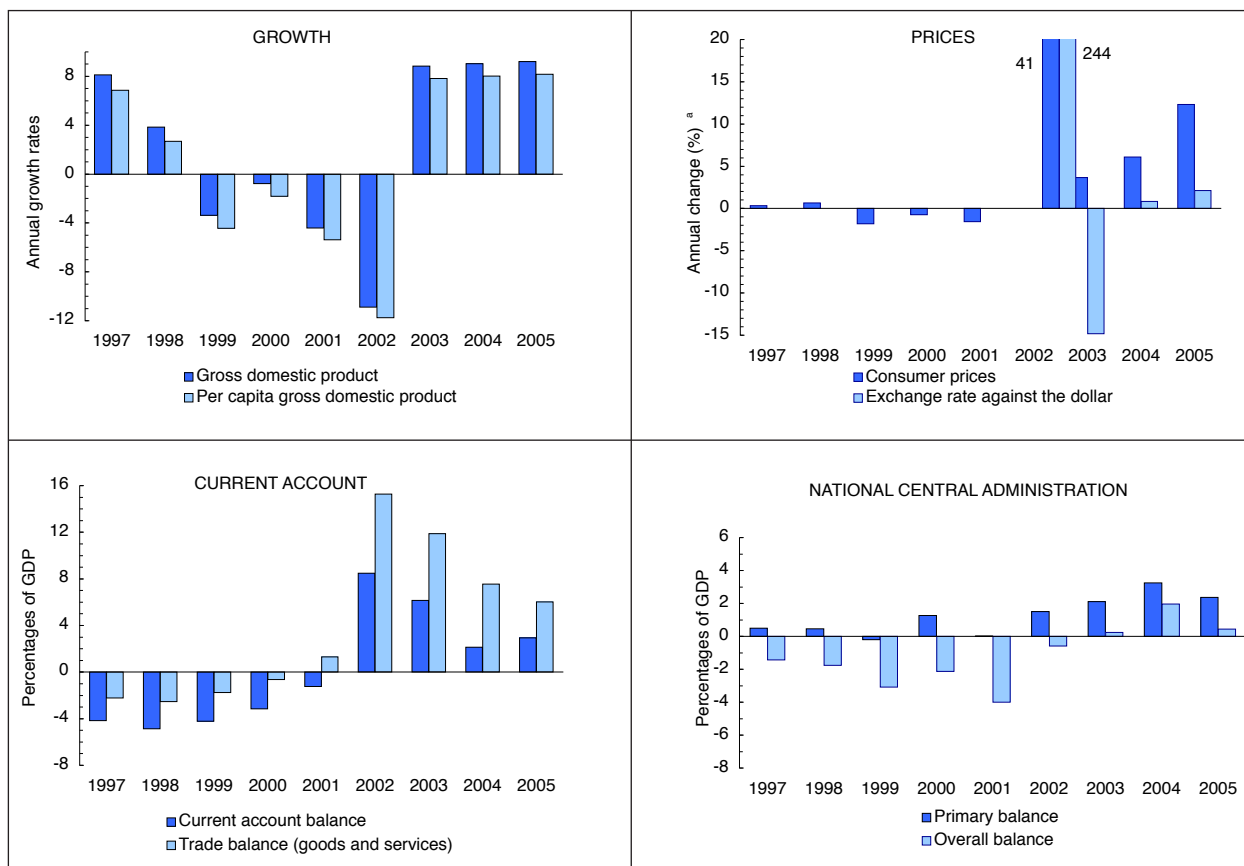
Although merchandise imports posted notable growth, the reduced elasticity of domestic absorption and a steady expansion of export volumes helped maintain a

positive trade balance of around US\$ 13.0 billion in 2005. Export prices remained relatively high and recorded a slight aggregate increase. The current account surplus swelled to US\$ 5.4 billion (around 3% of GDP), mainly thanks to the effect of public debt restructuring on the amount of interest owed on that debt. For the first time since 2000, the capital movements of the non-financial private sector (NFPS) yielded a positive balance of almost 2% of GDP. The oversupply of foreign exchange was absorbed by the central bank with a view to building up reserves and maintaining the exchange rate (in order to prevent the currency from appreciating). The central bank also engaged in domestic operations to sterilize the monetary effects of its interventions in the foreign-exchange market.

The primary surplus of the central government (adjusted using a cash-basis methodology) amounted to 3.7% of GDP, which was a high level in historical terms but nonetheless lower than the previous year. The public accounts of the provinces followed a similar trend, with a primary balance of 0.8% of GDP.

In 2005, the government completed its restructuring of the public debt on which it had defaulted in 2001: in exchange for the US\$ 62 billion worth of bonds (76% of the eligible amount) whose holders accepted the swap offer, slightly over US\$ 35 billion in new debt was issued (in addition to GDP-linked contingency payment

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

obligations). Although the public debt-to-GDP ratio remained high, the swap made it possible to lengthen the debt's maturity profile, increased the proportion of peso-denominated bonds (which are adjusted on the

basis of domestic prices) and considerably reduced the interest burden. In January 2006, the government paid off the whole of its outstanding debt with the International Monetary Fund (IMF).

2. Economic policy

The main traits of macroeconomic policy management included the maintenance of a considerable primary surplus, the country's return to voluntary debt markets after a four-year absence, a build-up of international reserves and the adoption of measures designed to directly influence price formation in response to the significant rise in inflation. Previously, differences of opinion had emerged

between the authorities and the International Monetary Fund (IMF), and the Fund had not been involved in the country's debt restructuring operation. The authorities held subsequent negotiations with the Fund on the possibility of implementing an IMF programme, but no agreement was reached and the government decided to use international reserves to repay its IMF debt ahead of time.

(a) Fiscal policy

In 2005, the national public sector's current resources slightly outpaced nominal GDP growth. National tax receipts swelled by 21.3%, thereby increasing the tax burden by 0.4 percentage points to 22.4% of GDP. Although considerable increases were recorded in revenues from the taxes on financial transactions (23%) and external trade (20%), about three quarters of the rise in receipts was attributable to broad-based taxes (VAT and tax on profits) and social security contributions.

Receipts from taxes on profits and assets as a whole expanded (23%) owing to an increase in income and the maintenance of the minimum income levels subject to taxes in nominal terms. In 2006, the government decided to raise these minimum thresholds, while VAT receipts rose by 19% as a result of higher prices and brisker economic activity. The steady increase in the wage bill in the formal sector and the elimination of ceilings for employer contributions had an impact on social security revenues (29%).

During 2005, NFPS expenditure rose by just over 25%, thereby outpacing the growth in revenues. Primary spending expanded by 21.7%, while debt interest payments surged by 80% owing to the regularization of debt service payments following the bond swap and amounted to 20.1% of GDP (19.6% in 2004). This result reflected transfers made to the provinces under existing revenue-sharing arrangements and to the private sector (in the form of energy and transport subsidies and family allowances), as well as rising capital outlays (73%). Payroll expenditure climbed in step with nominal GDP (19.2%), but social security spending rose by only 9%. In 2006, the government raised minimum pensions by 20% and higher pensions by 11%.

The primary surplus of the National Treasury stood at almost 20 billion pesos in 2005, which was more than enough to cover interest payments and to finance part of the debt payoffs. The provinces posted a significant primary surplus, although its level has been trending downward.

To cover its capital payments, the government issued securities, with much of the demand for this government paper coming from pension funds, trust funds and the Government of the Bolivarian Republic of Venezuela. The debt with the International Monetary Fund (IMF) (US\$ 9.5 billion) was paid off using reserves of the central bank, which received 10-year dollar-denominated bonds in compensation. At the end of 2005, public debt amounted to US\$ 128 billion (about 70% of GDP). This included the outstanding debt with IMF, but did not include the approximately US\$ 23 billion in holdouts, i.e., those that had chosen not to participate in the debt swap.

(b) Monetary policy

The monetary base expanded by nearly 10% in 2005, which was similar to the growth recorded in 2004. This increase reflected a rapid expansion of cash in circulation (29%), which was partly offset by a sharp fall (34%) in commercial bank deposits with the central bank. The comfortable liquidity situation of financial institutions paved the way for an increase in the proportion of holdings in the form of short-term securities issued by the central bank, to the detriment of bank reserves and to passive swap ("pases") operations with the monetary authority.

These operations represented over US\$ 28 billion at the end of 2005. The central bank continued to purchase foreign exchange in the first part of 2006, and this went some way towards reversing the decline in reserves that followed the payment of the country's debt with IMF. Intervention in the foreign-exchange market was the main factor in the monetary base's expansion, while sterilization mechanisms included the central bank's net bond placements, the recovery of rediscounts granted during the financial crisis and public-sector operations. Throughout the reporting period, the central bank continued to raise benchmark interest rates. By the end of 2005, the band for short-term interest rates was between 5% and 6% (i.e. around 2.5 percentage points higher than the year before). This monetary policy stance carried over into the first few months of 2006.

M3 monetary aggregates (money supply plus interest-bearing deposits of the private sector) climbed by just over 25% in 2005, which represents an increase of almost 10 percentage points in real terms. With interest rates remaining low, the expansion of the money supply (M1) jumped by nearly 35%. The level of private interest-bearing deposits climbed by slightly over 15%. The proportion of inflation-adjusted deposits increased, but remained below 10%, while official deposits expanded by around 19% in line with total deposits.

Bank loans increased by almost 12% in 2005. Credit to the public sector shrank by a quarter, while private-sector credit trended upward by 33% (although the latter has only just surpassed 10% of GDP following the sharp decline recorded at the beginning of the decade). The increase in financing for the private sector encompasses various types of operations, with a particularly strong upswing being seen in consumer loans. Towards the end of 2005, as various types of interest rates edged upward in step with benchmark rates, nominal yields on 30-day deposits rose to almost 4.7% (almost two percentage points higher than in 2004), while average rates on advances and discounts fluctuated between 11% and 18%.

Public bond market prices continued to trend upward, bond yields thus declined relative to similar bonds in the

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0	9.2
Per capita gross domestic product	6.9	2.7	-4.4	-1.8	-5.4	-11.7	7.8	8.0	8.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	0.5	8.7	2.5	-1.7	1.1	-2.3	6.9	-1.5	11.2
Mining	0.7	-3.8	-3.3	6.7	4.7	-3.7	3.7	-0.4	-0.7
Manufacturing	9.2	1.8	-7.9	-3.8	-7.4	-11.0	16.0	12.0	7.7
Electricity, gas and water	8.2	7.6	3.6	6.6	1.1	-3.0	6.9	6.5	5.0
Construction	16.6	8.7	-7.9	-9.3	-11.6	-33.4	34.4	29.4	20.4
Wholesale and retail commerce, restaurants and hotels	10.9	3.4	-6.9	-2.4	-7.8	-16.8	11.7	12.4	9.6
Transport, storage and communications	11.2	8.9	-1.3	1.7	-4.6	-7.9	8.2	13.4	14.8
Financial institutions, insurance, real estate and business services	7.3	7.0	-0.5	1.3	-4.4	-9.6	-1.1	2.2	7.0
Community, social and personal services	4.0	1.5	1.9	1.7	-0.1	-3.3	2.8	4.4	5.6
Gross domestic product, by type of expenditure									
Consumption	8.1	3.5	-1.3	-0.5	-5.2	-12.8	7.0	8.3	8.5
General government	3.2	3.4	2.6	0.6	-2.1	-5.1	1.5	2.7	6.2
Private	9.0	3.5	-2.0	-0.7	-5.7	-14.4	8.2	9.5	8.9
Gross domestic investment	17.7	6.5	-12.6	-6.8	-15.7	-36.4	38.2	34.4	22.7
Exports (goods and services)	12.2	10.6	-1.3	2.7	2.7	3.1	6.0	8.1	13.8
Imports (goods and services)	26.9	8.4	-11.3	-0.2	-13.9	-50.1	37.6	40.1	20.3
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	20.9	21.0	17.9	17.5	15.6	11.0	14.6	19.0	21.2
National saving	16.7	16.1	13.7	14.4	14.4	19.5	20.8	21.1	24.2
External saving	4.2	4.9	4.2	3.2	1.2	-8.5	-6.2	-2.1	-2.9
	Millions of dollars								
Balance of payments									
Current account balance	-12 219	-14 510	-11 948	-8 981	-3 291	8 668	7 982	3 278	5 407
Merchandise trade balance	-2 123	-3 097	-795	2 452	7 385	17 178	16 805	13 239	12 714
Exports, f.o.b.	26 431	26 434	23 309	26 341	26 543	25 651	29 939	34 550	40 013
Imports, f.o.b.	28 554	29 531	24 103	23 889	19 158	8 473	13 134	21 311	27 300
Services trade balance	-4 408	-4 490	-4 151	-4 284	-3 863	-1 590	-1 397	-1 666	-1 666
Income balance	-6 203	-7 387	-7 456	-7 548	-7 237	-7 484	-7 970	-8 922	-6 312
Net current transfers	515	465	454	399	424	564	545	627	671
Capital and financial balance ^d	15 549	18 600	13 960	7 763	-18 168	-22 059	-17 019	-10 230	2 312
Net foreign direct investment	5 507	4 965	22 257	9 517	2 005	2 776	878	3 832	3 505
Financial capital ^e	10 042	13 635	-8 297	-1 755	-20 173	-24 835	-17 897	-14 062	-1 193
Overall balance	3 331	4 090	2 013	-1 218	-21 459	-13 391	-9 037	-6 952	7 718
Variation in reserve assets ^f	-3 293	-3 436	-1 186	439	12 083	4 516	-3 581	-5 319	-8 857
Other financing ^g	-38	-654	-826	778	9 376	8 876	12 618	12 271	1 139
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	112.7	108.8	99.6	100.0	95.6	221.9	204.8	214.9	215.4
Terms of trade for goods (index: 2000=100)	102.2	96.6	90.9	100.0	99.3	98.7	107.2	109.2	106.9
Net resource transfer (percentage of GDP)	3.2	3.5	2.0	0.3	-6.0	-20.3	-9.5	-4.5	-1.6
Total gross external debt (billions of dollars)	130	148	153	155	166	157	165	171	114
Total gross external debt (percentage of GDP)	44.4	49.4	53.8	54.5	61.8	153.6	127.0	111.7	61.9
Net profits and interest (percentage of exports) ⁱ	-20.0	-23.7	-26.7	-24.1	-23.2	-25.9	-23.3	-22.4	-13.6
	Average annual rates								
Employment									
Labour force participation rate ^j	42.2	42.2	42.6	42.6	42.5	42.4	45.7	45.9	45.7
Unemployment rate ^k	14.9	12.9	14.3	15.1	17.4	19.7	17.3	13.6	11.6
Visible underemployment rate ^k	13.2	13.5	14.3	14.6	15.6	19.3	17.1	15.1	12.6
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	0.3	0.7	-1.8	-0.7	-1.5	41.0	3.7	6.1	12.3
Variation in wholesale prices (December-December)	-0.9	-6.3	1.2	2.4	-3.4	113.7	2.0	7.9	10.6
Variation in nominal exchange rate (December-December)	0.0	0.0	0.0	0.0	0.0	243.7	-14.8	0.8	2.1
Variation in average real wage	0.3	0.0	2.9	2.3	-0.8	-13.9	-1.9	10.0	6.1
Nominal deposit rate ^l	7.0	7.6	8.3	8.5	16.3	39.3	10.5	2.7	3.9
Nominal lending rate ^m	9.2	10.6	11.0	11.1	26.5	53.0	19.1	6.8	6.2

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
National central administration									
Total income	14.0	13.8	14.1	15.2	14.3	14.2	16.1	16.3	17.0
Current income	13.7	13.7	14.0	15.0	14.2	14.1	16.1	16.2	16.8
Tax revenue	1.1	3.0	4.4	6.7	7.8	6.7	5.9	5.8	5.0
Capital income	0.3	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.2
Total expenditure	15.4	15.5	17.1	17.3	18.3	14.8	15.9	14.4	16.6
Current expenditure	14.1	14.2	15.8	16.3	17.4	14.1	15.1	12.9	14.6
Interest	1.9	2.2	2.9	3.4	4.0	2.1	1.9	1.3	1.9
Capital expenditure	1.3	1.3	1.3	1.1	0.9	0.7	0.8	1.5	2.0
Primary balance	0.5	0.5	-0.2	1.3	0.0	1.5	2.1	3.2	2.4
Overall balance	-1.4	-1.8	-3.1	-2.1	-4.0	-0.6	0.2	2.0	0.4
National government debt									
Domestic	9.6	10.4	13.9	16.4	22.3	52.1	58.2	54.4	...
External	24.9	27.1	29.1	28.6	31.5	93.7	80.0	72.0	...
Money and creditⁿ									
Domestic credit ^o	23.1	26.3	29.9	31.0	33.2	41.1	36.8	32.1	26.3
To the public sector	9.8	10.2	11.4	12.2	16.3	42.5	39.8	36.3	30.5
To the private sector	20.1	22.7	25.0	24.2	23.0	16.7	11.5	9.6	10.0
Other	-6.9	-6.6	-6.6	-5.4	-6.2	-18.2	-14.5	-13.8	-14.3
Liquidity (M3)	21.5	25.0	28.4	29.2	29.0	20.6	21.4	21.9	22.7
Currency in circulation and local-currency deposits (M2)	11.5	12.7	13.3	12.9	11.5	18.7	20.5	20.4	21.1
Foreign-currency deposits	10.0	12.3	15.0	16.3	17.5	1.9	0.9	1.4	1.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1993 prices. ^c Based on figures in local currency expressed in dollars at current prices. Gross domestic investment does not include changes in stocks. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^j Economically active population as a percentage of the total population in urban areas. ^k Unemployment and underemployment rates as percentages of the economically active population, urban areas. ^l Fixed-term deposits, all maturities. ^m 30-day loans to leading firms. ⁿ The monetary figures are annual averages. ^o Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

United States. The implicit interest rate premium on bonds maturing in 2012 was around 430 basis points at the end of 2005, which represents a 200-point reduction in 12

months. Share prices rose further during the year. In mid-2006, the increase in long-term rates in the United States was having an impact on bond and equity markets.

3. The main variables

(a) Economic activity

GDP grew by more than 9% in 2005, and the aggregate activity indicator posted a year-on-year increase of around 8.5% in the first quarter of 2006. Although domestic absorption components were buoyant in 2005, export volumes also made a significant contribution to growth by posting a double-digit expansion (13.8%) for the first time in eight years. The ratio of consumption to GDP at constant prices (78%) remained below the levels of the 1990s; in fact, the domestic savings ratio was almost three percentage points higher than the cyclical peak reached

in 1998. As a result of relative price variations, at current values the ratio (26.8%) was more than eight percentage points higher than in 1998.

Thanks to the positive result in savings, the increase in capital formation (22.7%) was financed out of domestic resources. Investment was fuelled by construction (20.5%) and durable equipment (26.5%), particularly the increase in imported machinery (35.6%). In the fourth quarter of 2005, the investment-to-GDP ratio surpassed the 1997 level, which was the record high for the 1990s, both in terms of current values (almost four percentage points higher, at 24%) and constant prices (22.2%, half a percentage

Table 2
ARGENTINA: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	11.3	7.1	8.7	9.3	8.0	10.4	9.2	9.0	8.6	...
Merchandise exports, f.o.b. (millions of dollars)	7 374	9 379	8 960	8 837	8 423	10 599	10 843	10 149	9 730	...
Merchandise imports, c.i.f. (millions of dollars)	4 662	5 482	6 027	6 274	5 966	7 579	7 442	7 705	7 374	...
International reserves (millions of dollars)	14 627	16 926	17 501	18 884	19 587	22 285	24 783	27 179	20 525	23 027 ^c
Real effective exchange rate (index: 2000=100) ^d	215.5	208.3	215.5	220.4	217.2	214.0	213.1	217.1	220.8	220.6
Open unemployment rate	14.4	14.8	13.2	12.1	13.0	12.1	11.1	10.1	11.4	...
Consumer prices (12-month percentage variation)	2.3	4.9	5.9	6.1	9.1	9.0	10.3	12.3	11.1	11.0
Average nominal exchange rate (pesos per dollar)	2.89	2.88	2.98	2.94	2.93	2.89	2.89	2.98	3.06	3.07
Average real wage (variation from same quarter of preceding year)	16.0	13.9	7.8	3.9	1.8	2.9	9.2	10.2	8.1	...
Nominal interest rates (annualized percentages)										
Deposit rate ^e	2.5	2.4	2.8	3.1	2.9	3.7	4.3	4.8	5.7	6.6
Lending rate ^f	9.1	6.3	5.9	5.8	5.5	6.0	6.4	6.7	7.5	8.3
Interbank interest rate ^g	1.4	2.3	2.5	2.4	2.3	3.4	4.7	5.5	6.7	6.7
Sovereign bond spread (basis points)	4 873	5 188	5 440	4 703	5 393	462	349	504	344	385
Stock price index (in dollars, December 2000=100)	87.3	69.7	88.1	97.4	107.8	114.6	163.4	140.3	172.2	177.7
Domestic credit (variation from same quarter of preceding year) ^h	7.2	5.8	0.3	2.6	0.2	-3.8	-5.6	-9.2	-9.6	-7.5 ^c
Non-performing loans as a percentage of total credit ⁱ	10.4	10.1	9.4	8.2	7.1	6.1	5.2	3.9	3.6	3.5 ^c

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1993 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e Fixed-term deposits, all maturities. ^f 30-day loans to leading firms. ^g Buenos Aires interbank offered rate (BAIBOR). ^h Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ⁱ Refers to total credit extended by the banking system.

point higher). Although investment in durable equipment at constant prices did not match the previous record of 9.2% (for the final quarter of 1997), it nonetheless did reach nearly 8.4% of GDP.

In a context of across-the-board expansion, goods-producing sectors once again expanded more (10.1%) than services (8.2%), although the difference between these two sectors' growth rates narrowed. In goods production, noteworthy performances were turned in by agriculture (11.9%) and construction (20.4%). As for services, transport and communications fared well (14.8%), as did financial intermediation (17.4%), which increased for the first time since the end of the convertibility regime. Manufacturing growth (7.7%) was a little less than aggregate GDP, while mining and minerals declined slightly (-0.7%).

Despite the small size of the increase in the area under crops (2%), grain production in the 2004/2005 growing season soared by 25% to a record level of over 85 million tons. This was attributable to all-time record wheat, maize and soybean harvests. The reduction in the area under cereal crops (especially wheat and maize) is expected to bring down output for the 2005/2006 growing season. In contrast, there was an increase in the areas sown with oilseed crops (particularly sunflowers and soybeans).

Steady growth in external demand for beef pushed up domestic prices against the backdrop of a reduction in the number of animals slaughtered, a slight increase in meat production and an upswing in domestic consumption. In 2005, the year-on-year increase in farmgate cattle prices amounted to nearly 20%, while consumer beef prices

soared by almost 30%. The government attempted to negotiate price agreements with organizations in the sector and, in the face of continuing price increases, in March 2006 decided to suspend sales abroad for 180 days (with the exception of those covered by country-to-country agreements and exports to the European Union — under the Hilton Quota). Towards the end of May, the moratorium was converted into a quantitative restriction, under which exports were limited to 40% of the volume of the previous year.

Crude petroleum production dropped again in 2005. Natural gas output also fell, for the first time since 2002. Lagging investment in hydrocarbon production was an issue of public concern. In the light of increased demand for energy and dwindling hydrocarbon reserves, the policy governing the supply of natural gas (which represents a considerable proportion of the energy matrix), including the gas that Argentina purchases from Bolivia, and the expansion and diversification of primary energy sources were all issues on an agenda that remains open to debate.

In 2005, industrial output reached a new record as it rose for the third consecutive year, this time by almost 8%. Although the increase was more widespread across the various sectors this time around, certain activities nonetheless stood out, such as the automotive industry (26.7%) and non-metallic mineral products (14.4%) used in construction. This industrial buoyancy was accompanied by no more than a slight rise in the use of installed capacity, which attests to the fact that several sectors have increased their productive potential.

Construction continued to boom, thanks to both public works and private building projects. There was also considerable demand for housing, which was reflected in fresh increases in real estate prices.

(b) Prices, wages and employment

The rate of price increases picked up speed in 2005, pushing up the consumer price index (CPI) to 12.3%. In the first four months of 2006, the CPI increased by around 1% per month. Throughout the year, price increases were recorded for certain domestically consumed exportables such as fresh beef (almost 30%), dairy products (17.1%) and fish and seafood (18.1%). The price index (which does not include seasonal items or goods whose prices are regulated) climbed by an above-average 14.1%. Particularly strong increases were seen in private services (16.5%), probably as a result of the surge in domestic demand.

The strategy for controlling inflation became a key issue on the economic policy agenda and in public debate. The government promoted the conclusion of agreements with major producers and distribution agents, raised duties, and reduced or eliminated drawback facilities for exports of certain domestically consumed goods.

The price of the dollar did not change significantly, as the government implemented a policy aimed at stabilizing the price of foreign exchange in order to maintain the economy's external competitiveness. The real appreciation of the dollar was consequently a mere 3.2% in terms of the multilateral exchange rate.

Against a backdrop of strengthening labour demand, real wages rose (especially in the formal private sector). In the first few months of 2006, wage negotiations resulted in the issuance of informal guidelines by the authorities indicating that wage hikes should be held to around 19% for the year as a whole; subsequent wage increases were generally in line with those recommendations. Wage increases in the public sector and informal private sector were generally in line with the rise in retail prices.

Towards the end of 2005, the urban employment rate (41.3%) was almost one percentage point higher than it had been a year earlier. The increase in employment took place across all sectors and geographical areas, thereby bringing down the unemployment rate by two percentage points in the fourth quarter compared to the final quarter of 2004. Although the unemployment rate rises from 10.1% to 11.4% if calculations include people working for State employment programmes and those actively seeking employment, the latter figure is still three percentage points lower than one year before.

(c) The external sector

In 2005, the current account surplus stood at slightly over 2.9 points of GDP. This was US\$ 2.2 billion more than in 2004, as the effects of the debt swap were taken into account from the second quarter of 2005.¹ The trade deficit remained about as large as it was in 2004, while the income account deficit narrowed by almost US\$ 2.6 billion, partly as a result of the reduction in interest obligations (almost US\$ 3.5 billion) and partly due to the US\$ 900 million increase in the deficit recorded under the heading of profit remittances and dividends.

A surplus of US\$ 2.3 billion (1.5% of GDP) was posted on the capital and financial account. The increase of almost US\$ 1 billion in this balance is mainly attributable to the

¹ Until the debt-swap operation of 2005, balance-of-payments figures included the total interest owed on government debts in default since 2001 in the income account. From the second quarter of 2005, the figures take into account interest on the regularized debt, without including interest corresponding to securities not included in the swap.

performance of the non-financial private sector which, following four years of narrowing deficits, recorded almost US\$ 3.5 billion (1.9% of GDP) in net income. This surplus was partly offset by a smaller positive balance for the public sector's aggregate account due to higher net payments to IMF and a sharp decline in involuntary financing (arrears). Foreign direct investment was up by nearly 9% on the previous year.

Merchandise exports topped US\$ 40 billion in 2005 (up by 16%), thanks to a 15% rise in volumes sold and a 1% price increase. Although patterns varied in terms of volume and price, all major categories expanded considerably. In primary products (+16%) and agriculturally-based manufactures (+10%), volumes showed a strong increase while prices fell. Industrial manufactures (+25%) saw a rise in both volumes and prices, while higher fuel sales (+11%) were attributable to a price hike that more than

offset shrinking volumes. From a geographical standpoint, MERCOSUR lost some export share (from 19.6% to 19.2%) in favour of China, East Asia, India and the rest of Latin America.

In 2005, merchandise imports (US\$ 28.7 billion) expanded significantly (+28%), although this growth rate was, nonetheless, much lower than the +61% registered in 2004. Increases were most striking in fuels (+54%), where they were attributable to higher international prices, and in capital goods (+33%), where they were attributable to increased volumes. The rise in purchases of intermediate goods (+20%) is largely the result of higher prices. In geographical terms, the share accounted for by MERCOSUR expanded once again, this time to just over 38%, while the shares of the North American Free Trade Agreement (NAFTA) and the European Union decreased to just under 17% in each case.

Bolivarian Republic of Venezuela

1. General trends

In 2005, the Bolivarian Republic of Venezuela recorded GDP growth of 9.3%. The economy's expansion was driven by non-oil activities (10.3%), whereas the petroleum sector showed no more than a slight increase (1.7%). All sectors registered rises, with the highest rates being observed in the financial sector (30.8%), construction (20.1%), commerce (19.5%) and communications (19.8%). On the demand side, the components that showed the strongest growth were investment (20.5%) and private consumption (16.3%).

GDP thus marked up a 29% cumulative increase over the 2003 figure, in contrast to the 16% slump experienced in 2002-2003 compared with 2001. Although GDP, measured at 1997 prices, was higher than it was in 2001, some sectors still remain below their 2001 levels; the petroleum and construction sectors, for example, were 4% and 12% lower, respectively. Gross fixed capital formation is still 2% lower than the 2001 figure,¹ despite strong growth in 2004 and 2005. Despite a surge in merchandise imports, the strong export earnings made possible by buoyant oil prices on international markets resulted in a substantial current account surplus in 2005 (equivalent to 20.1% of GDP, in current dollars).²

Economic growth was reflected in a reduction in total unemployment and a recovery in real wages. High oil prices, combined with more efficient tax collection, generated a significant increase in fiscal revenues, enabling authorities to maintain and, indeed, step up their social action programmes. These programmes, which are known as "missions", target mainly poor or

extremely poor sectors and focus primarily on the areas of health, education and employment.

In December 2005, the Bolivarian Republic of Venezuela was admitted to MERCOSUR as a non-voting member, and in April 2006 the country announced its intention to withdraw from the Andean Community of Nations (CAN). Nevertheless, in accordance with its commitments under CAN, it is bound to maintain existing tariffs with the other member countries of this group for the next five years. In May 2006, the country announced its withdrawal from the Group of Three (G-3), to which it had belonged together with Mexico and Colombia.

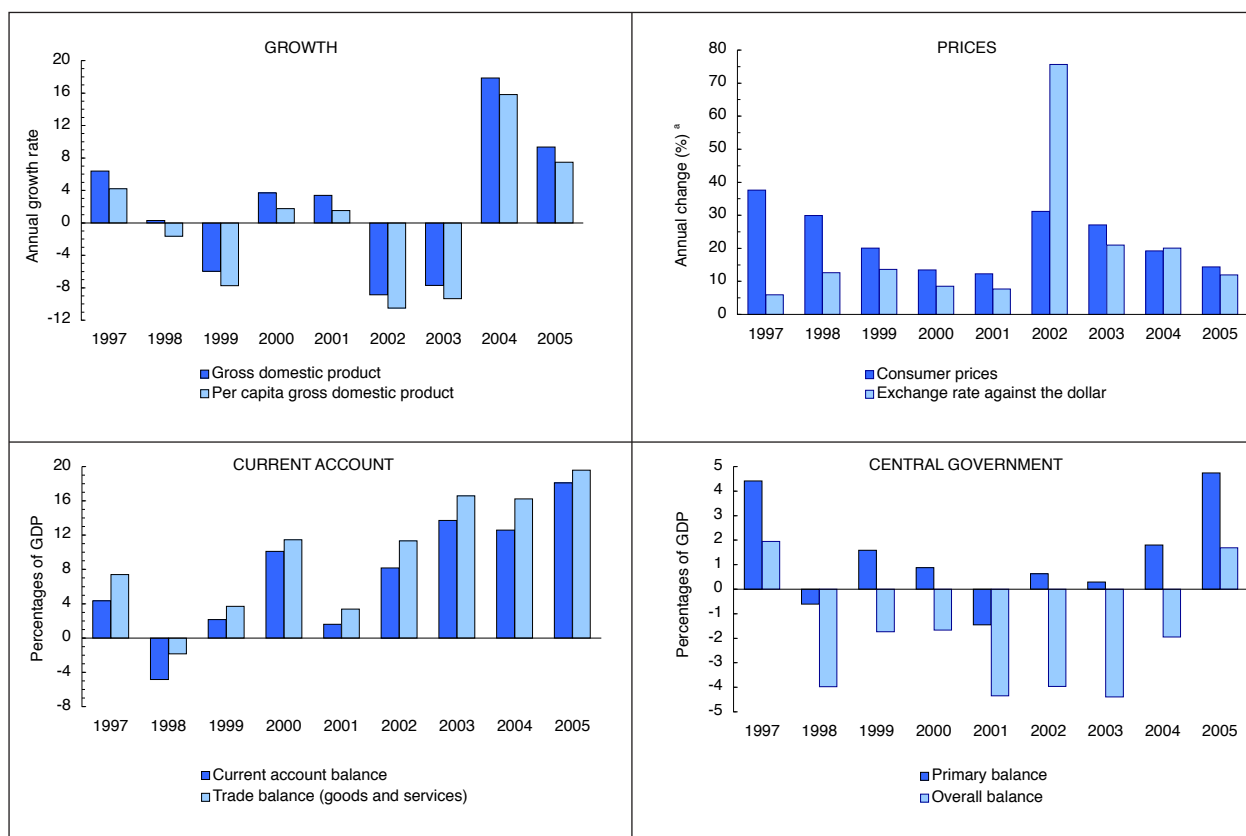
The trends observed in 2005 have continued into 2006. In the first quarter of 2006, economic activity recorded a 9.4% rise over the first quarter of 2005, and growth for the year as a whole is projected at between 7% and 8%; average annual inflation is expected to stand at 12%, and the exchange rate is likely to remain at 2,150 bolívares = US\$ 1.

Presidential elections are scheduled for December 2006.

¹ A nation-wide general strike that lasted from December 2002 to February 2003 brought the economy to a standstill, driving down the country's GDP in those two years.

² In 2005, the average annual price of the Venezuelan basket of crude increased by 37% over the 2004 average. In 2006, the average price for January-May was 23.9% (US\$ 56 per barrel) higher than it was in 2005.

Figure 1
BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
^a December-December variation.

2. Economic policy

(a) Fiscal policy

During 2005, the authorities maintained a clearly expansionary fiscal policy, which they implemented primarily through current and capital transfers to public agencies. In nominal terms, the central government's total public expenditure expanded by 43% over its 2004 level; nevertheless, the financial balance showed a surplus equivalent to 1.7% of GDP owing to a strong increase in revenues (63.9%). Even though the VAT rate was lowered from 15% to 14% in October 2005, tax revenues were up by 72.1% thanks to a steep rise in proceeds from the tax on petroleum earnings (193.4%), an upswing in receipts from the tax on bank debits (43%) and the higher foreign-exchange gains paid over to the government by

the central bank (113%). In addition, measures aimed at reducing tax evasion helped to increase the collection of VAT and other taxes. Yet another factor was the overall rise in the prices of goods and services subject to excise taxes. Despite skyrocketing petroleum prices, oil revenues still account for about 50% of the government's total income because receipts from other sources have also climbed. In 2005, the total expenditure of the budgetary central government was similar to the 2004 level (26.9% of GDP), while its total revenue rose to 28.6% (up from 24.6% in 2004).

The Hydrocarbons Act, which entered into force in early 2005, altered the tax rates and royalties charged under existing operating agreements in the petroleum sector. Royalties were raised from 1% to 16.66% of

the value of extracted crude oil, while the profits tax rate was increased from 35% to 50%. In April 2005, the government announced that all companies working under the terms of operating agreements would have to become joint ventures with PDVSA, with the latter holding more than 50% of the stock. The State paid for its shares with restricted government bonds. In May 2006, the government announced the introduction of a new levy on crude oil extraction (33.3% of the well-head value of crude). As a result of this measure's implementation, all oil companies operating in the country will be paying the same royalty rate. In February 2006, the government suspended collection of the tax on bank debits.

In 2005 and 2006, the government has been using dollars to invest in foreign bonds³ (most of which it then sells to national financial institutions), as well as setting up foreign-currency funds abroad and pursuing an ambitious programme to reschedule foreign debts with a view to obtaining longer terms and lower rates. In addition, it has restructured domestic debt so as to improve the yield curve of government bonds. During the first half of 2006, the government invested close to US\$ 4.4 billion in the repurchase of all its outstanding Brady bonds.

During 2005, the government continued to issue bonds denominated in dollars but payable in bolívars. These bond issues, together with the sale of Argentine bonds, has enabled it to offer domestic agents financial instruments that will help move capital out of the country and absorb bolívars in the local market.

(b) Monetary policy

One of the major challenges facing the economic authorities in 2005 and 2006 has been how to handle the steadily rising level of domestic liquidity, which is being driven up by the country's voluminous foreign-exchange earnings from oil exports, as well as by the sharp increase in fiscal spending.

Although monetary policy has allowed for the expansion of monetary aggregates, the central bank has continued to intervene in the market in an attempt to mop up excess liquidity. Up to April 2006, the bank had issued certificates of deposit equivalent to approximately 1.4

times the monetary base. In December 2005, broad money (M3) was 52.7% higher than it had been in December 2004. The increase in monetary aggregates has moderated in 2006, however, and as of April, M3 had accumulated a 10% rise relative to December 2005.

During 2005, deposits in the banking system increased by 35% (sight and savings deposits expanded by 60% and 65%, respectively), while bank credit to the private sector rose by 40.8%. The authorities have set minimum limits for the shares of bank credit to be allotted to specific sectors. The mandated allotments are: 16% to the agricultural sector, 10% for mortgage loans, 3% for microfinance and 2.5% to the tourism sector.

The maximum and minimum limits on lending and deposit rates set by the governing council of the central bank entered into force on 1 May 2005. Restrictions were also placed on banking commissions.⁴ In 2005, the average lending and deposit rates of the six main commercial banks stood at 16.43% and 6.5%, respectively; at the end of May 2006, these rates were on the order of 15% and 6.83%, respectively.

The central banks' assets/liabilities position and its performance have been influenced by the quantitative and qualitative expansion of the types of operations it carries out and by changes in rules and policies applied for handling such items as foreign exchange. Thus, for example, in addition to stepping up its implementation of absorption policies, the central bank has transferred substantial amounts of funds drawn from its international reserves and foreign-exchange gains to the public sector. This has resulted in a negative operating balance for the first four months of 2006 and makes it difficult to interpret or assess the balance-sheet items.

In July 2005, the National Assembly adopted the Central Bank of Venezuela Act, under which *Petróleos de Venezuela S.A.* (PDVSA) is no longer obliged to sell all of its dollars to this institution; now, it need only sell as much as is needed to cover its commitments in bolívars;⁵ the remainder is to be used to capitalize the National Development Fund (FONDEN), which was created in 2005. In addition, under a temporary article included in the Act, the central bank made a one-time US\$ 6 billion transfer to the Executive branch from

³ From May 2005 to April 2006, the Venezuelan Government invested US\$ 2.29 billion in Argentine government bonds (US\$ 1.99 billion in 12-year bonds and US\$ 300 million in 15-year bonds). It then sold US\$ 1.469 billion worth of these securities to local financial institutions, bringing the government's effective portfolio as of the end of April 2006 to approximately US\$ 821 million. The government has also invested US\$ 25 million in Ecuadorian government bonds. In May 2006, it was announced that the Argentine Government would be selling US\$ 239 million in 12-year bonds to Venezuela at market value.

⁴ A maximum of 28% in the case of loans and a minimum of 6.56% and 10% for savings and time deposits, respectively.

⁵ In addition, the authorities made changes in the Macroeconomic Stabilization Fund (FEM) and created the Treasury Bank, a public financial institution which is now in the initial stage of its operations.

Table 1
BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	6.4	0.3	-6.0	3.7	3.4	-8.9	-7.7	17.9	9.3
Per capita gross domestic product	4.2	-1.6	-7.8	1.8	1.5	-10.5	-9.3	15.8	7.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.4	3.5	1.9	6.5	2.0	-0.8	-1.8	...	...
Mining	9.8	0.6	-6.4	2.4	2.6	-12.9	-0.5	...	...
Manufacturing	5.1	-1.7	-7.3	4.8	0.3	-13.7	-7.6	25.4	9.1
Electricity, gas and water	4.7	0.5	-2.2	4.7	4.8	2.1	-0.5	6.9	8.5
Construction	17.2	1.4	-17.4	4.0	13.5	-8.4	-39.5	32.1	20.1
Wholesale and retail commerce, restaurants and hotels	4.1	-1.3	-5.3	4.8	4.2	-12.4	-9.6	26.4	12.9 ^c
Transport, storage and communications	9.0	-0.1	-7.5	7.6	2.8	-4.4	-6.5	18.3	16.1
Financial institutions, insurance, real estate and business services	3.0	0.6	-6.7	0.5	3.4	-3.1	-4.6	12.5	11.2
Community, social and personal services	-0.5	-0.4	-3.9	2.2	2.4	-0.2	3.4	14.8	6.9
Gross domestic product, by type of expenditure									
Consumption	5.0	0.8	-2.9	4.6	6.2	-6.2	-2.5	16.0	14.5
General government	4.2	-3.1	-7.5	4.2	6.9	-2.5	5.7	13.9	7.5
Private	5.1	1.8	-1.7	4.7	6.0	-7.1	-4.6	16.6	16.3
Gross domestic investment	34.0	4.4	-10.6	6.7	13.6	-34.0	-34.0	89.8	20.5
Exports (goods and services)	9.4	3.5	-11.0	5.8	-3.5	-4.0	-9.9	11.8	5.2
Imports (goods and services)	33.9	11.3	-9.3	12.4	14.1	-25.2	-19.6	60.0	30.0
	Percentages of GDP								
Investment and saving^d									
Gross domestic investment	27.7	30.7	26.5	24.2	27.5	21.2	15.6	21.5	21.7
National saving	32.0	25.8	28.7	34.3	29.1	29.3	29.3	34.1	39.7
External saving	-4.3	4.9	-2.2	-10.1	-1.6	-8.2	-13.7	-12.6	-18.1
	Millions of dollars								
Balance of payments									
Current account balance	3 732	-4 432	2 112	11 853	1 987	7 599	11 448	13 830	25 359
Merchandise trade balance	8 954	952	6 471	16 664	7 460	13 421	16 483	21 430	31 532
Exports, f.o.b.	23 871	17 707	20 963	33 529	26 667	26 781	27 170	38 748	55 487
Imports, f.o.b.	14 917	16 755	14 492	16 865	19 207	13 360	10 687	17 318	23 955
Services trade balance	-2 608	-2 649	-2 839	-3 253	-3 305	-2 909	-2 644	-3 626	-4 082
Income balance	-2 517	-2 534	-1 453	-1 388	-2 020	-2 756	-2 411	-3 885	-1 984
Net current transfers	-97	-201	-67	-170	-148	-157	20	-89	-107
Capital and financial balance ^e	-638	1 027	-1 054	-5 895	-3 818	-12 026	-6 005	-11 932	-19 902
Net foreign direct investment	5 645	3 942	2 018	4 180	3 479	-244	1 341	1 866	1 497
Financial capital ^f	-6 283	-2 915	-3 072	-10 075	-7 297	-11 782	-7 346	-13 798	-21 399
Overall balance	3 094	-3 405	1 058	5 958	-1 831	-4 427	5 443	1 898	5 457
Variation in reserve assets ^g	-2 643	3 853	-608	-5 449	2 028	4 427	-5 454	-1 898	-5 457
Other financing ^h	-452	-448	-450	-508	-197	0	11	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ⁱ	141.4	116.5	102.6	100.0	95.2	123.7	136.8	143.2	143.4
Terms of trade for goods (index: 2000=100)	70.1	51.2	66.1	100.0	82.2	87.6	98.7	118.1	154.4
Net resource transfer (percentage of GDP)	-4.2	-2.1	-3.0	-6.7	-4.9	-15.9	-10.1	-14.4	-15.6
Total gross external debt (millions of dollars)	37 242	35 087	37 016	36 437	35 398	35 460	39 672	44 546	47 233
Total gross external debt (percentage of GDP)	43.4	38.4	37.8	31.1	28.8	38.2	47.5	40.6	33.7
Net profits and interest (percentage of exports) ^j	-10.0	-13.2	-6.5	-4.0	-7.2	-9.9	-8.6	-9.8	-3.5
	Average annual rates								
Employment									
Labour force participation rate ^k	63.8	65.1	66.3	64.6	66.5	68.7	69.2	68.5	66.2
Open unemployment rate ^l	11.4	11.3	15.0	13.9	13.3	15.8	18.0	15.3	12.4
Sector informal ^m	47.7	49.8	52.4	53.0	50.3	51.0	52.6	49.8	47.3
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	37.6	29.9	20.0	13.4	12.3	31.2	27.1	19.2	14.4
Variation in wholesale prices (December-December)	17.3	23.3	13.6	15.8	10.2	49.4	48.4	23.1	14.2
Variation in nominal exchange rate (December-December)	5.9	12.6	13.6	8.5	7.7	75.6	21.0	20.0	11.9
Variation in average real wage	25.6	5.4	-4.6	1.5	2.4	-10.1	-16.7	-3.9	0.1
Nominal deposit rate ⁿ	14.5	36.2	20.6	14.9	14.7	28.8	17.2	12.6	11.7
Nominal lending rate ^o	22.0	45.3	31.3	24.5	24.8	38.4	25.7	17.3	15.6

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Central government									
Total income	23.8	17.4	18.0	20.2	20.8	22.2	23.4	24.6	28.6
Current income	23.8	17.4	18.0	20.2	20.8	22.2	23.4	24.6	28.6
Tax revenue	17.5	12.2	13.0	12.9	11.4	10.6	11.3	13.0	15.8
Total expenditure ^p	21.9	21.4	19.8	21.8	25.1	26.1	27.8	26.5	26.9
Current expenditure	17.4	16.7	16.4	17.5	19.3	19.1	20.8	20.1	19.7
Interest	2.5	3.4	3.3	2.5	2.9	4.6	4.7	3.7	3.1
Capital expenditure	3.1	4.0	3.0	3.3	4.4	5.1	5.5	5.2	6.0
Primary balance	4.4	-1.4	1.0	0.9	-1.5	0.6	0.3	1.8	4.7
Overall balance	2.0	-4.0	-1.7	-1.7	-4.4	-4.0	-4.4	-1.9	1.7
Public debt	31.4	30.1	29.0	27.3	30.4	39.0	47.4	39.3	33.7
Domestic	5.1	4.6	6.0	8.8	12.1	14.8	17.7	14.2	11.4
External	26.3	25.5	23.1	18.6	18.3	24.3	29.7	25.0	22.3
Money and credit^q									
Domestic credit ^r	13.6	15.2	14.5	13.1	14.3	13.4	14.6	15.3	17.3
To the public sector	1.8	1.5	1.9	2.7	3.1	3.3	3.5	4.1	3.6
To the private sector	8.5	11.2	10.2	9.1	10.1	9.0	7.3	7.5	9.5
Other	3.3	2.5	2.4	1.3	1.1	1.1	3.8	3.7	4.1
Liquidity (M3)	15.8	18.3	18.2	16.8	17.4	15.1	17.1	17.1	18.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1997 prices. ^c The figure for 2004 does not include restaurant and hotel activities, which are only considered in total GDP. ^d Based on figures in local currency expressed in dollars at current prices. ^e Includes errors and omissions. ^f Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^g A minus sign (-) denotes an increase in reserves. ^h Includes the use of IMF credit and loans and exceptional financing. ⁱ Annual average, weighted by the value of merchandise exports and imports. ^j Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^k Economically active population as a percentage of the working-age population; nationwide total. ^l Unemployment rate as a percentage of the economically active population, nationwide total. ^m Population employed in the informal sector as a percentage of the employed population. ⁿ 90-day deposits. ^o Average lending rate of the country's six major commercial and universal banks. ^p Includes extrabudgetary expenditure and net lending. ^q The monetary figures are annual averages. ^r Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

its international reserves which was then transferred to FONDEN. Following a reinterpretation of the law, the National Assembly approved an additional US\$ 4.2 billion transfer from the central bank's international reserves to the FONDEN.

(c) Exchange-rate policy

In March 2005 the authorities devalued the bolívar by 12% in nominal terms (bringing the rate to 2,150 bolívares = 1 US\$) while maintaining the existing foreign-exchange regime. Despite this measure, the establishment of limits on the amount of foreign-currency credit that credit-card holders may use and the fact that foreign exchange is now more readily available through the Foreign Exchange Administration Commission have kept the rate of exchange on the parallel market at between 15% and 20% above the official rate. October 2005 saw the entry into force of a law that establishes penalties for the purchase and sale

of any amount of foreign currency, with the exception of securities operations.

(d) Other policies

The government has signed agreements with several countries under which it will supply petroleum at below-market prices. Pursuant to the Bolivarian Alternative Agreement for the Americas (ALBA), oil has been supplied to Cuba in exchange for services provided by the Cuban Government in the area of health and education. In addition, the Government of Venezuela has signed the PETROCARIBE agreement, in which it pledges to supply oil to participating Caribbean countries and provide credit facilities. Under this agreement, buyers pay down an initial amount and pay off the remainder through long-term, low-interest loans. The Venezuelan Government has also signed agreements with other countries of the region for the supply of petroleum and petroleum products.

Table 2
BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	35.0	14.3	14.2	12.1	6.6	10.7	9.5	10.2	9.4	...
Merchandise exports, f.o.b. (millions of dollars)	8 373	9 152	10 518	10 705	11 526	13 437	15 595	14 929	15 699	...
Merchandise imports, f.o.b. (millions of dollars)	3 187	3 843	4 857	5 431	5 020	5 849	6 283	6 803	5 899	...
International reserves (millions of dollars)	17 837	18 008	16 437	18 375	19 928	23 080	24 734	23 919	24 934	22 263
Real effective exchange rate (index: 2000=100) ^c	143.5	146.4	142.0	141.0	137.5	149.1	145.5	141.9	141.8	139.4
Unemployment rate	17.3	16.1	15.0	12.5	14.3	12.2	12.1	10.4	11.2	...
Consumer prices (12-month percentage variation)	23.6	22.3	20.8	19.2	15.8	15.9	16.0	14.4	10.3	11.8
Average nominal exchange rate (bolívares per dollar)	1 805	1 918	1 918	1 918	1 918	2 147	2 147	2 147	2 147	2 147
Average real wage (variation from same quarter of preceding year)	-5.7	-3.4	-3.1	-3.2	0.0	1.4	-0.4	-0.5	3.9	...
Nominal interest rates (annualized percentages)										
Deposit rate ^d	11.8	12.8	12.5	13.5	12.8	11.9	10.9	11.0	10.3	10.1
Lending rate ^e	18.0	17.6	17.2	16.4	16.3	15.7	15.5	14.9	14.8	14.1
Interbank interest rate ^f	3.7	4.0	3.6	6.2	1.1	3.5	2.3	3.6	4.0	4.8 ^g
Sovereign bond spread (basis points)	667	647	490	411	459	466	309	318	190	228
Stock price index (in dollars, December 2000=100)	67.7	75.4	91.2	88.9	77.2	68.5	...	...	...	...
Domestic credit (variation from same quarter of preceding year) ^h	65.3	62.0	61.0	60.6	63.4	60.9	61.6	55.4	48.7	...
Non-performing loans as a percentage of total credit ⁱ	3.4	2.5	2.2	1.5	1.6	1.5	1.3	1.1	1.3	1.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1997 prices. ^c Quarterly average, weighted by the value of merchandise exports and imports. ^d 90-day deposits. ^e Average lending rate of the country's six major commercial and universal banks. ^f Overnight rate. ^g Data to May. ^h Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ⁱ Refers to total credit extended by the banking system.

3. The main variables

(a) Economic activity

In the first quarter of 2006, GDP showed a year-on-year increase of 9.4%, thanks to the strength of construction, commerce, communications and the financial sector. On the expenditure side, private consumption displayed the strongest growth with a year-on-year rise for the first quarter of close to 20%.

(b) Prices, wages and employment

Cumulative inflation, measured by the consumer price index, stood at 14.4% in 2005, a significant decline from the 19.2% recorded in 2004. This improvement is attributable to a number of factors, such as the maintenance

of price controls and the greater availability of goods, thanks to strong foreign currency earnings which have fuelled a rise in imports. Other factors include the expansion of the distribution and marketing network for mass consumer goods sold at subsidized prices within the framework of the MERCAL mission and the real appreciation of the exchange rate, which has made imports less expensive.

The producer price index rose by 14.2% between December 2005 and December 2004 owing to the rise in prices for domestically produced goods. Import prices climbed by 10.9% over the same period. In April 2006, the producer price index showed a cumulative rise of 3.8% over its December 2005 level (local products: 3.9%, and imports: 3.4%).

Average annual wages were up by 19.1% in 2005 compared with 2004, with private-sector and public-sector wages climbing by 16.2% and 26.6%, respectively, for an increase in real terms in both cases. In the first quarter of 2006, this index showed a 20.6% rise in relation to the same quarter of 2005 (17% for private-sector wages and 29.8% for wages in the public sector). The government raised the minimum wage by 26% effective 1 May 2005. In 2006, the minimum wage was adjusted upward again, first by 15% with effect from 1 February and then by a further 10% as of 1 September.

The more robust pace of economic activity was reflected in a decline in unemployment, from which dropped from 13.9% in the second half of 2004 to 11.4% in the second half of 2005, although, in the first quarter of 2006, it inched back up to 11.2%. In terms of average annual rates, unemployment was down from 15.3% in 2004 to 12.4% in 2005. According to estimates published by the National Institute of Statistics, extreme poverty decreased substantially in 2005 relative to its 2003 levels, when they had reached a five-year peak.

(c) The external sector

In 2005, merchandise exports soared by 43.2% in value terms (petroleum exports were up by 50.6% and non-petroleum exports by 8.7%), while imports of goods climbed by 38.3%. Public enterprises' oil exports expanded by 46%, while those of private companies (which account for 18% of the country's total exports of crude oil) jumped

by 77%. In the first quarter of 2006, exports of goods continued to increase sharply (36.2%) owing mainly to the upswing in oil prices; imports also continued to trend upward, although at a more moderate pace (17.5%). As a result, both the trade and current account surpluses have continued to climb.

International reserves increased during 2005, peaking at US\$ 32.111 billion in August. In December 2005, they slipped to US\$ 29.636 billion as dollars were transferred from the country's international monetary reserves to FONDEN. In October, the authorities announced that they had transferred approximately US\$ 14.4 billion of reserves held in United States Treasury bonds and deposits in United States banks to deposits in the Bank for International Settlements. Since the beginning of 2006, international reserves have continued to increase and by the end of April stood at US\$ 31.365 billion.

In the fourth quarter of 2005, the country's external debt amounted to US\$ 47.233 billion (34% of GDP), compared with US\$ 44.546 billion in the fourth quarter of 2004. Approximately 50% of the debt is in the form of bonds and notes, and the increase in the use of these types of instruments, along with commercial credits, is attributable to higher public-sector borrowing. Despite the measures taken by the authorities, the external debt swelled to US\$ 48.316 billion in the first quarter of 2006 as a consequence of these factors. As a percentage of GDP, however, it showed a decline from its 2004 level of 40.6% to approximately 34% in 2005 and the first quarter of 2006.

Bolivia

1. General trends

In 2005, the Bolivian economy turned in a good performance on several fronts. GDP grew by 4.1%, which was 0.2 percentage points more than the previous year. Similarly, per capita GDP rose by 1.8%, which was 0.1 percentage points higher than in 2004. The deficit of the non-financial public sector (NFPS) narrowed by 3.2 GDP percentage points, the balance of payments posted a surplus of US\$ 492.9 million and net international reserves swelled by US\$ 503.6 million. These results occurred in the context of two opposing factors: favourable external conditions for hydrocarbon-producing countries (with natural gas prices rising by 28.9% and petroleum prices by 44.1% in 2005), yet in a domestic political environment characterized by social protests, presidential and parliamentary elections and major institutional reform.

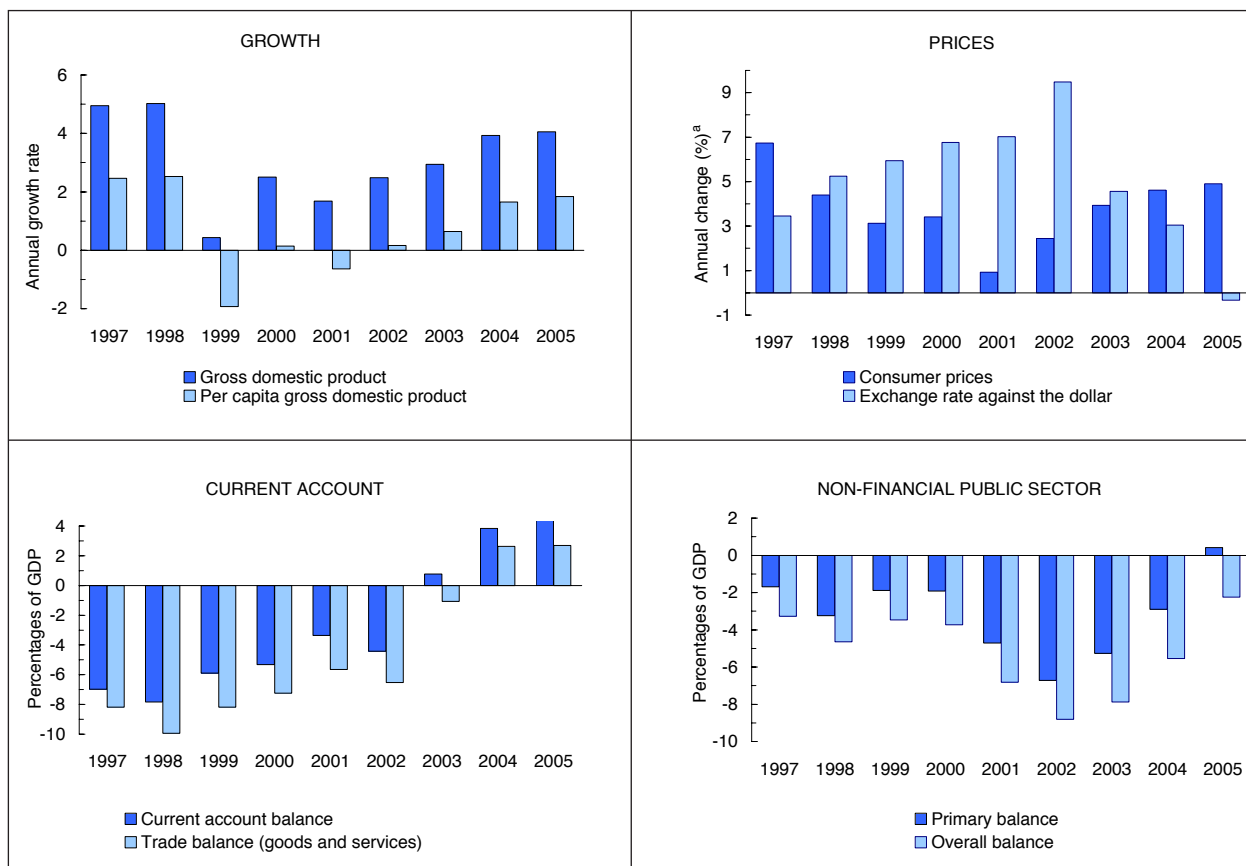
In political terms, 2005 was quite an eventful year. In the first half of the year, major social protests called for the nationalization of hydrocarbons, as Congress discussed the hydrocarbons act. These demonstrations culminated with the resignation of the President, who was replaced by a transition leader. The second half of the year was dominated by Presidential elections. In December, a new President was elected with a landslide victory. Unlike in previous administrations, the parliamentary majority ensures a significant support base for the new government.

The first half of 2006 has again been dominated by elections, this time by the vote for representatives to the Constituent Assembly in early July. There are also signs of institutional change, with a supreme decree issued on 1 May nationalizing the country's hydrocarbons sector and a change of direction in Bolivia's integration strategy, in the form of various types of cooperation agreements

concluded with Cuba and the Bolivarian Republic of Venezuela. As far as improving the fiscal accounts and strengthening net international reserves is concerned, it appears that Bolivia will not renew the stand-by agreement with the International Monetary Fund (IMF) which was extended in 2005.

Given the structural nature of these changes and the lack of more specific information, it is too soon to attempt to assess their impact. For instance, the decree on the nationalization of hydrocarbons provides a 180-day period for negotiations with companies affected by the measure. In any event, gas export prices are expected to be higher than in 2005. In addition, it is not yet known how much will be invested as part of the cooperation agreements Bolivia has signed. Nevertheless, given the favourable fiscal and external conditions prevailing this year, the Bolivian economy is expected to grow by 4.2%.

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

2. Economic policy

The main economic policy measures implemented in 2005 were the adoption of the hydrocarbons tax and steps to facilitate the remonetization of the economy.

(a) Fiscal policy

At the end of 2005, the NFPS deficit stood at 2.3% of GDP, which means it was almost 3.2 GDP percentage points narrower than in 2004 and the smallest NFPS deficit this decade. This improvement in the fiscal

balance was due to an increase nearly 4.9 GDP points in fiscal revenues, combined with a smaller 1.4 point rise in expenditure. The fiscal performance was attributable to the direct hydrocarbons tax, which brought in revenues amounting to 3.1 percentage points of GDP. Law 3058 promulgated on 17 May 2005 amended the tax and royalty structure. All gas fields must now pay a direct tax of 32% on production, in addition to a national royalty of 6% and a government royalty of 12%. In fact, in 2006, the direct hydrocarbons tax will not necessarily provide

real relief for the Bolivian Treasury, as the distribution mechanism allocates 42.3% to the Treasury and 57.7% to the departments.¹

The authorities continued to collect the levy on financial transactions, which resulted in fiscal revenues of almost 0.8% of GDP. This tax will continue to be collected during 2006. There was also an increase in receipts from other taxes such as VAT and taxation of corporate profits. The profits tax raised close to 2.8 GDP points, partly owing to the receipts from the tax on the windfall profits of firms extracting non-renewable natural resources. This surtax was decreed in 1994, but collected for the first time in 2005.

The fiscal cost of pensions was 0.2 GDP percentage points lower than in 2004, bringing the figure to 4.1% of GDP in 2005. Pension costs have been falling since 2002, when outlays represented 4.9 percentage points of GDP. The public debt was restructured in 2005, with external debt decreasing by 5.4 GDP points and domestic debt rising by 0.7 points. Public securities denominated in bolivianos have expanded significantly, increasing by 17.4 percentage points as a proportion of all public instruments.

(b) Monetary policy

One of the central bank's key objectives is to keep the inflation rate low and stable, for which it sets a cap on net domestic credit and maintains a minimum level of international reserves. In 2005, monetary targets were comfortably achieved thanks to the favourable fiscal and external situation. The fiscal deficit, whose target level was revised down in October from 5% of GDP to 3.5%, closed at 2.1%, thereby easing the country's borrowing needs. In a similar vein, the US\$ 503.6 million increase in net international reserves was 3.73 times the amount anticipated.

Since mid-2005, monetary aggregates have swelled significantly in real terms. The monetary base and M1, M2 and M3 all expanded more strongly than in 2004, by 30.2%, 28.8%, 33.4% and 37.5%, respectively. The growth of the monetary base was driven mainly by the rise in net international reserves. The central bank's open market operations were consistent with the seasonal pattern of monetary aggregates, since the net balance of public securities fell by US\$ 17.1 million in the first half of the year and increased by US\$ 39.8 million in the second. With abundant liquidity in the economy in 2005, most interest rates on boliviano-denominated instruments came

down. The interest rate on 13-week treasury bills dropped from 5.82% to 4%. The rate on repo operations dipped from 6.01% to 5.26%, while the weighted interest rates on credits secured against the liquid assets fund (RAL) retreated from 7.5% to 6.75%.

The growth surge in these aggregates was absorbed by the demand for money driven by economic growth and currency substitution in the direction of the boliviano. This, in turn, was the result of a relative abundance of foreign exchange and the measures implemented by the central bank as described below.

(c) Exchange-rate policy

In 2005 the central bank maintained the crawling-peg exchange rate regime that it has operated since the second half of the 1980s, with small non-preannounced depreciations or appreciations of the boliviano against the dollar. The aim is to maintain a competitive real exchange rate, although this is subordinate to the inflation target.

The nominal exchange rate depreciated 0.37% in 2005 and appreciated by 0.2% up to April 2006. Exchange-rate stability has been attributed to favourable external conditions and the policy measures implemented by the central bank to help remonetize the economy. These measures were: (a) the new reserve requirement established in April, which raised the relative cost of holding foreign currency by increasing the legal reserve rate for foreign-currency instruments from 10% to 12%, and established a further reserve requirement on such instruments of 2.5% over what is known as the additional reserve base (the difference between foreign- and local-currency denominated liabilities); (b) increases in the spread between the buying and selling rate of exchange from Bs 0.02 to Bs 0.06 and from Bs 0.06 to Bs 0.08, respectively, in August and November, which quadrupled the cost of moving money from one currency to another. As a result, net international reserves swelled by 52.6% to stand at US\$ 1,714,200,000,000 in 2005. This trend seems to have continued into 2006, as reserves had increased by 29.2% (or US\$ 509.2 million) by April. In absolute terms, this increase corresponds to 101.1% of the total for the whole of 2005, which attests to the favourable external environment prevailing in 2006. Lastly, between December 2004 and December 2005, the real exchange rate appreciated by 2.5%, while the rate of appreciation between December 2005 and March 2006 was 2.3%.

¹ Of the funds allocated to the National Treasury, 74.02% is assigned to the armed forces, national police, the public power, the development fund and Yacimientos Petrolíferos Fiscales Bolivianos (YPFB); 11.81% to indigenous and native peoples; and 14.17% to the compensation fund. The allocation to departments is broken down as follows: 21.7% to the three departments that produce hydrocarbons; 54.2% to the other departments; and 24.1% for departmental levelling. In turn, departmental funds are earmarked as follows: 56.64% for prefectures, 34.7% for municipalities and 8.7% for universities.

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	5.0	5.0	0.4	2.5	1.7	2.5	2.9	3.9	4.1
Per capita gross domestic product	2.5	2.5	-1.9	0.1	-0.6	0.2	0.6	1.7	1.8
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	4.5	-4.4	2.6	3.4	3.5	0.4	8.6	0.5	5.1
Mining	6.1	5.5	-4.6	6.4	-1.5	2.5	4.4	9.5	13.7
Manufacturing	2.0	2.5	2.9	1.8	2.7	0.3	4.0	5.6	3.2
Electricity, gas and water	4.7	2.4	4.6	1.9	0.7	2.2	3.1	2.8	2.6
Construction	4.9	35.7	-16.9	-4.1	-7.0	16.2	-23.1	1.8	1.4
Wholesale and retail commerce, restaurants and hotels	4.1	2.0	0.8	3.6	1.1	2.0	2.1	3.7	2.3
Transport, storage and communications	9.2	7.1	-0.8	2.4	3.0	4.3	4.0	4.1	3.2
Financial institutions, insurance, real estate and business services	12.6	12.5	13.3	-0.6	0.2	-3.1	-2.0	-1.7	0.6
Community, social and personal services	4.9	3.6	2.9	2.4	2.6	3.0	3.0	1.5	1.1
Gross domestic product, by type of expenditure									
Consumption	5.1	5.1	2.8	2.3	1.5	2.2	2.1	2.8	2.9
General government	3.4	3.8	3.2	2.1	2.9	3.5	3.6	1.6	0.5
Private	5.4	5.2	2.8	2.3	1.3	2.0	1.9	2.9	3.3
Gross domestic investment	30.2	28.5	-18.8	-7.4	-17.5	17.9	-12.1	-12.3	19.9
Exports (goods and services)	-2.1	6.5	-12.8	15.0	8.4	5.7	12.5	16.4	9.6
Imports (goods and services)	13.5	22.3	-17.1	4.7	-5.0	13.1	0.9	5.3	13.5
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	19.6	23.6	18.8	18.1	14.3	16.3	13.3	11.2	13.7
National saving	12.6	15.8	12.9	12.8	10.9	11.9	14.1	15.1	18.7
External saving	7.0	7.8	5.9	5.3	3.4	4.4	-0.8	-3.9	-5.0
	Millions of dollars								
Balance of payments									
Current account balance	-554	-666	-488	-446	-274	-350	62	337	467
Merchandise trade balance	-477	-656	-488	-364	-423	-476	-18	302	329
Exports, f.o.b.	1 167	1 104	1 051	1 246	1 285	1 299	1 598	2 146	2 671
Imports, f.o.b.	1 644	1 760	1 539	1 610	1 708	1 775	1 616	1 844	2 341
Services trade balance	-172	-189	-190	-244	-36	-41	-69	-71	-74
Income balance	-197	-162	-196	-225	-211	-205	-302	-385	-373
Net current transfers	292	341	386	387	396	371	451	491	584
Capital and financial balance ^d	654	791	515	407	237	57	15	-211	26
Net foreign direct investment	728	947	1 008	734	703	674	195	63	-280
Financial capital ^e	-74	-156	-493	-327	-467	-617	-180	-274	306
Overall balance	101	125	27	-39	-37	-293	77	126	493
Variation in reserve assets ^f	-90	-133	-32	39	28	275	-93	-138	-504
Other financing ^g	-11	8	5	1	9	17	16	13	11
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	103.8	98.5	98.6	100.0	101.0	95.4	104.1	111.6	119.9
Terms of trade for goods (index: 2000=100)	107.9	102.0	97.1	100.0	95.8	96.2	98.5	104.1	111.8
Net resource transfer (percentage of GDP)	5.6	7.5	3.9	2.2	0.4	-1.6	-3.4	-6.7	-3.5
Gross external public debt (millions of dollars)	4 532	4 659	4 574	4 460	4 497	4 400	5 142	5 045	4 942
Gross external public debt (percentage of GDP)	57.2	54.8	55.2	53.1	55.2	55.7	63.5	57.9	52.9
Net profits and interest (percentage of exports) ⁱ	-13.9	-11.9	-15.0	-15.3	-13.9	-13.2	-15.4	-15.0	-11.9
	Average annual rates								
Employment									
Labour force participation rate ^j	52.5	49.5	55.9	56.1	60.6	58.0	60.4	58.6	...
Open unemployment rate ^k	4.4	6.1	7.2	7.5	8.5	8.7	9.2	6.2	...
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.7	4.4	3.1	3.4	0.9	2.4	3.9	4.6	4.9
Variation in nominal exchange rate (December-December)	3.5	5.3	5.9	6.8	7.0	9.5	4.6	3.0	-0.3
Variation in real minimum wage	2.0	16.1	7.6	2.9	10.8	4.7	0.8	-4.2	-5.1
Nominal deposit rate ^l	...	...	...	...	...	2.7	1.8	2.0	1.7
Nominal lending rate ^l	...	...	...	...	13.7	10.9	9.1	8.2	8.2

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Non-financial public sector									
Total income	29.5	31.3	32.6	33.7	30.5	27.6	28.9	27.5	31.8
Current income	28.1	29.9	30.8	31.5	28.1	25.4	26.0	25.0	29.7
Tax revenue	15.8	18.8	17.9	18.6	17.9	17.7	17.8	20.5	25.2
Capital income	1.4	1.4	1.8	2.2	2.4	2.3	2.9	2.5	2.2
Total expenditure	32.8	35.9	36.1	37.4	37.3	36.5	36.8	33.0	34.1
Current expenditure	25.5	28.9	28.9	30.3	28.9	28.1	28.7	23.9	24.0
Interest	1.6	1.4	1.6	1.8	2.1	2.1	2.6	2.6	2.7
Capital expenditure	7.2	7.0	7.1	7.1	8.4	8.4	8.1	9.1	10.1
Primary balance	-1.7	-3.2	-1.9	-1.9	-4.7	-6.7	-5.3	-2.9	0.4
Overall balance	-3.3	-4.7	-3.5	-3.7	-6.8	-8.8	-7.9	-5.5	-2.3
Public debt ^m	61.7	61.2	65.0	66.3	73.8	78.0	90.7	85.0	76.7
Domestic ⁿ	13.6	13.8	16.7	19.4	26.0	28.6	30.7	31.5	30.4
External	48.1	47.4	48.3	46.9	47.8	49.4	60.0	53.5	46.3
Money and credit^o									
Domestic credit ^p	66.2	68.4	73.7	70.1	67.2	64.7	62.5	56.8	52.7
To the public sector	13.1	11.1	10.7	10.8	12.5	14.1	15.4	15.0	14.0
To the private sector	53.0	57.3	63.0	59.3	54.7	50.6	47.1	41.9	38.8
Liquidity (M3)	47.9	48.9	51.0	49.1	50.7	47.0	45.4	40.1	40.1
Currency in circulation and local-currency deposits (M2)	7.1	7.3	6.7	6.2	6.4	6.3	6.7	7.1	8.9
Foreign-currency deposits ^q	40.9	41.7	44.3	42.9	44.3	40.7	38.7	33.0	31.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1990 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^j Economically active population as a percentage of the working-age population, urban total; up to 1998, departmental capital cities. ^k Unemployment rate as a percentage of the economically active population, urban total; up to 1998, departmental capital cities. ^l Bank operations (61-90 days), in dollars. ^m Does not include publicly guaranteed private debt. ⁿ Domestic debt corresponds to the debt of the central government. ^o The monetary figures are annual averages. ^p Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^q Refers to demand and time deposits, savings banks and other obligations of the banking sector with the private sector.

3. The main variables

(a) Economic activity

In 2005, the Bolivian economy grew by 4.1% in relation to 2004. This was the highest GDP growth rate for six years and 0.5 percentage points higher than the 2004 figure, despite the political problems that led to supply shocks in the second and third quarters of 2005.

The fastest-growing branches of activity were mining and quarrying (13.7%) and agriculture, forestry, hunting and fishing (5.1%). The expansion of mining and quarrying was the largest increase in 15 years, while agriculture, forestry, hunting and fishing grew 4.78 percentage points more than in 2004. Within the latter category, the best performance was reported by non-industrial agricultural products, which were up 9.01%. Mining and quarrying accounted for 33.5% of the growth rate of GDP. This category includes crude oil and natural gas (up 15.1%) and metal and non-metallic minerals (up by 11.6%). The growth rate of hydrocarbons was 8.7 percentage points,

which was lower than in 2004, while mining turned in the highest growth rate in 16 years. In 2005, manufacturing activity expanded by 3.21%, commerce by 2.9%, electricity and water by 2.6% and construction by 1.5%. A number of sectors that are quite dynamic creators of employment, such as manufacturing, commerce and construction, recorded relatively modest performances in 2005.

On the expenditure side, in 2005 final consumption increased by 3.3% for households and 0.5% for public administration, while gross capital formation rose by 2.8%. The ratio of this last indicator to GDP was 12.8%, or 78% of the average ratio recorded during the 1990s. Gross private capital formation fell by around 6%. Private investment in hydrocarbons exploration, for example, was down by nearly 50.6% in 2005 to a mere 16.1% of the high recorded in 2000, representing this activity's lowest level of investment in nine years.

In the first quarter of 2006, Bolivia's GDP recorded growth of 4.3% in relation to the year-earlier period. The

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	3.9	3.6	4.7	3.6	4.8	4.1	3.5	3.9	4.3	...
Merchandise exports, f.o.b. (millions of dollars)	469	553	619	583	544	669	745	777	897	980
Merchandise imports, c.i.f. (millions of dollars)	395	442	467	559	495	562	620	666	661	...
International reserves (millions of dollars)	620	558	719	872	782	888	1 067	1 328	1 491	1 816 ^c
Real effective exchange rate (index: 2000=100) ^d	110.4	109.7	111.0	115.4	117.7	120.0	121.0	121.0	121.7	122.6
Consumer prices (12-month percentage variation)	4.2	4.9	4.3	4.6	5.7	6.4	5.5	4.9	3.7	3.5
Average nominal exchange rate (bolivianos per dollar)	7.86	7.91	7.96	8.02	8.06	8.09	8.07	8.02	8.00	8.00
Nominal interest rates (annualized percentages)										
Deposit rate ^e	1.6	2.1	2.5	1.8	1.7	1.6	1.6	2.1	2.2	2.2
Lending rate ^e	7.4	7.9	8.8	8.8	8.5	7.6	8.6	8.1	7.5	7.7
Repurchase rate ^f	6.2	8.1	9.8	7.8	...	8.3	8.0	7.5	7.5	7.6 ^c
Domestic credit (variation from same quarter of preceding year) ^g	3.2	1.7	0.9	2.4	1.1	3.1	2.6	1.8	-3.6	...
Non-performing loans as a percentage of total credit ^h	18.7	18.1	17.4	14.5	16.8	14.7	14.9	12.4	13.3	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1990 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e Bank operations (61-90 days); three-month average, in dollars. ^f Repurchase rate, in dollars. ^g Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^h Refers to total credit extended by the banking system.

sectors that registered the highest levels of growth were metal and non-metallic minerals (18.7%), financial services (17.7%) and petroleum and natural gas (12.42%). The construction sector, on the other hand, continued to grow below the average for the economy, at 1.23%.

(b) Prices, wages and employment

Prices climbed by 4.9% in 2005, which exceeded both the central bank's original target of 3.8% and the adjusted target of 4.2%. This figure was also 0.3 percentage points higher than in 2004, mainly owing to supply constraints on a number of goods caused by the social protests calling for the nationalization of the hydrocarbons industry in May and June, as well as increases in urban and inter-urban transport costs recorded at the beginning of the year. Since then, annualized inflation has been slowing. From 6.4% in June 2005, it declined to 3.5% in June 2006. Cumulative inflation to June 2006 stood at 2.1%. For this year, the central bank set an inflation target of 4% (within a range of one percentage point on either side).

In May 2006, the minimum monthly wage was

increased from 440 to 500 bolivianos, thereby restoring purchasing power to the level recorded following the previous increase in 2003. Furthermore, the employment rate is thought to have fallen slightly amidst a moderate pace of economic growth.

(c) The external sector

In 2005, the balance of payments posted a surplus of US\$ 492.9 million, which was equivalent to 4.9 GDP percentage points. This balance has been positive for three years in a row, and was US\$ 364 million up on the 2004 figure. The current account balance was US\$ 129.2 million higher than in 2004, while the capital and financial account was US\$ 327.9 million higher. The trade balance turned in a surplus of US\$ 329.5 million (3.5 percentage points of GDP), which was 9.2% higher than in 2004. In 2005, merchandise exports climbed by 24.5% on the strength of external sales of gas and other fuels, which were up by 58.8% and 52.4%, respectively. Exports of minerals and non-ferrous metals expanded by 17.7%, while manufacturing exports rose by 7.4%.

External sales of agricultural goods, on the other hand, declined by 6.3% owing to the slump in soybeans, sugar and other goods. In general, external sales benefited from higher prices for export commodities and Bolivia's terms of trade improved by 5.2% in 2005. Imports increased by 27%, mainly on the back of intermediate and final consumer goods, which expanded by 27.9% and 24.8%, respectively. The deficit for net factor income narrowed

by US\$ 11.6 million, mainly thanks to the increase in incoming interest payments. Similarly, net current transfers swelled by 18.9%.

Lastly, a positive variation of US\$ 237.8 million on the capital and financial account (including errors and omissions) yielded a surplus of US\$ 26.3 million. Inward net foreign investment dropped by US\$ 342 million, as disinvestment increased by US\$ 361 million.

Brazil

1. General trends

In 2005, Brazil's GDP expanded by 2.3%, after having grown by 4.9% in 2004. The lower rate of growth was mainly the result of a sharp slowdown in gross fixed capital formation (from 10.9% in 2004 to 1.6% in 2005). Meanwhile, the rate of expansion in household consumption (3.1%) outstripped average economic growth. With inflation easing over the year (consumer price inflation came in at 5.7% in 2005, as against 7.6% in 2004), the authorities began to gradually lower interest rates in September 2005. The country continued to run large surpluses on both the central government's primary balance (4.9% of GDP) and on the balance-of-payments current account (1.8%). In December 2005, Brazil announced that it was going to pay off its US\$ 15.5 billion in outstanding liabilities with the International Monetary Fund (IMF).

The indicators available for 2006 point to higher economic growth this year, with the rate forecast to come in between 3.5% and 4%, based on first-quarter expansion (1.4% up on the last quarter of 2005). This year's growth projection is a reflection of good macroeconomic

conditions, lower rates of interest, on-target inflation and still-favourable external conditions, which have helped to generate substantial foreign-exchange inflows. Brazil is due to hold general and presidential elections in October 2006.

2. Economic policy

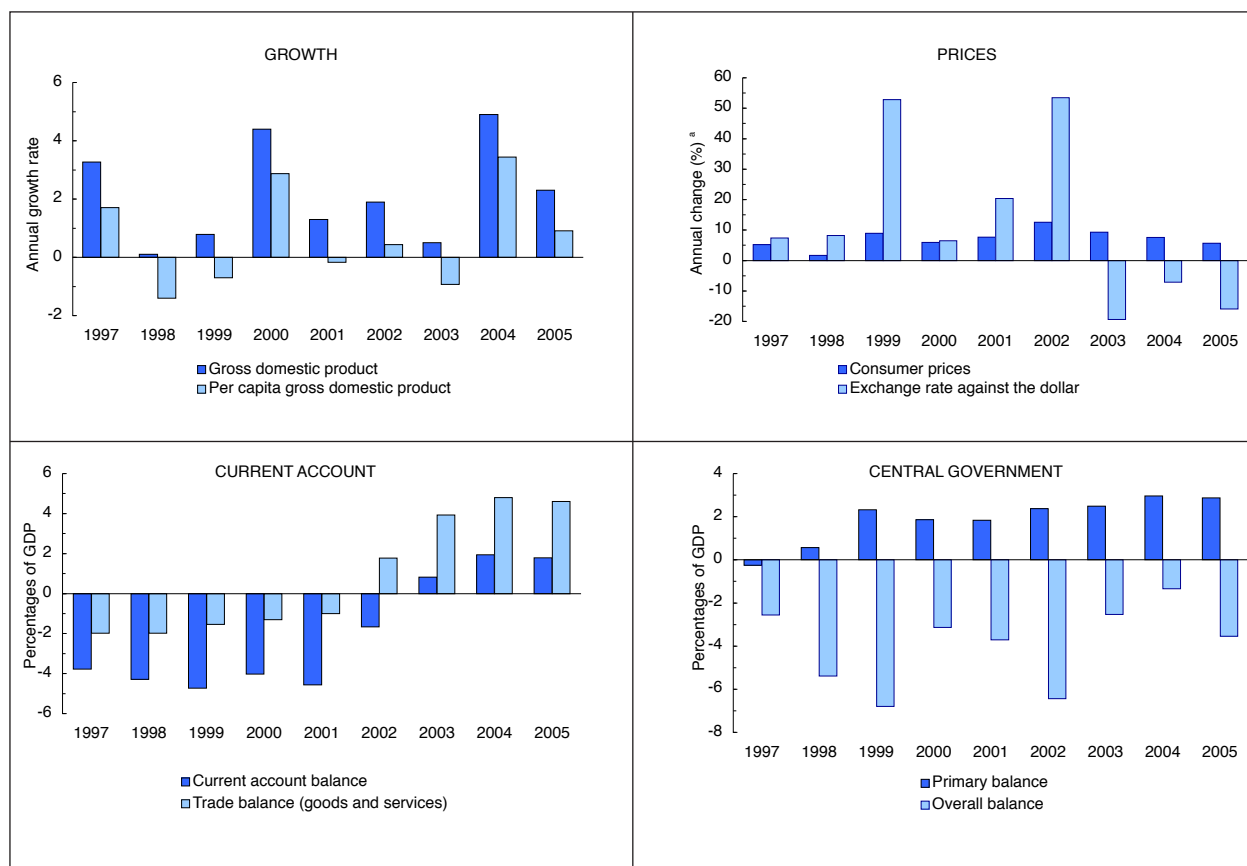
(a) Fiscal policy

The main objective of fiscal policy in 2005 was to soften the impact on net public debt of the interest rate rise of late 2004. Throughout the year, the authorities worked to build up the primary fiscal surplus in order to control the expansion in public debt. This surplus stood at 4.9% of GDP at year's end (well above the target of 4.25%), which made it possible to hold the nominal deficit down to 3.28% of GDP. The larger surplus was achieved thanks to the healthy balance posted once again by the federal government (2.9% of GDP) and, most of all, to an increase in the primary surplus yielded by State enterprises (from 0.6% of GDP in 2004 to 0.9% in 2005) thanks to higher operating profits and low

financial costs. As an annual average, these firms' net interest payments over the last two years have been equivalent to zero. Net public debt remained stable at around 51% of GDP.

The federal government's receipts, including social security payments, exceeded 20% of GDP in 2005, up from 19% in 2004. Unlike the situation in other years, however, the higher tax revenues were not generated by legislative or procedural changes; instead, the 22.1% nominal rise in income tax revenues was driven by an expansion in corporate profits in 2004, while the increased receipts from the manufactured products tax (15.6%) were attributable to record motor vehicle sales. The higher revenues from these two taxes permitted an increase of 24.2% in transfers to states and municipalities.

Figure 1
BRAZIL: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
^a December-December variation.

As well as higher transfers, financing of social security continued to put pressure on central government spending. In addition, current expenditures, especially on health, education and income transfer programmes, also climbed more steeply. The National Social Security Institute (INSS) ran a deficit of 1.9% of GDP in 2005. Successive real increases in the minimum wage and the rate of expansion of new benefits (4.7% in 2005) pushed up expenditures on pensions and retirement benefits to 7.5% of GDP. This exceeded the expansion of income from employers' contributions, which remains at close to 5.6% of GDP, despite increased formalization of employment.

The federal government's capital spending was up by 14% in 2005, even though some difficulties arose with budget execution. Projects under the pilot investment programme (which are not included in the calculation of the primary surplus, as an exception agreed upon with IMF) yielded an implementation rate of only 37% in 2005.

In the first five months of 2006, the federal government's expenditure rose faster (16.1% year-on-year) than its income (11.3%) owing to substantial increases in spending on payroll, income transfer programmes and capital expenditures (this last item was up by 83% year-on-year).

In 2005 bonds indexed to the exchange rate declined steeply as a proportion of the total federal public debt (to 2% in December 2005), while the share of fixed-rate bonds rose (28% of the total). In the first five months of 2006, the proportion of price-indexed bonds increased from 15.5% of the total at the end of 2005 to 22.4% in May 2006. Foreign investors qualify for an income-tax exemption for interest earned on federal bonds and this, together with their longer maturity, has boosted demand for these securities. By May 2006, the public held federal bonds worth 997.517 billion reais, or the equivalent of 50.0% of GDP. Higher interest rates and lower inflation in 2005 translated into an increase in the real interest paid on the public debt (7.6% of GDP in 2005, up from 3.2% in 2004).

(b) Monetary and exchange-rate policy

Developments in Brazil's economy in 2005 reflected the government's efforts to maintain the credibility of its macroeconomic policy by meeting pre-announced inflation targets. In September 2004, the central bank began raising the benchmark interest rate (SELIC) in a process that took it from an annual rate of 16% at that time to 19.75% by June 2005. In September 2005, the SELIC rate began to be gradually lowered again and in May 2006 stood at 15.25%. Inflation as measured by the broad consumer price index (IPCA) amounted to 5.7% in 2005, which was close to the target of 5.1%. Market expectations for 2006 place the inflation rate close to the year's target of 4.5%.

Monetary policy has also been directed towards slowing the expansion of the money supply, which eased from a rate of 21.2% in 2004 to 12.1% in 2005 and then to 11.4% in the 12 months to April 2006. During this period (December 2004 to April 2006), the expansionary impact of the central bank's build-up in international reserves (to more than US\$ 21 billion) was offset by an increase in the national treasury's local-currency deposits with the central bank, which were equivalent to some US\$ 20 billion.

Lending operations continued to expand briskly (21.7%) in 2005. This trend was particularly strong in credit to private individuals, where an increase of 38.7% was driven by an expansion in payroll loans extended at below-market rates (payments on these loans are deducted directly from payrolls, pensions or retirement benefits). This

type of loan expanded by 84.3% in 2005 and accounted for 45.7% of all credit to individuals. By December 2005, 6.8 million loan contracts of this type had been signed by pensioners and retirees with incomes equivalent to the minimum wage. This number of loans represents 55% of the number of pensioners at that income level.

Throughout 2005, the larger supply of foreign exchange generated by Brazil's hefty trade surplus speeded the appreciation of the exchange rate, which gained a nominal 12%. Although, as noted earlier, the central bank bought foreign exchange to meet its external debt reduction objectives, this did not prevent the strong appreciation of the *real*, and the impact of this began to show up in the results for early 2006, which reflected a slackening of growth in merchandise exports. In April 2006, the real effective exchange rate calculated by ECLAC was 33% lower than the average for 2003.

(c) Other policies

A number of reform initiatives were put in place during 2005, including the regulation of public-private partnerships and new corporate insolvency legislation. Discussions on fresh proposals, such as tax and labour reforms, were constrained by the political crisis that broke out in Brazil in May 2005, however. The government has provided incentives to certain sectors, particularly those related to investment (including construction), exports and technological innovation, by reducing or eliminating federal taxes on their inputs.

3. The main variables

(a) Economic activity

Higher economic growth projections for 2006 notwithstanding, the different sectors are expected to perform very unevenly. As in 2005, when agriculture expanded by 0.8%, calculations for this sector show it performing below the average rate of economic growth in 2006. In the first quarter of 2006, agriculture recorded a year-on-year contraction of 0.6%, which was attributable to the weak performance of the livestock sector and of some main crops (cotton and rice). Both in 2005 and thus far in 2006, this sector's poor showing has stemmed from a number of factors, including a sharp fall in domestic agricultural prices in recent months, exchange-rate appreciation and some producers' high levels of indebtedness.

The manufacturing sector expanded year-on-year by 3% in the first quarter of 2006, with considerable growth in the production of consumer durables and capital goods and more modest increases in output of intermediate and non-durable consumer goods. Manufacturing is projected to expand at a rate of close to 4% in 2006, compared with 1.3% in 2005.

Mining production has maintained a robust upward path, expanding by 11% in 2005 relative to the 2004 figure and marking up a year-on-year growth rate of 12.6% for the first quarter of 2006. This upswing is being driven by growth in iron production, mainly for export, and in petroleum and gas, principally for the domestic market. The construction sector climbed by 7% in the first quarter of 2006, compared to the year-earlier period,

Table 1
BRAZIL: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	3.3	0.1	0.8	4.4	1.3	1.9	0.5	4.9	2.3
Per capita gross domestic product	1.7	-1.4	-0.7	2.9	-0.2	0.4	-0.9	3.4	0.9
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-0.8	1.3	8.3	2.2	5.8	5.5	4.5	5.3	0.8
Mining	5.5	8.6	5.9	10.5	3.2	6.2	3.3	-0.7	10.9
Manufacturing	2.9	-3.5	-2.5	5.1	0.4	3.2	0.6	7.7	1.3
Electricity, gas and water	5.9	5.2	1.4	4.2	-5.6	3.0	2.7	4.6	3.6
Construction	7.6	1.5	-3.7	2.6	-2.7	-1.8	-5.2	5.7	1.3
Wholesale and retail commerce, restaurants and hotels	3.0	-4.7	-0.6	4.5	0.5	-0.2	-1.8	7.9	3.3
Transport, storage and communications	4.3	0.9	4.0	8.6	5.8	6.5	1.6	1.6	1.6
Financial institutions, insurance, real estate and business services	3.1	1.9	1.9	4.3	1.9	1.7	0.8	2.8	2.5
Community, social and personal services	1.0	2.1	2.1	1.8	0.9	0.2	1.2	2.8	1.5
Gross domestic product, by type of expenditure									
Consumption	2.9	-0.0	0.3	3.2	0.6	-2.5	-0.8	2.1	2.4
General government	2.1	2.4	2.4	1.3	1.0	1.4	1.3	0.1	1.6
Private	3.1	-0.8	-0.4	3.8	0.5	-3.7	-1.5	4.1	3.1
Gross domestic investment	8.3	-0.6	-7.6	9.7	-1.1	5.6	1.1	10.9 ^c	1.6 ^c
Exports (goods and services)	11.1	3.7	9.2	10.6	11.2	7.9	9.0	18.0	11.6
Imports (goods and services)	17.8	-0.3	-15.5	11.6	1.2	-12.3	-1.7	14.3	9.5
	Percentages of GDP								
Investment and saving^d									
Gross domestic investment	21.5	21.1	20.2	21.5	21.2	19.8	19.8	21.3	20.6
National saving	17.7	16.8	15.4	17.5	16.6	18.1	20.6	23.2	22.4
External saving	3.8	4.3	4.7	4.0	4.6	1.7	-0.8	-1.9	-1.8
	Millions of dollars								
Balance of payments									
Current account balance	-30 491	-33 829	-25 400	-24 225	-23 215	-7 637	4 177	11 679	14 193
Merchandise trade balance	-6 652	-6 603	-1 261	-698	2 650	13 121	24 794	33 641	44 748
Exports, f.o.b.	53 189	51 136	48 011	55 086	58 223	60 362	73 084	96 475	118 308
Imports, f.o.b.	59 841	57 739	49 272	55 783	55 572	47 240	48 290	62 835	73 560
Services trade balance	-9 309	-9 045	-6 983	-7 162	-7 759	-4 957	-4 931	-4 678	-8 146
Income balance	-16 344	-19 617	-18 844	-17 886	-19 743	-18 191	-18 552	-20 520	-25 967
Net current transfers	1 814	1 436	1 688	1 521	1 638	2 390	2 867	3 236	3 558
Capital and financial balance ^e	22 240	17 527	8 635	32 206	19 764	-3 542	-451	-5 073	13 398
Net foreign direct investment	18 608	29 192	26 886	30 498	24 715	14 108	9 894	8 339	12 550
Financial capital ^f	3 632	-11 665	-18 251	1 708	-4 951	-17 650	-10 345	-13 412	848
Overall balance	-8 251	-16 302	-16 765	7 981	-3 450	-11 178	3 726	6 607	27 590
Variation in reserve assets ^g	8 284	6 990	7 783	2 260	-3 307	-302	-8 496	-2 244	-4 319
Other financing ^h	-33	9 312	8 983	-10 242	6 757	11 480	4 769	-4 363	-23 271
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ⁱ	69.9	72.3	108.0	100.0	119.7	130.5	130.6	124.6	101.5
Terms of trade for goods (index: 2000=100)	113.6	111.9	97.0	100.0	99.6	98.4	97.0	97.9	99.2
Net resource transfer (percentage of GDP)	0.7	0.9	-0.2	0.7	1.3	-2.2	-2.8	-5.0	-4.5
Total gross external debt (billions of dollars)	200	224	226	217	210	211	215	201	169
Total gross external debt (percentage of GDP)	24.8	28.4	42.0	36.0	41.3	45.7	42.5	33.3	21.3
Net profits and interest (percentage of exports) ^j	-27.6	-33.4	-34.1	-27.7	-29.2	-26.0	-22.2	-18.8	-19.3
	Average annual rates								
Employment									
Labour force participation rate ^k	58.5	58.2	57.1	58.0	56.4	56.7	57.1	57.2	56.6
Open unemployment rate ^l	5.7	7.6	7.6	7.1	6.2	11.7	12.3	11.5	9.8
Visible underemployment rate ^l	...	...	...	...	...	3.6	4.4	4.1	3.3
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	5.2	1.7	8.9	6.0	7.7	12.5	9.3	7.6	5.7
Variation in wholesale prices (IPA-DI) (December-December) ^m	7.8	1.5	28.9	12.1	11.9	35.4	6.3	14.7	-1.0
Variation in nominal exchange rate (December-December)	7.4	8.2	52.9	6.5	20.4	53.4	-19.3	-7.1	-15.9
Variation in average real wage	2.7	0.1	-4.5	-1.1	-4.9	-2.1	-8.8	0.7	-0.3
Nominal deposit rate ⁿ	16.7	14.9	12.3	8.2	8.8	9.4	11.0	8.2	9.4
Nominal lending rate ^o	63.2	68.3	64.8	41.9	41.1	44.4	49.8	41.1	43.7

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
General government^p									
Total income ^q	15.4	16.9	17.9	17.7	18.7	19.6	19.0	19.9	20.9
Tax revenue ^r	13.6	15.5	17.0	16.9	17.8	19.1	18.5	19.2	20.3
Total expenditure	17.4	22.1	25.0	20.8	22.4	26.1	21.5	21.4	24.6
Current expenditure	12.3	16.7	20.1	15.9	17.1	20.7	16.9	16.3	18.8
Interest	2.3	6.0	9.1	5.0	5.5	8.8	5.0	4.3	6.4
Capital expenditure	5.1	5.4	4.9	4.8	5.3	5.3	4.7	5.2	5.8
Primary balance	-0.3	0.6	2.3	1.9	1.8	2.4	2.5	3.0	2.9
Overall balance	-2.6	-5.4	-6.8	-3.1	-3.7	-6.4	-2.5	-1.3	-3.5
Central government debt									
Domestic	19.3	25.3	32.5	32.1	34.4	41.7	37.2	34.0	33.7
External	2.0	4.2	8.5	7.8	8.6	14.7	10.3	7.1	2.4
Money and credit^s									
Domestic credit ^t	43.6	50.8	69.4	69.5	73.4	74.6	76.3	76.5	79.4
To the public sector	13.0	17.6	35.4	36.3	38.7	40.8	43.4	43.9	43.2
To the private sector	30.7	33.1	33.5	32.8	34.3	33.6	32.7	32.5	36.2
Other	0.0	0.0	0.4	0.4	0.4	0.3	0.2	0.1	0.0
Liquidity (M3)									
Currency in circulation and local-currency deposits (M2)	23.8	26.9	26.7	24.2	24.2	25.9	25.1	24.8	26.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at the previous year's prices. ^c Refers to gross fixed capital formation. ^d Based on figures in local currency expressed in dollars at current prices. ^e Includes errors and omissions. ^f Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^g A minus sign (-) denotes an increase in reserves. ^h Includes the use of IMF credit and loans and exceptional financing. ⁱ Annual average, weighted by the value of merchandise exports and imports. ^j Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^k Economically active population as a percentage of the working-age population; six metropolitan areas. ^l Unemployment and underemployment rates as percentages of the economically active population; six metropolitan areas. ^m IPA-DI: wholesale price index (acronym in Portuguese). ⁿ Certificates of deposit. ^o Pre-set corporate rate. ^p Includes federal government and the central bank. ^q Cash income. ^r Gross tax revenue. ^s The monetary figures are annual averages. ^t Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

after a modest expansion of 1.4% in 2005 overall. In this first quarter, the services sector's 2.8% expansion was led by commerce (4.8%) and transport (3.6%), followed by financial services (2.9%) and public administration services (2.6%).

The first quarter of 2006 brought an upturn in gross fixed capital formation, which rose by just 1.6% in 2005 as a consequence of sluggish activity levels and high rates of interest. For 2006 overall, investment is expected to climb to the equivalent of 21% of GDP. In the first four months of the year, imports of capital goods were up by 29.4% in relation to the same period of 2005, and production of domestic capital goods rose by 6.7% year-on-year in the first quarter of 2006.

The brisker growth of investment was attributable mainly to a brighter outlook for economic growth, particularly because of expectations of a drop in long-term interest rates and in the cost of imported goods, the latter as a result of exchange-rate appreciation. The conditions still warrant a degree of caution in business circles, however, although some sectors are using nearly all of their installed capacity, which represents a stimulus for investment, this will also depend on the behaviour of interest rates. Nevertheless, investment is likely to

be the fastest-growing component of demand in 2006. Household consumption should also expand significantly. Two factors that are likely to help bring this about are an increase in aggregate wages and continued expansion of consumer credit.

(b) Prices, wages and employment

In 2005 the authorities' continuation of their policy of keeping interest rates high, in conjunction with the exchange rate's appreciation, contributed to a sharp slowdown in domestic inflation and to convergence towards its target level, with the IPCA rising by 5.7%, which was not far above the target of 5.1%. The slower rise was most apparent in the prices of goods. The manufacturing wholesale price index rose by only 0.9% in 2005, compared with 19.5% in 2004, while the agricultural wholesale price index decreased by 6.3% over the year. In 2006, as pressure for public utility rate hikes eases (since they are tied to the preceding year's price index), and the decline in the prices of agricultural products is expected to continue, annual inflation is likely to come in very close to its 4.5% target level. In the 12 months to May, the IPCA recorded a below-target variation of 4.2%.

Table 2
BRAZIL: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	4.0	5.1	5.9	4.7	2.8	4.0	1.0	1.4	3.4	...
Merchandise exports, f.o.b. (millions of dollars)	19 448	23 858	26 972	26 197	24 451	29 226	33 042	31 589	29 387	31 513
Merchandise imports, f.o.b. (millions of dollars)	13 324	14 996	16 906	17 609	16 147	17 872	20 060	19 481	20 046	21 307
International reserves (millions of dollars)	51 612	49 796	49 503	52 935	61 960	59 885	57 008	53 799	59 824	62 670
Real effective exchange rate (index: 2000=100) ^c	125.2	129.6	125.0	118.8	113.6	103.9	97.6	92.2	89.7	91.3
Urban unemployment rate	12.2	12.3	11.2	10.2	10.5	10.1	9.5	9.2	9.9	...
Consumer prices (12-month percentage variation)	5.9	6.1	6.7	7.6	7.5	7.3	6.0	5.7	5.3	4.0
Average nominal exchange rate (reales per dollar)	2.89	3.04	2.98	2.78	2.67	2.48	2.34	2.25	2.19	2.18
Average real wage (variation from same quarter of preceding year)	-1.8	1.5	0.8	2.2	-1.5	-1.9	0.6	1.3	1.9	...
Nominal interest rates (annualized percentages)										
Deposit rate ^d	7.8	8.3	8.7	7.8	8.7	9.6	10.5	8.7	0.7	0.7
Lending rate ^e	42.2	41.2	40.3	40.7	43.0	44.4	44.2	43.0	42.6	41.7 ^f
Interbank interest rate ^g	16.2	15.8	15.8	16.9	18.4	19.5	19.6	18.7	17.2	15.7
Sovereign bond spread (basis points)	559.0	650.0	469.0	382.0	458.0	414.0	345.0	311.0	235.0	254.0
Stock price index (in dollars, December 2000=100)	104.5	92.6	115.8	141.8	146.6	154.8	209.8	212.7	257.8	248.9
Domestic credit (variation from same quarter of preceding year) ^h	12.6	14.8	14.4	11.5	13.3	12.8	14.8	17.4	17.5	19.1 ⁱ
Non-performing loans as a percentage of total credit ^j	4.1	3.8	3.6	3.6	3.7	3.5	4.1	4.2	4.6	4.9 ^f

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at the previous year's prices. ^c Quarterly average, weighted by the value of merchandise exports and imports. ^d Certificates of deposit. ^e Pre-set corporate rate. ^f Data to May. ^g SELIC (Special System for Settlement and Custody) rate. ^h Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ⁱ Data to April. ^j Refers to total credit extended by the banking system.

The economic slowdown in 2005 did not drag down labour market indicators, since the average unemployment rate for the year was 9.8%, as against 11.5% in 2004. Although the average annual labour force participation rate decreased from 57.2% in 2004 to 56.6% in 2005, a further 463,000 jobs (an increase of 2.3%) were created in metropolitan areas. Implementation of a plan for promoting formal employment that had been launched in 2002 continued in 2005, with 558,000 jobs being formalized in metropolitan areas, for an annual growth rate of 6.3%. Average real income climbed throughout 2005 and thus, as of December 2005, stood 5.9% above the figure recorded in December 2004.

The government has taken steps to boost the incomes of the poorest population groups by introducing substantial real increases in the minimum wage (8.2% in 2005 and 13% in 2006) and expanding the coverage of income transfer programmes, such as the *Bolsa Familia* scheme, which was serving more than 8 million families by December 2005.

Total wages have evolved positively in the last few quarters, with a real expansion of 5% in the 12 months to April 2006 in Brazil's main metropolitan regions. This was aided by an increase in employment, albeit at a lower rate than in 2005 (72,000 new jobs were created in the first four months of 2006), and continued efforts to encourage the formalization of workers (the average formality index was 54.1% in April 2006, compared with 52.5% a year earlier 2005). The substantial drop in inflation in 2005 also buoyed real wages.

(c) The external sector

In 2005, the balance-of-payments current account posted a surplus of US\$ 14.193 billion (1.8% of GDP), as Brazil's merchandise trade activity returned an unprecedented surplus of US\$ 44.748 billion. Net capital inflows in the form of foreign direct investment (FDI) and portfolio investment amounted to US\$ 17.434 billion. This inflow of hard currency helped to bring about a substantial nominal

appreciation (11.8%) of the *real* against the United States dollar, which bolstered inflation containment efforts. The central bank bought some of the surplus foreign exchange in order to build up its reserves, pay off its debt with IMF (US\$ 15.5 billion) and the Paris Club (US\$ 3 billion) and to retire Brady bonds (US\$ 6.6 billion). In response to the favourable balance-of-payments position, together with abundant liquidity in international financial markets, Brazil's country-risk premium dropped throughout 2005 to a record low of 217 basis points in April 2006.

In the first five months of 2006, Brazil's external accounts continued to perform well, as they have since 2004. In that period the value of exports amounted to US\$ 49.466 billion, which was 13.8% up on the same period of 2005, thanks to an increase of 2.5% in volume and of 11.1% in prices. Imports stood at US\$ 34 billion, representing a 22.1% gain on the year-earlier period, driven by a rise of 13.2% in import volumes and of 7.8% in prices. The expansion in imports reflected the upturn in domestic economic activity and the appreciation of the currency. Brazil's fastest-growing exports were commodities, which posted gains of 2.6% in volume and 14.7% in price, followed by manufactures, which were up by 3.6% and 9.7%, in volume and price, respectively.

A notable feature of the income balance is the expansion seen in profit remittances in the last few years. In 2005, such remittances outstripped total net inflows of FDI for the first time since 1994 and reached US\$ 12.686 billion. Outflows corresponding to profit remittances continued to rise steeply in the first five months of 2006, giving rise to a deficit of US\$ 7.22 billion (as against US\$ 5.07 billion in the same period of 2005).

As a result of these developments, in the first five months of 2006 the current account showed a surplus of US\$ 2.506 billion (0.7% of GDP). This balance, which was somewhat less than the US\$ 3.973 billion (1.2% of GDP) recorded in the same period of 2005, reflected a US\$ 15.465 billion trade surplus (close to the figure of US\$ 15.624 billion for the year-earlier period) and a combined deficit of US\$ 14.638 billion on the services and income accounts (up from US\$ 13.043 billion in January-May 2005).

Brazil's continued surpluses on its balance-of-payments current account have paved the way for an adjustment in its capital and financial accounts, which recorded outflows of US\$ 9.593 billion in 2005 and net inflows of US\$ 5.292 billion in the first five months of 2006. After coming in at US\$ 12.5 billion in 2005, FDI in those five months totalled US\$ 2.458 billion (1.7% of GDP), which was a steep drop from the US\$ 5.699 billion (2.5% of GDP) posted in the first five months of 2005. The increased availability of foreign exchange has also enabled Brazil to continue paying down its external financial liabilities. As in 2003 and 2004, in 2005 Brazil recorded net outflows of foreign exchange in the form of debt payments, this time in the amount of US\$ 27.6 billion (145% more than in 2004). Brazil thus brought its total external debt down to US\$ 169.45 billion in December 2005 and to US\$ 160.696 billion in May 2006. As a result, the country has been able to improve its external indicators, build its international reserves to US\$ 63.381 billion in May 2006 (up from US\$ 53.799 billion in late 2005) and lower its ratio of net debt to exports of goods to 0.6%, compared with 2.4% at the end of 2002.

Chile

1. General trends

For the second consecutive year, the Chilean economy expanded at a rate of over 6%, in a context of favourable terms of trade, large fiscal and balance-of-payments surpluses, inflation within the target range and unemployment levels gradually declining, albeit more slowly than desired. In 2005 growth was led by domestic demand (i.e., consumption and investment), in contrast to the export-driven performance of 2004. The central bank maintained its policy of curbing monetary expansion by raising interest rates as the gap between actual and potential output gradually narrowed. The fiscal policy of a structural surplus of 1% of GDP was also maintained, which, together with exceptional copper and molybdenum prices, translated into an actual surplus of 4.7% of GDP. The new government, which entered office in March 2006, intends to continue with this policy.

Thanks to the high copper and molybdenum prices and despite high oil prices, the current account posted a surplus, contrary to the original expectations. These factors, together with the favourable terms of trade, led to a significant appreciation of the peso. This situation would have been exacerbated had the larger flows external income been used to fund higher fiscal expenditure.

At the end of 2005 inflation was at 3.7%, within the annual target range of 2%-4%. The unemployment rate declined to 8% thanks to growth in employment, despite higher rates of participation in the economically active population, especially for women. Nevertheless, unemployment remains one of the main concerns as regards the economy.

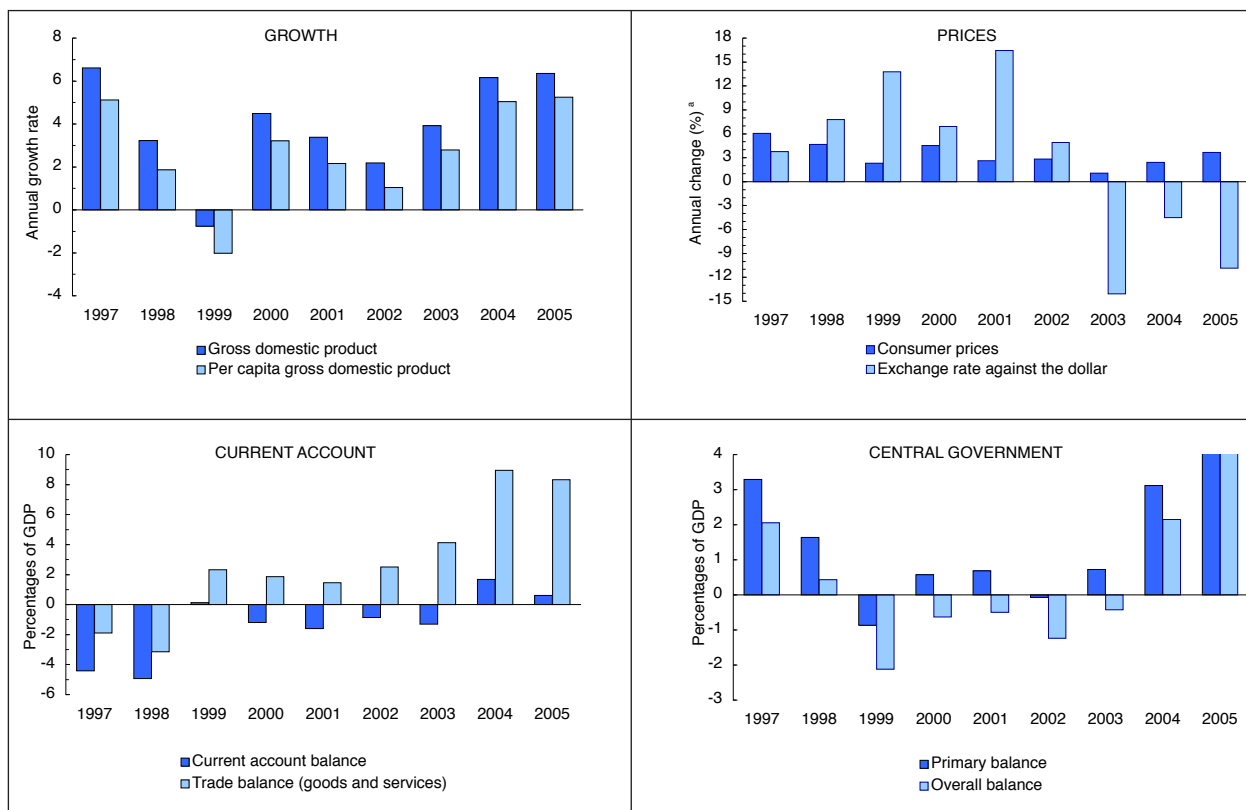
Despite the good macroeconomic situation, the short-term outlook is not risk-free. First, average oil prices are expected to be higher in 2006 than they were in 2005. As there seems to be little margin between oil production and consumption, any supply constraints could cause spikes and volatility in prices in the context of a tight market. If this translated into inflationary pressure, especially in the more developed countries, external interest rates could rise even higher and slow the growth of external demand. Thanks to the low level of fiscal

debt and moderate private indebtedness, this should not have serious financial implications for the State or for business. Nevertheless, in such a scenario the monetary authorities would be likely to raise interest rates again, which would dampen domestic demand, the economy's most dynamic driver in the past few years.

A second external risk factor is associated with the continuity of the gas supply from Argentina. Supply restrictions are expected to continue during 2006, but any worsening of the situation will push up costs, which could affect production in some branches of industry. This risk factor should diminish in the medium term as energy projects come on stream.

A third risk factor, this time of a domestic nature, stems from the high copper and molybdenum prices, which have reached unprecedented levels and will, on average, be higher than those of the previous year. Commodity prices always have a large speculative component, in view of the very tight balance between supply and demand. While high, but slightly more moderate, prices (from US\$ 2 to US\$ 2.5 per pound of copper) may persist for another year, the long-term cost has historically been less than US\$ 1 per pound, suggesting the possibility of an expansion in supply that would cause prices to drop. The

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
^a December-December variation.

risk exists, therefore, that private and public economic agents may commit to expenditure plans on the basis of short-term prices that will not hold and may later have to adjust their spending downwards.

With inflation stable, another important factor in monetary and fiscal policy decisions is the possibility of achieving a significant reduction in unemployment in the short term and bringing the rate down to levels similar to those of 1996-1998. Analysts now agree that that situation, when unemployment was close to 6%, was not sustainable because of the context of surplus spending and overheating of the economy at the time. This would apparently not be the case today, however, as there is no spending surplus and fiscal affairs are clearly solvent. Moreover, it is estimated that a stable inflation rate is compatible with unemployment in the range of 6.4% to 9.3%.¹ Nevertheless, after two years in which actual GDP grew by 6.2% on average and exceeded the 5% growth rate of potential GDP, any gaps

in capacity may be assumed to have diminished. In these circumstances, the potential for reducing unemployment without generating an impact on inflation is a function of the existing capacity margin, in particular the level of idle capacity and the availability of energy resources. Dynamic investment in 2005 brought a number of developments that should have a positive impact on capacity in the medium term. In the light of the public debate on this subject, policies to strengthen investment and increase productivity should return to the fore given the need to increase the growth of potential GDP in order to strike a balance in which rates of unemployment and inflation are lower.

Be that as it may, the projections for 2006 indicate a performance similar to that of 2005, notwithstanding a temporary slowdown in the first quarter of the year, when unemployment rates became sticky and the consumer price index (CPI) spiked above the target range, owing to sharp rises in external fuel prices.

¹ See Central Bank of Chile, *Monetary Policy Report*, Santiago, Chile, May 2006.

2. Economic policy

(a) Fiscal policy

Fiscal policy maintained its countercyclical slant in 2005, with the target of a structural surplus of 1% of GDP, and this has continued in 2006. Over these two periods, public expenditure expanded steadily at 6.1% and 6.6%, respectively, in real annual terms. With growth at over 6% for two consecutive years and the positive impact this has had on tax revenues, coupled with extraordinarily high copper and molybdenum prices, the overall surplus for 2005 was equivalent to 4.7% of GDP, which was more than double the figure for the previous year and the highest since 1997. This achievement made it possible to reduce domestic and external debt and build up assets. The central government's gross debt thus declined from 10.8% of GDP in 2004 to 7.5% of GDP in 2005, and in net terms it moved from a debtor position equivalent to 4.2% of GDP to a creditor position equivalent to 0.1%. This was reflected in the spreads on Chile's external sovereign bond issues, which in 2005 averaged 51 basis points for fixed-rate bonds and 19 basis points for floating-rate bonds.

In the second quarter of 2006, the government sent to Congress a draft bill on fiscal responsibility, which provides for the establishment of a number of funds in which to hold windfall revenues. These funds will then be used to cover financing needs during lower-income periods, to ensure compliance with State guarantees and to meet the higher expenditure that minimum pensions will entail.

According to current projections, public spending will increase by 6% in real terms in 2006. Moreover, the trends in revenues seen in 2005 carried over into the first quarter of the year, so that the overall balance looked close to 6% of GDP and for the year as a whole will be higher than the 2.3% originally stipulated in the budget law.

This solid fiscal position has meant that, despite the fluctuations associated with uncertainties over oil prices and external interest rates, which affected emerging market bond prices in April and June 2006, there have been no great changes in Chilean bond spreads, either sovereign or corporate.

(b) Monetary and exchange-rate policy

During 2005 and thus far in 2006, the central bank has continued with the policy of reining in the monetary expansion that began in September 2004. In June 2006 the monetary policy rate was 5%, well up from the low of 1.75% recorded in August 2004. Despite the hikes, in the view of the monetary authorities the benchmark rate is still below the neutral rate, implying that monetary policy has continued to be stimulative. The rationale for toning down this stimulus is that actual growth has exceeded potential growth for the past two years, which narrows the manoeuvring room in which to increase growth without pushing up inflation.

Although inflation steepened in response to rises in oil prices and other external prices, it remained within the central bank's target range. Moreover, core inflation indicators showed a smaller rise than inflation calculated on the basis of the CPI, while inflationary expectations remained anchored at an annual 3%, all of which tends to indicate that inflation is under control.

As occurred with other currencies and in view of the greater availability of foreign currency owing to the improved terms of trade, the Chilean peso continued to appreciate during 2005 and in the first quarter of 2006 reached levels that even the central bank did not consider attributable to fundamentals.² This, together with indications that inflation was under control, mitigated the increase in the monetary policy rate. The risk assessment conducted by the monetary authorities, however, concluded that inflation was more likely to rise than to fall, so the policy of hikes in the monetary policy rate may well continue, unless the economy slows sharply, as occurred temporarily in the first quarter.

The gradual rise in the monetary policy rate translated into higher deposit rates, despite which bank credit to the private sector was buoyant enough to bolster domestic expenditure. In 2005, personal, consumer and housing loans expanded at an annual nominal rate of between 18% and 20% and business loans were up by an average of 15% and these growth rates have held steady in 2006.

² See Central Bank of Chile, *Monetary Policy Report*, Santiago, Chile, May 2006.

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	6.6	3.2	-0.8	4.5	3.4	2.2	3.9	6.2	6.3
Per capita gross domestic product	5.1	1.9	-2.0	3.2	2.2	1.0	2.8	5.0	5.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.4	2.3	0.8	6.6	7.5	6.8	2.6	9.6	3.8
Mining	11.3	8.3	10.6	3.2	5.7	-4.2	5.5	7.0	0.2
Manufacturing	4.7	-2.3	-0.5	4.9	0.6	1.9	3.3	7.2	5.2
Electricity, gas and water	8.3	4.4	-4.7	9.5	1.5	3.3	4.3	5.2	6.8
Construction	6.3	1.9	-9.9	-0.7	4.1	2.5	4.3	4.2	9.8
Wholesale and retail commerce, restaurants and hotels	7.6	3.5	-4.4	4.4	2.6	0.9	4.9	6.7	8.5
Transport, storage and communications	10.9	6.6	0.8	8.6	7.4	5.3	5.8	6.2	8.3
Financial institutions, insurance, real estate and business services	5.9	5.0	0.5	4.0	3.0	2.8	2.8	4.7	5.1
Community, social and personal services	3.9	3.4	3.0	2.3	2.1	2.2	2.1	2.2	2.4
Gross domestic product, by type of expenditure									
Consumption	6.5	4.3	-0.4	3.6	2.9	2.5	4.0	6.1	7.6
General government	5.8	2.2	2.7	3.0	2.9	3.1	2.4	6.1	4.5
Private	6.6	4.7	-1.0	3.7	2.9	2.4	4.2	6.1	8.2
Gross domestic investment	9.4	2.2	-20.1	14.0	0.8	2.2	7.8	14.3	22.2
Exports (goods and services)	11.2	5.2	7.3	5.1	7.2	1.6	6.5	11.8	6.1
Imports (goods and services)	13.2	6.7	-9.5	10.1	4.1	2.3	9.7	18.0	20.4
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	27.7	26.9	20.9	21.9	22.1	21.7	21.9	21.4	23.0
National saving	23.3	22.0	21.0	20.7	20.5	20.8	20.6	23.0	23.6
External saving	4.4	4.9	-0.1	1.2	1.6	0.9	1.3	-1.7	-0.6
	Millions of dollars								
Balance of payments									
Current account balance	-3 660	-3 918	99	-898	-1 100	-580	-964	1 586	703
Merchandise trade balance	-1 428	-2 040	2 427	2 119	1 844	2 386	3 685	9 195	10 180
Exports, f.o.b.	17 870	16 323	17 162	19 210	18 272	18 180	21 664	32 215	40 574
Imports, f.o.b.	19 298	18 363	14 735	17 091	16 428	15 794	17 979	23 020	30 394
Services trade balance	-136	-452	-737	-719	-844	-701	-646	-689	-588
Income balance	-2 617	-1 889	-2 233	-2 856	-2 526	-2 847	-4 608	-7 999	-10 624
Net current transfers	520	462	643	558	427	583	605	1 079	1 735
Capital and financial balance ^d	6 979	1 727	-846	1 234	504	862	598	-1 772	1 013
Net foreign direct investment	3 809	3 144	6 203	873	2 590	2 207	2 701	5 646	4 764
Financial capital ^e	3 170	-1 417	-7 049	361	-2 086	-1 345	-2 103	-7 418	-3 751
Overall balance	3 318	-2 191	-747	337	-596	282	-366	-186	1 716
Variation in reserve assets ^f	-3 318	2 191	747	-337	596	-282	366	186	-1 716
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^g	90.8	92.5	98.2	100.0	111.2	109.1	114.5	107.1	101.6
Terms of trade for goods (index: 2000=100)	94.5	91.0	94.2	100.0	93.3	97.2	102.8	124.9	139.8
Net resource transfer (percentage of GDP)	5.3	-0.2	-4.2	-2.2	-2.9	-3.0	-5.4	-10.3	-8.3
Total gross external debt (millions of dollars)	29 034	32 591	34 758	37 177	38 527	40 504	43 067	43 517	45 014
Total gross external debt (percentage of GDP)	35.1	41.1	47.6	49.4	56.2	60.2	58.4	45.8	39.1
Net profits and interest (percentage of exports) ^h	-12.0	-9.3	-10.6	-12.3	-11.3	-12.6	-17.3	-20.9	-22.3
	Average annual rates								
Employment									
Labour force participation rate ⁱ	54.2	54.4	54.4	53.7	52.9	52.5	52.9	53.2	53.5
Open unemployment rate ^j	6.1	6.4	9.8	9.2	9.1	9.0	8.5	8.8	8.0
Visible underemployment rate ^j	5.2	4.0	4.9	5.4	6.4	5.6	5.9	7.6	7.8
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.0	4.7	2.3	4.5	2.6	2.8	1.1	2.4	3.7
Variation in wholesale prices (December-December)	1.9	0.3	13.5	7.9	3.1	10.4	-1.0	7.8	3.2
Variation in nominal exchange rate (December-December)	3.8	7.8	13.8	6.9	16.4	4.9	-14.1	-4.5	-10.8
Variation in average real wage	2.4	2.7	2.4	1.4	1.7	2.0	0.9	1.8	1.9
Nominal deposit rate ^k	12.7	16.3	8.9	8.7	6.5	4.1	3.2	2.4	4.5
Nominal lending rate ^k	20.2	27.4	17.6	18.7	16.7	14.4	13.0	11.0	13.5

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Central government total^l									
Total income	21.7	21.1	20.4	21.7	21.8	21.1	20.8	22.2	24.4
Tax revenue	16.3	16.4	15.7	16.5	16.6	16.7	15.9	15.7	17.3
Total expenditure	19.6	20.7	22.5	22.3	22.3	22.4	21.3	20.0	19.7
Interest	1.2	1.2	1.3	1.2	1.2	1.2	1.2	1.0	0.9
Primary balance	3.3	1.6	-0.9	0.6	0.7	-0.1	0.7	3.1	5.5
Overall balance	2.1	0.4	-2.1	-0.6	-0.5	-1.2	-0.4	2.2	4.7
Central government debt^m									
Domestic	13.2	12.5	13.8	13.7	15.0	15.7	13.1	10.8	7.5
External	1.6	1.5	1.4	1.3	1.1	1.0	1.2	1.7	2.1
	11.6	11.0	12.4	12.4	13.9	14.7	11.8	9.0	5.4
Money and creditⁿ									
Domestic credit ^o	...	58.6	60.7	60.7	61.5	60.5	58.2	56.6	57.1
To the public sector	...	-2.6	-2.4	-1.7	-2.7	-3.5	-3.6	-2.1	-3.5
To the private sector	...	61.1	63.1	62.4	64.1	63.9	61.8	58.7	60.6
Liquidity (M3)	40.3	45.4	50.1	49.9	51.6	52.6	49.5	46.6	49.6
Currency in circulation and local-currency deposits (M2)	38.7	43.2	46.1	45.5	46.3	46.7	44.0	41.5	45.0
Foreign-currency deposits	1.6	2.3	4.0	4.4	5.3	5.9	5.6	5.1	4.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1996 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Annual average, weighted by the value of merchandise exports and imports. ^h Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ⁱ Economically active population as a percentage of the working-age population; nationwide total. ^j Unemployment and underemployment rates as percentages of the economically active population; nationwide total. ^k Non-adjustable 90-360 day operations. ^l Reflects the new accounting methodology set out in the 2001 IMF manual. ^m Does not include guaranteed debt. ⁿ The monetary figures are annual averages. ^o Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

After achieving growth of 6.2% of GDP in 2004, the economy expanded again by 6.3% in 2005. National income grew by 8.6% and 9.1% in 2004 and 2005, respectively. In the first quarter of 2006 GDP growth rates were lower than for the previous period (at close to an annual 5%), but this seems to have been caused by temporary problems in some sectors and more rapid growth is forecast for the second half of the year, in keeping with a projected annual growth rate of between 5% and 6%.

Domestic demand (total consumption and gross fixed capital formation) was the main driver of expansion in 2005, growing in real terms by 11.4%; this contrasts with the previous year, when exports led aggregate demand with an expansion of 11.8% (6.1% in 2005).

Investment in machinery and equipment posted an impressive 43.6% rate of real expansion in 2005 (21.2% in 2004), while investment in construction expanded at a real rate of 10.2% (5.5% in 2004). This investment growth reflected financial conditions that were still propitious,

the upswing in domestic demand and a falling exchange rate that stimulated capital goods imports. Consistently with the current phase of the business cycle, the effect of higher interest rates and forecasts of further rises, the pace of investment is expected to have slowed somewhat in the first quarter of 2006.

In line with the higher level of domestic demand, the most buoyant sectors in 2005 were construction (9.8%), commerce (8.5%) and transport and telecommunications (8.3%). These were followed by agriculture and livestock and forestry (5.7%) and the industrial sector (5.2%), especially those branches of activity that produce mainly for domestic demand. Mining showed meagre growth of 0.2%, while the fishing sector contracted by 2%.

In the first quarter of 2006 activity levels slipped somewhat, which was attributable to temporary factors, in particular weather conditions affecting agricultural activity and exports and delays in the start-up of a number of construction projects. Indeed, the indicators for June show an upturn in activity, with an expansion rate of close to 6%.

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	4.8	5.5	6.9	7.4	6.6	7.2	5.8	5.8	5.1	...
Merchandise exports, f.o.b. (millions of dollars)	7 498	7 926	8 022	8 769	9 388	10 100	10 062	11 025	12 566	14 430
Merchandise imports, c.i.f. (millions of dollars)	5 407	5 734	6 628	7 149	7 316	7 901	8 687	8 733	8 846	9 177
International reserves (millions of dollars)	15 953	15 844	15 832	15 994	15 365	16 625	15 635	16 929	15 940	18 161 ^c
Real effective exchange rate (2000=100) ^d	103.9	109.1	109.0	106.4	106.8	106.3	99.7	94.1	96.0	97.1
Open unemployment rate	8.1	9.6	9.7	7.8	7.9	8.7	8.5	6.9	7.9	...
Consumer prices (12-month percentage variation)	-0.7	1.1	1.4	2.4	2.4	2.7	4.0	3.7	4.0	3.9
Average nominal exchange rate (pesos per dollar)	587	629	628	593	579	581	552	526	527	527
Average real wage (variation from same quarter of preceding year)	3.1	2.5	1.3	0.4	1.2	1.8	2.2	2.3	1.5	...
Nominal interest rates (annualized percentages)										
Deposit rate ^e	2.2	2.2	2.3	2.9	3.6	4.4	4.5	5.6	5.3	5.5
Lending rate ^e	11.0	10.6	11.2	11.1	12.2	13.8	14.2	13.9	15.0	14.6
Interbank interest rate ^f	1.8	1.7	1.8	2.2	2.6	3.2	3.7	4.4	4.6	5.0
Sovereign bond spread (basis points)	126.5	118.1	97.1	...	...	...	...	...	...	...
Stock price index (in dollars, December 2000=100)	142.3	138.2	154.8	176.9	177.2	184.2	216.6	202.4	214.7	202.1
Domestic credit (variation from same quarter of preceding year) ^g	8.4	9.4	11.6	11.3	12.7	13.1	12.8	13.0	12.8	13.0 ^c
Non-performing loans as a percentage of total credit ^h	1.6	1.5	1.4	1.2	1.2	1.1	1.0	0.9	0.9	0.9 ⁱ

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1996 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e Non-adjustable 90-360 day operations. ^f Overnight rate. ^g Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^h Refers to total credit extended by the banking system. ⁱ Data to April.

(b) Prices, wages and employment

Inflation reached an annual average of 3.1% in 2005, measured by the CPI, and of 3.7% for the period December-December, although it breached the 4% ceiling on several occasions. The core inflation indicators generally came in under 3% annually, but all rose gradually as domestic demand climbed and idle production capacity diminished.

In the first half of 2006, 12-month inflation again edged towards 4%, partly because of the rise in international fuel prices and the resulting increases in the price of public transport. In 2005 and early 2006 the petroleum stabilization fund was used to moderate the pass-through of external price fluctuations to domestic prices, especially for gasoline, diesel and, consequently, public transport. As oil prices continued to rise, the effects were gradually passed on to the domestic prices of a

number of services with regulated prices. As borne out by the core inflation indices, however, there is no evidence that this is causing secondary inflation, suggesting that the higher fuel prices have been successfully processed as variations in relative prices.

On average, in 2005 the wholesale price index (WPI) rose by 5.5%, reflecting price increases of 6.8% and 1.3% for domestic and imported products, respectively. The appreciation of the peso has caused drops in the local-currency prices of most imported products, with the exception of mining products which posted an annual average increase of 29% as a result of the price boom.

Up to April 2006 the WPI rose by an annual average of 5.8%, again driven by the prices of domestic products, which were up by 7.8% in annualized terms, while import prices fell by 0.6%.

In 2005 real hourly wages increased at an average annual rate of 1.9%, which was similar to the figure observed

in 2004 and reflects a trend that has continued into 2006. Nominal hourly wages continue to reflect the price trends described here, but are also gradually showing the effects of a single upward adjustment in the form of a three-hour reduction in the working week in 2005. Meanwhile, unit labour costs, which had posted real reductions in 2005, showed an increase of some 1.9% towards the end of the year and in the first quarter of 2006. These costs may diminish as economic activity and productivity pick up momentum in the second half of the year.

The unemployment rate was 6.9% in the fourth quarter of 2005, with the average for the year at 8.0%, which was less than in the previous year. This reflected a 2.3% expansion of the labour force, a 3.2% rise in the number of employed and a 7.1% reduction in the number of unemployed, in annual average terms.

The labour force has been very dynamic, particularly in the case of women. The female labour force grew at an average annual rate of over 4%; women's rate of participation in the economically active population has risen, while the figure for men has held steady. This translates into higher unemployment rates among women (9.8% in 2005) despite the growth in employment.

In the first quarter of 2006 the unemployment rate was 7.9%, which was identical to the figure for the previous year, but rates higher than those of 2005 have been observed since.

Consistently with the trend in aggregate demand, in 2005 the largest growth in employment was seen in sectors associated with domestic demand (construction, commerce and services). Thus far in 2006 the greatest increases have been observed in agriculture and mining, probably owing to the price boom in the mining sector.

(c) The external sector

The current account recorded a surplus of US\$ 703 million (0.6% of GDP) in 2005. The trade surplus (f.o.b.) was close to US\$ 9.6 billion, compared to US\$ 8.5 billion in 2004; merchandise exports expanded to US\$ 32.2 billion in 2004, as against US\$ 40.6 billion in 2005, while imports of goods rose from US\$ 23 billion to US\$ 30.4 billion in that period.

The export performance breaks down into an annual increase of 22% in prices, especially copper and molybdenum, and of 2.9% in volume. Industrial exports rose steadily, with annual growth of over 10% for the second consecutive year.

The increase in imports can be disaggregated into an 8.8% rise in prices, especially oil, which was up by 33.2%, and a 20% increase in volume. Notably, imports of capital goods expanded by 52.3%, as a result of rapid growth in investment in 2005.

Net foreign direct investment diminished from US\$ 5.646 billion in 2004 to US\$ 4.764 billion in 2005. In this regard, it must be borne in mind that in 2004 a high proportion of FDI consisted of mergers and acquisitions. Since the promulgation of the Foreign Investment Statute (Decree Law 600) in 1974 US\$ 60.6 billion has been built up in FDI stock, with one third of this corresponding to mining.

International reserves stood at US\$ 16.9 billion at the end of 2005, compared to US\$ 16 billion at the end of 2004.

External debt rose from US\$ 43.5 billion in 2004 to US\$ 45 billion in 2005, but fell to 39.1% as a proportion of GDP.

Colombia

1. General trends

In 2005, the Colombian economy expanded by 5.1%. All the sectors showed improvements and there was a significant rise in domestic demand, especially in investment and private consumption. Accordingly, fiscal indicators improved and unemployment declined. The central bank operated an expansionary monetary policy with high liquidity and low interest rates, in the context of decreasing inflation. As for foreign trade, exports and imports grew rapidly, as did flows of foreign direct investment (8.2% of GDP in 2005 compared to 3.2% in 2004).

The outlook for 2006 promises a similar rate of economic growth, especially as regards consumption and investment. On the external front, however, lower growth in some trading partner countries could slow the expansion of exports. The devaluation observed thus far in 2006 will tend to reduce import growth. The unemployment rate should continue to fall and the quality of employment to improve, thus reducing

poverty levels. ECLAC estimates a GDP growth rate of 4.8%, while government projections include a current-account deficit of 1.3% of GDP, a fiscal deficit of 2.0% and an inflation rate of 4.5%.

In 2006, Colombia introduced a new system of parliamentary elections to coincide with the presidential election. President Uribe was re-elected in May, for a four-year term.

2. Economic policy

In 2005, monetary policy was expansionary, which translated into a decline in interest rates and a significant expansion of credit, especially consumer loans. In the course of the year, the central bank intervened actively in the foreign-exchange market in order to curb the peso's appreciation. The fiscal targets were easily met.

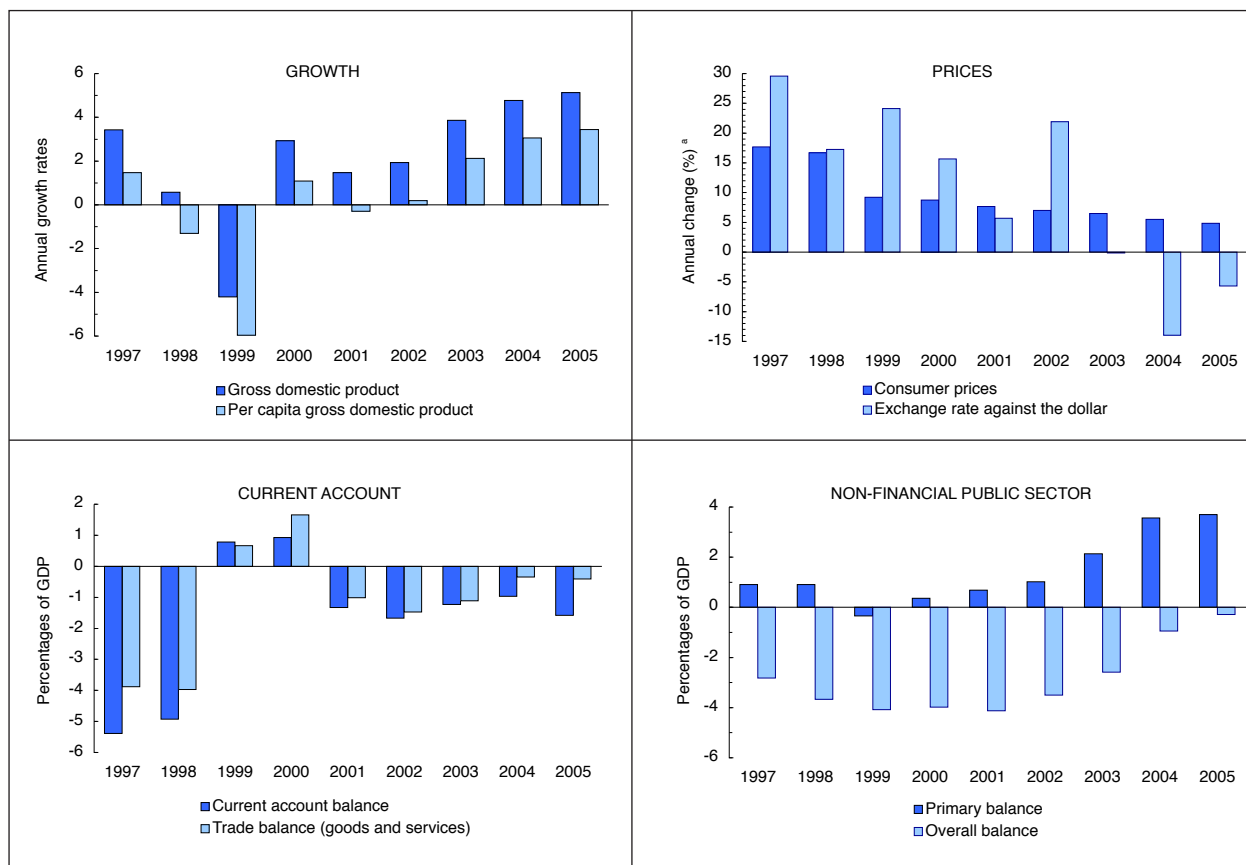
(a) Fiscal policy

From the fiscal perspective, 2005 was a good year. The consolidated public sector achieved a fiscal equilibrium, despite initial projections of a deficit of 1.2% of GDP, thanks to the narrowing of the non-financial public sector deficit (0.3% of GDP in 2005, compared to 0.9% in 2004) owing, in turn, to an increase in the surplus of the decentralized sector. This surplus was attributable to the improved

results for social security, especially in pension funds and unemployment, as well as those of State enterprises such as Empresa Colombiana de Petróleos (ECOPETROL), which offset the central government deficit.

The central government deficit was 4.8% of GDP, which was less than in 2004 (5.5%), owing to higher revenues. Total expenditure remained constant at around 21% of GDP. The rise in income was the result of higher tax collection on the back of the improved economic performance; the rise in the VAT rate from 7% to 10% for some products; the buoyancy of imports, which swelled tariff and VAT receipts; and the broadening of the income tax base and improvements in tax administration. Total expenditure rose by 10.3%, investment expenditure by 0.5% and current spending by 11.2%, with this last item consisting largely of reflecting transfers. Expenditure

Figure 1
COLOMBIA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

corresponding to interest payments on debt fell by 4%, as a result of the appreciation of the peso and a rise in the value of debt securities.

Central government borrowing needs, including the costs of financial restructuring, amounted to 5.2% of GDP. The bulk of financing came from domestic debt issues, in the framework of the policy of substituting domestic for external debt. The balance of central government debt decreased from 52% of GDP in 2004 to 50.9% in 2005, with the domestic debt component rising from 31% to 34% of GDP and the external component falling from 21% to 16.8%.

According to government estimates, the consolidated public sector deficit will be equivalent to 1.5% of GDP in 2006, mainly because the surplus of the decentralized sector — especially ECOPETROL and the social security segment— will be smaller (3.3% of GDP compared to

4.5% in 2005) and, to a lesser extent, because the central government deficit will be larger (5%, compared to 4.8% in 2005).

In the first half of 2005, Congress approved three laws on key economic issues: a reform to the pension system which eliminated special regimes and the system known as “mesada 14” (which provides two additional pension payments annually) for future pensioners, established a pension cap of 25 times the minimum wage and prohibited workers from using collective agreements to obtain better retirement conditions than those of the general system; the Stock Market Act; and the Legal Stability Act. The purpose of the last two laws is to guarantee market transparency and create an investment-friendly environment in Colombia by ensuring stable rules of the game.

In the first quarter of 2006, the central government

deficit amounted to 2% of GDP, which was less than the figure observed for the same period of 2005 (2.2% of GDP). Total income expanded by 0.4% of GDP with respect to the year-earlier period, mainly as a result of higher receipts from VAT (on domestic goods and imports) and income tax. Expenditure increased by 0.2% of GDP, the main reason being the rise in investment expenditure on road infrastructure, mass transport systems and security.

(b) Monetary policy

In 2005, expansionary monetary policy kept interest rates low and liquidity abundant. In September the intervention rate was lowered for the first time since December 2004, from 6.5% to 6%. Market interest rates showed nominal reductions and held steady in real terms. The average deposit rate was 7.0% in 2005, less than the figure for 2004 (7.4%), while the real interest rate remained relatively stable (2%). The lending rate was 14.6% in nominal terms and 9.2% in real terms. A downward trend in interest rates on securities was a constant feature of the domestic public debt market in 2005. Public securities rose in value owing to a combination of factors: macroeconomic stability, the drop in inflation, broad liquidity, peso appreciation and demand from foreign investors. The value of the Colombian stock market soared by 118%.

The growth of monetary aggregates gathered pace in 2005. The money supply (M1) expanded at an annual average rate of 18%, three percentage points more than in 2004. The rate of increase for broad monetary (M3) went from 13.5% to 17.9%. In general, the financial system expanded more rapidly and the quality of the credit portfolio improved, especially for consumer loans, which were up by over 30%, while the mortgage portfolio continued to contract. These trends continued at the beginning of 2006.

In the first half of 2006, the central bank (Banco de la República) shifted its monetary stance and raised the intervention rate twice, in April and June, by a total of 50 basis points, bringing it to 6.5%. Although the central bank expects the inflation target for 2006 to be achieved, it anticipates possible inflationary pressures over the next few years, hence the interest rate adjustment. Growth of monetary aggregates slowed in the first quarter of 2006. The rate for M1 slipped from the 18% observed in December 2005 to 15.7% in March 2006, owing to the reduction in current account deposits. The growth rate for M3 was down from 17.9% to 12.6%.

Interest rates continued to fall in the first few months of 2006. The nominal deposit rate came down from 6.3% at the end of 2005 to 5.9% in April 2006, and the lending rate was down from 13.3% to 12.9%. Stiffer competition in the property market helped to bring down rates on loans for house purchases quite significantly.

Interest rates on the public debt continued to trend downward until the middle of the first quarter of 2006, but were subsequently raised in view of expectations of further interest rate hikes in the United States. Reflecting these developments, stock market prices started to drop in February 2006.

(c) Exchange-rate policy

In 2005, the price of the dollar fell by an annual average of 11.6%, which was equivalent to a real appreciation of 8%. Throughout 2005, the Colombian peso continued to gain in value, although less strongly than in 2004. Contributing factors included larger capital flows (mainly in the form of foreign direct investment) and the terms-of-trade upturn owing to higher international prices for raw materials.

In order to slow the appreciation of the peso, the central bank continued with the discretionary purchase of dollars, some of which it sold to the government to prepay external debt as part of the effort to substitute domestic for external debt.

The local currency continued to appreciate into the first quarter of 2006, but at the end of March, as occurred in most other emerging markets, this trend was reversed by an increase in the value of the dollar. In May, the exchange rate stood at 2,418 pesos per dollar, which was similar to the figure recorded in December 2004 and represented a depreciation of 6% in relation to December 2005. The exchange rate's volatility may be attributed to expectations of hikes in external interest rates.

(d) Trade policy

In February 2006 free trade negotiations between Colombia and the United States were concluded. The resulting agreement will be submitted to the respective congresses for consideration and approval in the second half of the year and should enter into force in mid-2007.

In June 2006, negotiations began for a free trade accord between Colombia, El Salvador, Guatemala, and Honduras. Six rounds of talks are planned, culminating in an agreement expected in December.

Table 1
COLOMBIA: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	3.4	0.6	-4.2	2.9	1.5	1.9	3.9	4.8	5.1
Per capita gross domestic product	1.5	-1.3	-6.0	1.1	-0.3	0.2	2.1	3.1	3.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	0.7	0.0	-0.0	3.8	-0.4	0.1	2.7	4.2	2.1
Mining	3.7	15.6	18.5	-10.3	-6.1	-0.5	13.7	3.0	3.0
Manufacturing	0.5	-0.2	-8.6	11.8	1.3	2.6	4.5	7.0	4.0
Electricity, gas and water	1.0	1.8	-4.2	0.9	3.0	0.8	2.2	2.7	3.2
Construction	2.2	-7.2	-27.0	-3.9	3.9	12.4	13.3	10.6	12.6
Wholesale and retail commerce, restaurants and hotels	1.7	-1.6	-15.4	7.3	3.1	1.9	5.4	6.1	9.2
Transport, storage and communications	5.8	2.5	-1.9	1.5	4.0	2.4	2.9	5.4	5.1
Financial institutions, insurance, real estate and business services	4.9	-1.3	-4.9	-1.0	2.2	2.3	5.7	4.5	3.5
Community, social and personal services	7.2	1.8	3.3	0.6	0.7	-0.3	-0.2	2.7	4.0
Gross domestic product, by type of expenditure									
Consumption	5.3	-0.1	-3.2	1.4	2.3	2.2	1.7	3.9	4.9
General government	15.6	2.1	3.7	-0.2	1.1	-0.3	-0.3	3.3	4.8
Private	2.3	-0.9	-5.5	2.0	2.7	3.0	2.4	4.2	4.9
Gross domestic investment	-0.6	-6.3	-38.6	12.3	1.9	9.9	14.7	14.8	29.0
Exports (goods and services)	3.2	7.4	5.9	6.1	2.4	-5.0	5.7	11.4	4.6
Imports (goods and services)	6.2	-3.9	-24.7	6.0	6.8	1.7	4.7	16.9	25.2
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	20.9	19.7	12.9	13.7	14.3	15.3	17.2	17.6	19.2
National saving	15.5	14.8	13.7	14.6	12.9	13.6	16.0	16.7	17.6
External saving	5.4	4.9	-0.8	-0.9	1.3	1.7	1.2	1.0	1.6
	Millions of dollars								
Balance of payments									
Current account balance	-5 751	-4 857	671	779	-1 089	-1 359	-974	-938	-1 930
Merchandise trade balance	-2 638	-2 450	1 775	2 648	579	238	555	1 346	1 594
Exports, f.o.b.	12 065	11 480	12 037	13 737	12 848	12 315	13 812	17 224	21 727
Imports, f.o.b.	14 703	13 930	10 262	11 090	12 269	12 077	13 258	15 878	20 132
Services trade balance	-1 500	-1 461	-1 203	-1 259	-1 412	-1 435	-1 439	-1 679	-2 089
Income balance	-2 326	-1 697	-1 355	-2 283	-2 610	-2 867	-3 398	-4 332	-5 525
Net current transfers	713	750	1 455	1 673	2 354	2 706	3 309	3 727	4 089
Capital and financial balance ^d	6 028	3 460	-983	83	2 306	1 497	790	3 480	3 659
Net foreign direct investment	4 753	2 033	1 392	2 069	2 509	1 283	820	2 975	5 569
Financial capital ^e	1 276	1 427	-2 376	-1 987	-202	214	-30	505	-1 910
Overall balance	278	-1 398	-312	861	1 217	138	-184	2 541	1 729
Variation in reserve assets ^f	-278	1 398	312	-861	-1 217	-138	184	-2 541	-1 729
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^g	78.0	83.1	91.3	100.0	104.0	105.3	119.3	108.5	96.1
Terms of trade for goods (index: 2000=100)	93.3	81.2	87.2	100.0	94.2	92.5	95.2	108.5	117.7
Net resource transfer (percentage of GDP)	3.5	1.8	-2.7	-2.6	-0.4	-1.7	-3.3	-0.9	-1.5
Total gross external debt (millions of dollars)	34 409	36 681	36 733	36 130	39 101	37 329	38 012	39 445	38 350
Total gross external debt (percentage of GDP)	32.3	37.2	42.6	43.1	47.7	45.9	47.9	40.8	31.4
Net profits and interest (percentage of exports) ^h	-16.4	-12.6	-9.7	-14.5	-17.4	-20.2	-21.6	-22.2	-22.6
	Average annual rates								
Employment									
Labour force participation rate ⁱ	59.9	62.2	63.1	63.5	64.2	64.2	64.5	62.9	62.7
Open unemployment rate ^j	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4	14.0
Visible underemployment rate ^j	...	...	...	11.7	13.4	14.0	12.7	12.9	11.8
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	17.7	16.7	9.2	8.8	7.6	7.0	6.5	5.5	4.9
Variation in producer prices (December-December)	17.5	13.5	12.7	11.0	6.9	9.3	5.7	4.6	2.1
Variation in nominal exchange rate (December-December)	29.6	17.3	24.1	15.7	5.7	21.9	-0.2	-13.9	-5.7
Variation in average real wage	4.1	0.2	4.4	3.9	-0.3	2.8	-0.1	1.0	1.1
Nominal deposit rate ^l	24.1	32.6	21.3	12.1	12.4	8.9	7.8	7.8	7.0
Nominal lending rate ^m	...	44.5	29.4	18.8	20.7	16.3	15.2	15.1	14.6

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Non-financial public sectorⁿ									
Total income	31.3	30.5	33.9	33.7	35.1	34.7	35.4	37.5	34.9
Current income	28.8	28.3	32.9	33.2	35.1	34.7	35.4	37.5	34.9
Tax revenue	17.8	18.0	16.2	16.0	17.4	17.4	17.7	18.7	18.0
Capital income	2.5	2.2	0.9	0.4	-0.0	0.0	0.0	0.0	0.0
Total expenditure	34.1	34.2	38.0	37.6	39.2	38.2	38.0	38.5	35.2
Current expenditure	22.5	24.8	29.6	29.4	30.6	30.0	30.0	30.8	29.3
Interest	3.7	4.6	3.7	4.3	4.8	4.5	4.7	4.5	4.0
Capital expenditure	11.5	9.4	8.3	8.2	8.5	8.1	8.0	7.7	5.9
Primary balance	0.9	0.9	-0.3	0.4	0.7	1.0	2.1	3.6	3.7
Overall balance	-2.8	-3.7	-4.1	-4.0	-4.1	-3.5	-2.6	-0.9	-0.3
Debt of non-financial public sector									
Domestic	20.2	22.1	28.4	33.6	35.8	41.0	38.8	39.1	41.4
External	14.2	17.4	21.6	24.1	27.1	30.5	28.8	23.5	18.8
Money and credit^o									
Domestic credit ^p	30.3	32.9	33.4	26.9	22.1	19.7	15.2	15.1	18.7
To the public sector	0.6	0.9	3.5	5.1	6.3	6.3	6.5	6.7	5.9
To the private sector	33.7	35.4	33.7	26.6	24.1	22.9	22.2	21.9	21.9
Other	-0.4	-0.6	-4.1	-6.5	-8.2	-9.2	-12.2	-12.2	-9.5
Liquidity (M3)	36.9	38.6	38.0	34.0	33.8	33.9	33.5	34.1	35.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Annual average, weighted by the value of merchandise exports and imports. ^h Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ⁱ Economically active population as a percentage of the working-age population, thirteen cities; up to 1999, seven cities. ^j Unemployment and underemployment rates as percentages of the economically active population, thirteen cities; up to 1999, seven cities. ^k Includes hidden unemployment. ^l 90-day fixed-term certificates of deposit for banks and corporations. ^m Actual total system-wide rate. ⁿ Total expenditure and the balance figures include net lending. ^o The monetary figures are annual averages. ^p Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

The expansion in domestic demand became consolidated in 2005, as regards both private investment and household consumption. After growth of 4.8% in 2004, the economy accumulated an expansion of 5.1% in 2005.¹ Investment was substantially higher (29%), driven by tax incentives, readily available credit and low interest rates. Consumption also recorded rapid growth (4.9%) in both the private and public components (4.9% and 4.8%, respectively). In addition to the low interest rates, household consumption was stimulated by low inflation, a decrease in unemployment, increased consumer confidence and, to some extent, the wealth effect of the appreciation of shares in the stock exchange. The increase in public

consumption was coupled with the positive trend in tax income and favourable oil prices. The external sector made a negative net contribution to economic growth, since the expansion in exports was not enough to offset the jump in the volume of imports. The fastest-growing sectors were commerce (9.2%) and construction (12.6%), consisting mainly of public works. Industry and the agricultural sector posted a lower growth rate than in 2004 (4.0% and 2.1%, respectively).

The economy is expected to remain buoyant in 2006, although with a lower rate of growth than in 2005. In the first quarter of 2006 economic growth came in at an annual 5.4%, exceeding the annual 4.5% recorded in the year-earlier period. Investment continued to rise (27%); household consumption (5%) climbed strongly and public

¹ Excluding the effect of illicit crop eradication on aggregate production, the growth figure is an annual 5.2%.

Table 2
COLOMBIA: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	4.8	5.7	3.8	5.0	4.5	6.7	6.3	3.3	5.4	...
Merchandise exports, f.o.b. (millions of dollars)	3 406	4 024	4 568	4 733	4 632	5 562	5 442	5 554	5 454	...
Merchandise imports, c.i.f. (millions of dollars)	3 598	4 086	4 260	4 803	4 560	5 406	5 580	5 658	5 653	...
International reserves (millions of dollars)	11 192	11 462	11 995	13 394	12 643	13 586	14 784	14 787	14 963	14 452 ^c
Real effective exchange rate (index: 2000=100) ^d	112.5	109.5	106.5	105.4	98.5	96.6	95.3	94.1	93.3	101.1
Unemployment rate	17.1	15.8	15.1	13.7	15.8	14.1	13.8	12.1	14.1	...
Consumer prices (12-month percentage variation)	6.2	6.1	5.9	5.5	5.0	4.8	5.0	4.9	4.1	3.9
Average nominal exchange rate (pesos per dollar)	2 713	2 691	2 601	2 508	2 354	2 340	2 307	2 284	2 264	2 438
Average real wage (variation from same quarter of preceding year)	0.8	1.2	1.2	0.4	0.8	1.3	0.4	1.8	2.8	...
Nominal interest rates (annualized percentages)										
Deposit rate ^e	7.9	7.8	7.8	7.7	7.5	7.2	7.0	6.4	6.0	6.0
Lending rate ^f	15.1	15.2	15.0	15.0	15.1	14.8	14.8	13.6	13.5	12.5
Interbank interest rate ^g	7.1	6.8	6.8	6.8	6.6	6.5	6.4	5.6	5.9	6.2
Sovereign bond spread (basis points)	379	486	408	332	396	332	236	238	174	239
Stock price index (in dollars, December 2000=100)	252.2	234.1	278.4	376.4	402.5	494.6	581.7	783.0	917.8	580.6
Domestic credit (variation from same quarter of preceding year) ^h	...	...	...	24.2	...	...	...	23.0	...	...
Non-performing loans as a percentage of total credit ⁱ	6.7	...	...	...	...	...	...	...	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e 90-day fixed-term certificates of deposit for banks and corporations. ^f Actual total system-wide rate. ^g Reverse repo rate. ^h Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ⁱ Refers to total credit extended by the banking system.

consumption (3.2%) slowed. The available second-quarter data point to a good performance in industry and trade. A survey conducted by the Industrialists Association shows that 2006 is expected to be a good year for the sector. Businessmen report steady growth in sales and construction continues to expand.

(b) Prices, wages and employment

The cumulative variation in the consumer price index in 2005 was 4.9%, within the central bank's target range for annual inflation (between 4.5% and 5.5%) and 0.65 percentage points below the rate recorded in 2004 (5.5%). One contributing factor was the fall in prices of tradable goods, which were closely associated with the appreciation of the peso. The prices of regulated goods

trended downward, despite the rise in fuel prices, which helped to bring down inflation. In contrast, food prices showed an upward trend until October.

The central bank established an inflation target of 4.5% for 2006, with a margin of half a percentage point either way. Annual inflation, as measured by the consumer price index, continued to fall in the first half of 2006 and reached 4.0% in May, thanks to lower prices for foods, regulated goods and services and tradable goods.

In 2005, the producer price index (PPI) followed a downward trend, moving from 4.6% in 2004 to 2.1%. Currency appreciation in 2005 brought down the prices of imported goods, which to a large extent explains the drop in this index. The first semester of 2006 brought a change in the trend, however. In May the index showed a

4% rise over 12 months, compared to the 3.0% recorded for the same period of 2005.

Economic growth has led to a steady decline in unemployment, reflecting both an increase in the number of employed and a contraction in the national labour supply. In 2005, the average unemployment rate for urban areas (13 metropolitan areas) was 14.0%, compared to 15.4% in 2004. Nationwide, the drop in unemployment was larger (down from 13.6% to 11.8%). Job creation, which amounted to 494,000 positions between 2004 and 2005, represented an annual increase of 2.8% in the number of employed. Meanwhile, the labour force participation rate was down from 60.8% to 59.9%. The main concern with regard to labour issues continues to be the high rate of underemployment, which remained at 31.6%. The monthly minimum wage (equivalent to US\$ 164) was raised by 1.2% in 2005.

The results for the first four months of 2006 are highly positive, with unemployment down and employment rising. Nationwide, the unemployment rate dropped from 13.1% to 12.5% and the number of employed rose by 2.6%.

(c) The external sector

Notwithstanding the appreciation of the peso, Colombia's exports benefited from rising international prices for raw materials and good performances in the economies of its trading partners. Exports were up by 26% in 2005, mainly owing to a positive showing by traditional exports (35%) and, to a lesser degree, of non-traditional products (19%). The United States continued to be the main export destination (40% of total exports), followed by the Bolivarian Republic of Venezuela (10%).

Traditional exports expanded thanks to the upturn in international prices and, to a lesser extent, to higher volumes of coffee, coal and ferronickel exports. In the case of oil and petroleum products, the increase in international prices more than compensated for the fall in export volumes (4% down on 2004). Non-traditional exports expanded strongly, mainly in sales of industrial products, although at a lower rate than in 2004. Growth in industrial exports was led by sales of motor vehicles and spare parts, as well as foods, beverages and tobacco.

In 2005, a substantial rise in domestic investment and real exchange-rate appreciation resulted in a 27% increase in imports. Almost half of this expansion corresponded to

purchases of capital goods, mainly for industry, reflecting the rapid growth of investment. Imports of raw materials and intermediate goods for industry were up significantly (16%). Imports of consumer goods rose by 26%, with durable goods contributing strongly (31%).

In the first half of 2006, total exports grew by 17.8%, owing mainly to increased sales of non-traditional products (19.3%), led by the industrial sector. Imports rose by 24%, driven by raw materials, capital goods for industry and transport equipment.

In 2005, the balance-of-payments current account posted a deficit of US\$ 1.93 billion, equivalent to 1.6% of GDP, and US\$ 992 million larger than in 2004. Net capital inflows amounted to US\$ 3.659 billion and gross international reserves were up by US\$ 1.729 billion. In December the reserve stock amounted to US\$ 14.957 billion, or the equivalent of 8.9 months of goods imports.

The bulk of the current account deficit reflected higher net outflows on the factor income account, associated mainly with payments of profits and dividends. This effect was partially offset by a larger trade surplus (US\$ 250 million) and an increase in net transfers, mainly in the form of workers' remittances, which rose by 5%.

The capital and financial account posted a surplus of US\$ 3.659 billion, which was equivalent to 3% of GDP and larger than the 2004 surplus (US\$ 3.48 billion) thanks to growth in net foreign direct investment (FDI), which rose from US\$ 3 billion in 2004 to US\$ 5.6 billion in 2005. External resources went to the industrial sector, oil and communications. Some large Colombian enterprises were sold, including Bavaria and Coltabaco.

In the first quarter of 2006, the balance-of-payments current account deficit was US\$ 568 million (1.7% of quarterly GDP), well in excess of the year-earlier figure of US\$ 29 million. At the same time, net capital inflows amounted to US\$ 609 million, contrasting with the outflow recorded for the same period of 2005 (US\$ 236 million).

External debt declined from 40.8% of GDP in 2004 to 31.4% in 2005. Of this total, the external indebtedness of the private sector decreased from 14.1% to 11.6% of GDP and of the public sector, from 26.7% to 19.7% of GDP. Colombia's external debt stock represented 28.5% of GDP in February 2006, compared with 32.4% in the same month of 2005. This included private debt equivalent to 10.7% of GDP and public debt equivalent to 17.8%.

Ecuador

1. General trends

Although economic growth was moderate (3.9%) in 2005 and GDP is expected to increase by 3.5% in 2006, the economy faces significant challenges as regards the oil industry and competitiveness in general. In particular, given problems in the electricity sector, the threat of losing access to external markets under advantageous conditions and cost issues, the government will have to make explicit efforts to lower barriers to private-sector competitiveness.

In 2005 the fiscal situation deteriorated with respect to 2004, despite the large oil revenues being earned thanks to high international prices for crude oil. The primary and overall surpluses of the non-financial public sector (NFPS) were smaller, although this did not prevent a further reduction of the debt-to-GDP ratio.

Throughout 2005 and into early 2006 private banks

continued to hold large percentages of their assets in foreign securities.

In the external sector, oil exports performed very well in 2005 and 2006 because of the high prices being fetched by crude petroleum. Nevertheless, the export volume was flat owing to problems experienced by the State-owned Petroleum Corporation of Ecuador (PETROECUADOR) and low levels of investment by private oil companies.

2. Economic policy

(a) Fiscal policy

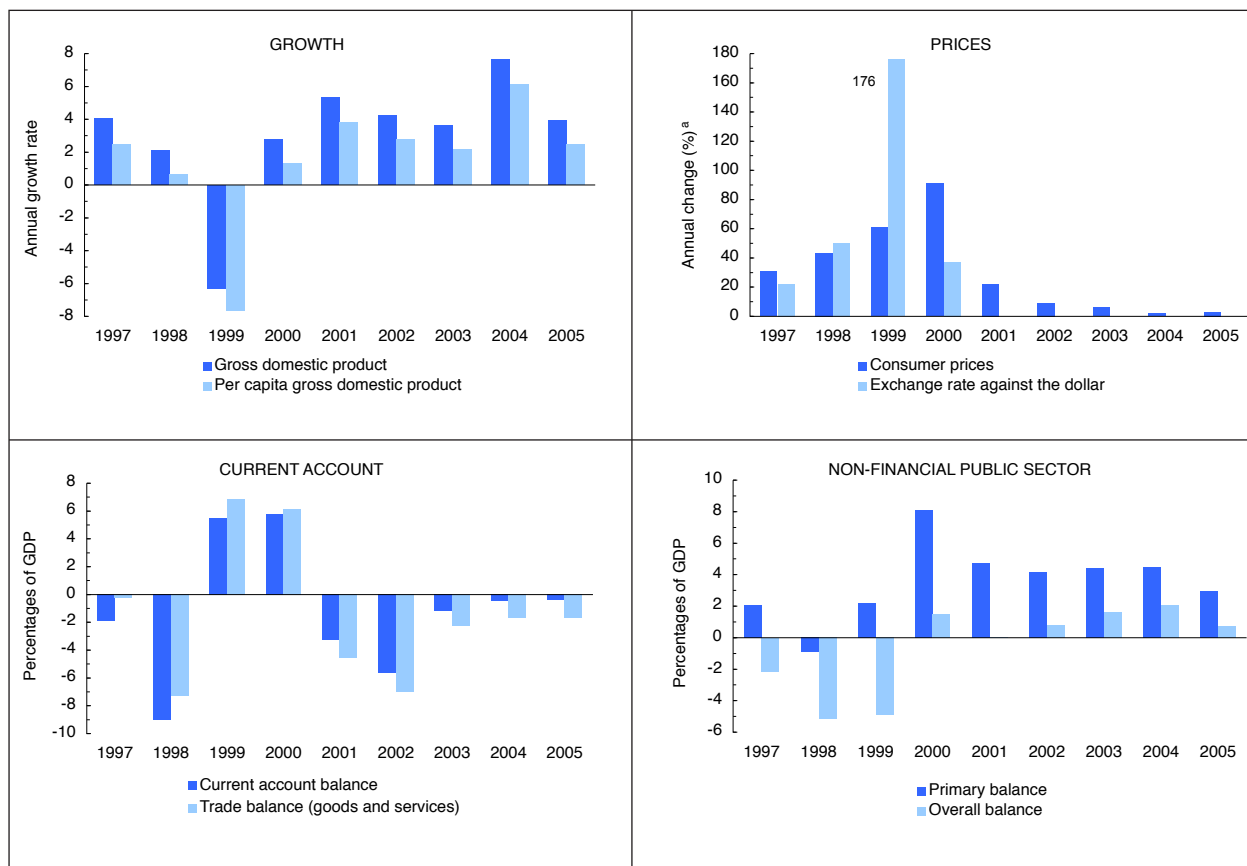
In 2005, the NFPS returned a primary surplus of 3% of GDP, while the overall surplus was 0.7%. This represented a significant decline with respect to the primary surplus of 4.5% of GDP and the global surplus of 2.1% of GDP recorded in 2004, owing to the fact that total spending grew more rapidly than total income: while spending expanded from 22.7% of GDP in 2004 to 24.5% in 2005, income increased from 24.8% to 25.2% of GDP. In nominal terms, total NFPS spending was up by 18.5%, while income grew by 11.9%. The central government posted a primary surplus of 1.9% of GDP and an overall deficit of 0.5% of GDP in 2005, which was an improvement on the primary surplus of 1.5% of GDP and the global deficit of 1% of GDP recorded in 2004.

Three significant factors had a bearing on income. First, the increase in oil export income accounts for

over half of the growth in total NFPS income. Second, almost a third of the rise in total income was attributable to the higher level of income tax collection, owing to the expansion of oil companies' earnings and of economic activity in general. Third, there was a rapid decline in fiscal income from the sale of petroleum products owing to the fact that domestic prices for petroleum products have been frozen since 2003 and much of the demand for such products is met by imports—paid for at international prices—because PETROECUADOR lacks installed refining capacity. NFPS revenues for domestic sales of petroleum products dropped from 2% of GDP to only 0.2% in 2005.

In terms of expenditure, there were significant increases in social security expenditure, which included the return of reserve funds by the Ecuadorian Social Security Institute, as ordered by Congress. Spending on wages expanded by 12.4% in 2005 and constituted almost

Figure 1
ECUADOR: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

a third of total NFPS expenditure (8% of GDP). Capital spending was also higher (gross fixed capital formation was up by 20.5% in 2005, reaching 5% of GDP (4.5% of GDP in 2004). Interest payments, in contrast, showed little nominal growth (1.3%) in 2005 and diminished as a share of GDP from 2.4% in 2004 to 2.2% in 2005. In general, fiscal spending continues to be very inflexible and the pre-allocation of income to a number of areas, such as subnational governments, is another fiscal management constraint worsening spending rigidities.

In July 2005, Congress amended the Fiscal Transparency, Stabilization and Responsibility Law, which had two main effects. First, the rule limiting expansion of central government primary spending was changed to apply only to current (and not capital) primary spending; second, the Fund for Stabilization, Social and Productive Investment and Public Debt Reduction (FEIREP), which had been used mainly to purchase domestic debt, was eliminated and replaced by an autonomous account entitled Special

Account for Production and Social Recovery, Scientific and Technological Development and Fiscal Stabilization (CEREPS), which allocates resources differently.

Another issue with important fiscal implications is the uncertain situation of the electricity sector. First, there are substantial cross debts among clients, distributors, generators and PETROECUADOR. This makes it difficult to establish the true position of the different companies, as the collectibility of the various debts is uncertain. This is important because a large part of the sector is publicly-owned. A second factor is that the distributors have significant operating problems and PETROECUADOR sells fuel to thermal generators at prices below opportunity cost (export price).

Ecuador's external public debt (including that of the central bank) diminished over the year, reaching US\$ 10.85 billion in December 2005 (29.9% of GDP), while the central government domestic debt rose in nominal terms to US\$ 3.686 billion (10.2% of GDP). External debt increased

in the first quarter of 2006, reflecting the receipt of a US\$ 400 million loan from the Latin American Reserve Fund (FLAR). On 15 May 2006 the government exercised an option to buy back, at face value, US\$ 740 million (of a total issue of US\$ 1.25 billion) in Global 2012 bonds, which carry a high coupon rate (12%). For this purpose, it used the US\$ 340 million remaining from its US\$ 650 million issue of Global 2015 bonds in December 2005, together with the US\$ 400 million loan from FLAR (disbursed in March 2006). This transaction lowered the cost of borrowing for Ecuador, since the coupon rate on the 2015 bond was 9.375% (with a return of 10.75%) and the FLAR loan was made at the LIBOR rate plus 2%.

Contingent liabilities are an important factor in the analysis of fiscal sustainability. In this connection, Occidental Petroleum sued the Ecuadorian State for the reimbursement of US\$ 75 million in VAT and the international arbiter in the proceedings ruled against Ecuador in July 2004. The British court to which the State then appealed upheld that ruling in March 2006.

(b) Monetary policy

The benchmark lending and deposit interest rates fluctuated slightly in 2005, but without significant changes. The reference lending interest rate was 9% in December 2005, while the deposit rate was 4.3%.

Accumulation of assets in the Ecuadorian banking sector expanded by 20.3% between December 2004 and December 2005. In 2005 loans increased by 27.2%, outstripping the previous year's figure; corporate loans were up 18.6% and loans to other resident sectors by 39.7%, with this latter item continuing to grow more

rapidly in 2006. Even so, in May 2006 corporate loans constituted 27.1% of total bank assets and loans to other resident sectors accounted for 22.7%. Interestingly enough, in 2005 and 2006 the banking system continued to accumulate non-share holdings, especially foreign securities. While total assets grew by 31.3% between December 2004 and May 2006, securities abroad expanded by 77.7% over this period and accounted for 12.7% of all assets (US\$ 1.487 billion). In addition, 11.7% of holdings (US\$ 1.372 billion)—almost one quarter of the system's assets—are held in transferable deposits abroad, which constitute “insurance” for Ecuadorian banks against bank runs and other contingencies. This preference for foreign assets seems to have become more pronounced in the first five months of 2006, when 45.5% of new assets were placed in foreign securities. Despite the high opportunity cost of keeping such large quantities of assets abroad, the banks reported profits in 2005.

(c) Other policies

In 2005, Ecuador's exchange-rate competitiveness improved, broadly speaking. The total real exchange effective rate was 4.3% higher (i.e., depreciation) than the average for 2004, which was mainly a reflection of the United States dollar's depreciation in relation to other currencies (such as the Colombian peso). The depreciation of Ecuador's real effective exchange rate in 2005 was led by real bilateral depreciation in relation to the Colombian currency (16.4%), followed by depreciation in relation to the Brazilian real (25.9%), although the latter trend had much smaller impact on the effective exchange rate owing to its lesser weight in Ecuador's external trade.

3. The main variables

(a) Economic activity

Ecuadorian GDP grew by 3.9% in 2005, which was a significant slowdown compared to 2004 when real GDP was up by 7.6%. The economic growth in 2005 was mainly attributable to the manufacturing industry, led by the meat, processed fish and machinery and equipment subsectors, as well as wholesale and retail trade and other services. In particular, mining and quarrying—basically the oil sector—expanded by only 1% in 2005, which contrasted with the sector's buoyancy in 2004. A particularly strong driver of spending were

exports, with expansion of 5.2%, followed by gross fixed capital formation (5.1%) and household consumption (4.9%). Final government consumption rose by 3.6%, slightly below GDP.

A growth rate of 3.3% is forecast for 2006, driven by commerce, transport and services in general. Manufacturing activity is expected to remain buoyant in 2006. The outlook for the oil industry, however, is less clear.

Ecuadorian oil production did not expand significantly in 2005 and increased only slightly in the first five months of 2006 (3.2%); thus, the potential gains from high international prices for crude oil were not fully

Table 1
ECUADOR: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	4.1	2.1	-6.3	2.8	5.3	4.2	3.6	7.6	3.9
Per capita gross domestic product	2.4	0.6	-7.6	1.3	3.8	2.8	2.2	6.1	2.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	10.0	-3.0	9.1	-0.1	3.6	5.4	4.5	0.4	4.7
Mining	-1.9	-1.6	1.4	8.0	1.1	-2.5	6.0	24.3	1.0
Manufacturing	8.5	8.3	-23.5	-32.4	11.6	6.3	0.4	-2.3	7.5
Electricity, gas and water	6.8	8.5	23.0	2.6	0.6	8.2	0.6	0.1	5.0
Construction	2.7	-0.2	-24.9	18.3	19.7	20.0	-0.7	3.0	1.6
Wholesale and retail commerce, restaurants and hotels	4.4	1.1	-11.3	3.8	4.8	2.2	3.1	3.1	5.5
Transport, storage and communications	8.2	9.4	-0.3	7.7	1.9	1.2	5.7	3.3	4.1
Financial institutions, insurance, real estate and business services	1.6	-5.0	-20.6	2.3	3.6	7.9	2.7	3.6	4.3
Community, social and personal services	3.4	5.1	-1.3	5.8	0.4	-0.4	2.3	2.8	3.6
Gross domestic product, by type of expenditure									
Consumption	4.3	3.6	-6.8	3.9	5.8	6.3	4.7	5.3	4.7
General government	4.7	-2.2	-5.5	4.7	-0.6	4.3	1.4	3.6	3.6
Private	4.2	4.5	-7.0	3.8	6.8	6.6	5.2	5.5	4.9
Gross domestic investment	12.5	14.2	-49.4	29.0	45.0	21.6	-12.8	10.3	3.0
Exports (goods and services)	7.8	-5.1	7.8	-1.0	-0.8	-0.8	7.4	14.3	5.2
Imports (goods and services)	15.4	7.0	-29.5	15.8	24.8	16.7	-4.2	10.8	6.1
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	21.5	25.3	14.7	20.1	24.3	26.5	21.4	22.5	23.4
National saving	19.5	16.2	20.2	25.9	21.0	20.8	20.2	22.1	23.0
External saving	1.9	9.0	-5.5	-5.8	3.3	5.6	1.2	0.5	0.4
	Millions of dollars								
Balance of payments									
Current account balance	-457	-2 099	918	921	-695	-1 399	-340	-155	-136
Merchandise trade balance	491	-1 132	1 588	1 395	-397	-998	86	413	591
Exports, f.o.b.	5 360	4 326	4 615	5 137	4 781	5 198	6 381	7 910	9 888
Imports, f.o.b.	4 869	5 458	3 028	3 743	5 179	6 196	6 294	7 497	9 297
Services trade balance	-543	-563	-451	-420	-572	-748	-734	-969	-1 193
Income balance	-1 026	-1 171	-1 308	-1 405	-1 364	-1 306	-1 465	-1 493	-1 609
Net current transfers	621	767	1 090	1 352	1 639	1 652	1 772	1 894	2 075
Capital and financial balance ^d	-65	1 314	-1 862	-6 618	436	1 275	461	436	645
Net foreign direct investment	724	870	648	720	1 330	1 275	1 555	1 160	1 530
Financial capital ^e	-789	444	-2 511	-7 338	-894	-0	-1 094	-725	-885
Overall balance	-521	-784	-944	-5 697	-258	-124	120	281	510
Variation in reserve assets ^f	-253	461	489	-307	106	66	-152	-277	-495
Other financing ^g	774	324	455	6 004	152	58	32	-4	-14
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	65.7	65.5	89.1	100.0	71.7	62.6	61.0	63.7	66.4
Terms of trade for goods (index: 2000=100)	89.1	75.8	89.1	100.0	84.6	86.8	89.8	91.5	102.4
Net resource transfer (percentage of GDP)	-1.3	2.0	-16.3	-12.7	-3.6	0.1	-3.4	-3.2	-2.7
Total gross external debt (millions of dollars)	15 099	16 401	16 282	13 564	14 411	16 288	16 595	17 010	18 926
Total gross external debt (percentage of GDP)	63.9	70.5	97.6	85.1	67.8	65.4	57.8	51.6	52.2
Net profits and interest (percentage of exports) ⁱ	-17.0	-23.4	-24.5	-23.5	-24.2	-21.5	-20.2	-16.9	-14.9
	Average annual rates								
Employment									
Labour force participation rate ^j	57.3	58.4	60.0	56.8	55.6	54.1	53.8	55.8	56.1
Open unemployment rate ^k	9.3	11.5	15.1	14.1	10.4	8.6	9.8	11.0	10.7
Visible underemployment rate ^l	...	13.6	15.2	13.8	11.3	9.3	8.8	7.2	6.6
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	30.6	43.4	60.7	91.0	22.4	9.3	6.1	1.9	3.1
Variation in producer prices (December-December)	...	...	186.9	64.9	-5.6	17.7	4.5	4.3	21.6
Variation in nominal exchange rate (December-December) ^m	22.2	50.1	176.0	37.3	0.0	0.0	0.0	0.0	0.0
Variation in minimum urban wage	-3.4	-7.2	-10.7	-3.6	11.5	0.9	6.1	2.4	3.0
Nominal deposit rate ⁿ	...	...	...	8.2	6.6	5.1	5.3	4.0	3.8
Nominal lending rate ⁿ	...	...	...	15.2	15.5	14.1	12.6	10.2	8.7

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Non-financial public sector									
Total income	19.9	17.3	21.1	25.9	23.3	25.5	24.1	24.8	25.2
Tax revenue	7.6	8.4	8.8	10.6	11.8	11.8	11.1	11.0	11.9
Capital income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure ^o	22.1	22.1	25.0	24.4	23.3	24.7	23.0	22.7	24.5
Current expenditure	16.8	17.2	19.0	19.4	16.7	18.4	17.9	17.9	19.4
Interest	4.2	4.2	7.1	6.6	4.7	3.4	2.9	2.4	2.2
Capital expenditure	5.3	5.0	6.0	5.0	6.6	6.4	5.1	4.9	5.1
Primary balance	2.1	-0.9	2.2	8.1	4.7	4.2	4.4	4.5	3.0
Overall balance ^p	-2.1	-5.2	-4.9	1.5	0.0	0.8	1.6	2.1	0.7
Debt of non-financial public sector	56.6	62.5	93.7	79.7	62.7	54.3	49.1	43.3	39.6
Domestic ^q	7.0	11.1	19.8	17.8	13.2	11.1	10.5	10.6	10.2
External	49.6	51.4	73.9	62.0	49.5	43.1	38.6	32.7	29.5
Money and credit^r									
Domestic credit ^s	...	...	...	...	26.5	21.9	16.8	15.7	16.2
To the public sector	...	...	...	...	-0.1	-0.2	-1.9	-2.9	-4.8
To the private sector	...	...	...	...	26.6	22.1	18.7	18.6	21.0
Quasi-money (M2)	...	...	...	23.4	22.0	22.7	19.1	19.3	21.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^j Economically active population as a percentage of the working-age population, three cities; up to 1998, urban total. ^k Unemployment rate as a percentage of the economically active population, three cities; up to 1998, urban total. Includes hidden unemployment. ^l Underemployment rate as a percentage of the economically active population, three cities; up to 1998, urban total. ^m In January 2000, the country adopted the United States dollar as its official currency. ⁿ Reference rate in dollars, monthly average. ^o On an accrual basis. ^p US\$ 130 million that was de-earmarked from the central government accounts by the Office of the Under-Secretary for the Treasury (equivalent to 0.5% of GDP) has not been deducted for 2003. ^q Central government's domestic debt. ^r The monetary figures are annual averages. ^s Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. As of 2000, includes net credit extended by the Central Bank of Ecuador and the National Finance Corporation.

realized. Total oil extraction rose by a mere 1% in 2005, since drilling by PETROECUADOR declined by 1.4% and private extraction climbed 2.4%. The State firm's crude extraction volume continued to decline, owing to lack of investment and internal problems in the company, leading to a drop in production from 119.7 million barrels (328,000 barrels per day) in 1994 to 71 million barrels (194,400 barrels per day) in 2005. In 2005 and 2006 the company experienced operating difficulties, mostly because of the debts accumulated by electricity generators and the need to import large quantities of petroleum products at market prices for subsequent heavily subsidized domestic sale. In May 2006 the Ecuadorian State rescinded its contract with Occidental Petroleum and delivered operation of its fields (Block 15, Eden-Yuturi and Limoncocha) to PETROECUADOR. These fields yielded an average of 100,000 barrels per day of crude, which was equivalent to 18.8% of Ecuador's total production. Unless PETROECUADOR can match the investment capacity and production efficiency of the

private sector, this change in administration could impact strongly not only on the fiscal position but also on GDP growth. Moreover, Occidental Petroleum filed a US\$ 1 billion claim against Ecuador with the International Centre for Settlement of Investment Disputes (ICSID), the World Bank's investment dispute settlement body.

Other factors could also affect production in the oil sector. First, Congress approved an amendment to the Hydrocarbons Law providing that, when crude oil prices exceed the prices agreed in contracts with private companies, the State shall receive at least 50% of the surplus generated, defined as the difference in prices multiplied by the number of barrels produced.¹ Second, local indigenous communities and environmental organizations have opposed private oil ventures operating in various parts of the country (including Blocks 23 and 24). Third, in August 2005 serious disturbances occurred in the provinces of Sucumbíos and Orellana, two major oil areas. These protests led to a temporary stoppage of PETROECUADOR crude oil exports.

¹ The prices will be adjusted according to the United States consumer price index.

Table 2
ECUADOR: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	7.6	11.8	7.3	4.2	3.3	3.8	3.6	4.9	...	...
Merchandise exports, f.o.b. (millions of dollars)	1 691	1 988	2 038	2 037	2 222	2 474	2 685	2 720	2 945	...
Merchandise imports, c.i.f. (millions of dollars)	1 693	1 949	2 115	2 470	2 354	2 532	2 513	2 887	2 786	...
International reserves (millions of dollars)	824	885	1 180	1 070	1 025	1 217	1 568	1 714	1 859	1 678 ^c
Real effective exchange rate (index: 2000=100) ^d	62.9	62.4	63.9	65.4	66.7	66.6	66.4	66.0	66.0	66.6
Unemployment rate	11.2	11.4	10.7	10.7	11.5	10.7	11.0	9.6	10.4	...
Consumer prices (12-month percentage variation)	4.0	2.9	1.6	1.9	0.9	2.1	2.9	3.1	4.2	2.8
Average nominal exchange rate (sucres per dollar) ^e	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000
Nominal interest rates (annualized percentages)										
Deposit rate ^f	4.8	4.1	3.7	3.7	3.6	3.7	3.9	4.1	4.3	4.3 ^c
Lending rate ^f	11.5	10.7	9.6	8.9	8.4	9.2	8.8	8.5	8.7	8.8 ^c
Interbank interest rate ^g	0.7	0.8	0.7	0.7	1.0	1.2	1.7	2.0	2.2	2.3
Sovereign bond spread (basis points)	701	952	778	690	660	808	634	669	524	519
Domestic credit (variation from same quarter of preceding year) ^h	-0.4	11.0	12.9	10.0	15.1	14.8	13.1	14.7	10.5	6.1 ^c
Non-performing loans as a percentage of total credit ⁱ	19.7	18.2	18.1	15.0	15.7	14.2	13.7	12.6	12.8	12.7 ^c

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e In January 2000, the country adopted the United States dollar as its official currency. ^f Reference rate in dollars, monthly average. ^g Interbank market, weighted average. ^h Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ⁱ Refers to total credit extended by the banking system.

(b) Prices, wages and employment

The consumer price index rose by 3.1% between December 2004 and December 2005, which was a larger variation than the 1.9% recorded in 2004. Price movements in 2006 are expected to reflect economic growth in the services sector, as well as increases in credit and the effects of the reimbursement of pension reserve funds that began in 2005. Cumulative inflation for the first six months of 2006 was 1.5%, whereas 12-month inflation for the period ending June 2006 was 2.8%.

In 2005, job creation was moderate in Ecuador, despite the growth of industry and the services sector, which usually create labour demand. The unemployment rate dipped slightly, from an average of 11% in 2004 to an average of 10.7% in 2005. This was despite a slight rise in the participation rate, since the employment rate increased by 0.3 percentage points. In the first six months of 2006, the average unemployment rate was 10.4%, which was below the 11.1% recorded for year-earlier period, while the employment rate was also 0.75 percentage points higher than in the first half of 2005.

The average minimum wage in 2005 was 3% above the 2004 figure and in the first five months of 2006 it was 3% up year-on-year.

As for quality of employment, “adequate” employment declined significantly, from an average of 46.2% in 2004 to 41.9% in 2005. Underemployment increased from 42.6% in 2004 to 47.3% in 2005. One possible interpretation is that growth in services and other activities with low rates of labour productivity contributed to the increasingly insecure employment conditions observed in 2005. During the first half of 2006 “adequate” employment was at 41.2%, similar to the level recorded for the same period of 2005, while underemployment was higher in the first half of 2006 (48.3%) than in the same period of 2005 (47.6%).

(c) The external sector

No balance-of-payments data have become available since the second half of 2005; hence, the analysis will focus on trade.

Ecuadorian exports performed well in 2005, growing

by 30.3%. Of this increase, 64% is attributable to the expansion in oil exports (38.4%). The jump in oil exports is almost entirely due to a 36.1% rise in crude oil prices, however, since the volume exported rose only 1.7%. Shrimp was the fastest-growing non-oil export in 2005, with a substantial rise of 38.7%, although this represented only about half the value exported in 1997. Banana exports grew moderately in 2005 (5.9%) and the fastest-growing non-traditional exports were canned tuna (up 35.2%) and motor vehicles (up 113.4%).

Crude oil exports are expected to remain buoyant in 2006, mainly because of the high prices. During the first five months crude exports rose by 57.3%, owing to an average price rise of 43.9%. Export volumes are unlikely to change significantly because of the problems being experienced by PETROECUADOR and private companies' lack of interest in substantially increasing their investments. Other exports, such as shrimp, should also have a good year, in particular owing to the weakness of the United States dollar compared to the currencies of Ecuador's trade partners. In relation to banana exports, it is not yet clear how the European Union's shift from quotas to tariffs on banana imports in 2006 will affect Ecuadorian exports in the long run.

Imports rose by 26.4% in 2005; over a third of this growth reflected increased imports of fuel and lubricants (72.3%) and almost another third was attributable to imports of capital goods (up 31.5%), mainly for industry. Fuel and lubricant imports reflected not only the higher oil prices, but also the need to meet expanding domestic demand for petroleum products, in view of the limited refining capacity of PETROECUADOR. Imports of consumer goods grew by 14.1%, while raw material imports increased by 14.4%. In the first five months of 2006 the value of imports was up by 19.8%, mostly due to large imports of fuel and lubricants, which are continuing the upward trend recorded in 2005.

Lastly, the negotiations for a free trade agreement between Ecuador and the United States have stalled and it is not clear when they will resume. This is a matter of concern for exporters who benefit from preferential tariffs under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which helped them to place their products in the United States market. Those preferences expire this year so, unless the free trade agreement (which is opposed by part of the population) is signed, sectors that used to benefit under ATPDEA will face higher tariffs.

Paraguay

1. General trends

The Paraguayan economy grew by 2.9% in 2005, boosted by the expansion of the livestock sector (18% real growth for the year), commerce (3.6%) and communications (12%), and despite a 5.8% downturn in crop-farming owing to the impact of drought on a number of crops. The overall figure reflects a slowing of the economy in comparison with the recovery enjoyed in the two previous years, which had followed the downswings of 1999 and 2000. The economy had expanded in 2003 and 2004 despite the drought, with growth rates of 3.8% and 4.1%, respectively, both of which exceeded the 1992-1998 average of 3%. Thanks to a favourable international context, the economy is expected to pick up in 2006, with growth projected at over 3%.

Inflation as measured by the consumer price index had stood at just 2.8% in 2004, but rose to 9.9% in 2005, mostly owing to imported inflation. As of June 2006, the cumulative inflation rate was 3.7%, but for the year as a whole it is expected to be inside the central bank's target band.

The central government ended 2005 with a slight overall fiscal surplus of 0.8% of GDP, higher than expected. For 2006, thanks to the new stand-by agreement

with IMF, the public accounts should remain balanced.

The current-account deficit in 2005 was 1.4% of GDP (in current dollars) and the capital and financial account showed a surplus of 2.9%. International reserves increased by 1.7% of GDP.

The greatest challenge facing Paraguay is to resolve the executive power's current difficulty in obtaining the approval of Congress for fundamental reforms, which is impairing governance.

2. Economic policy

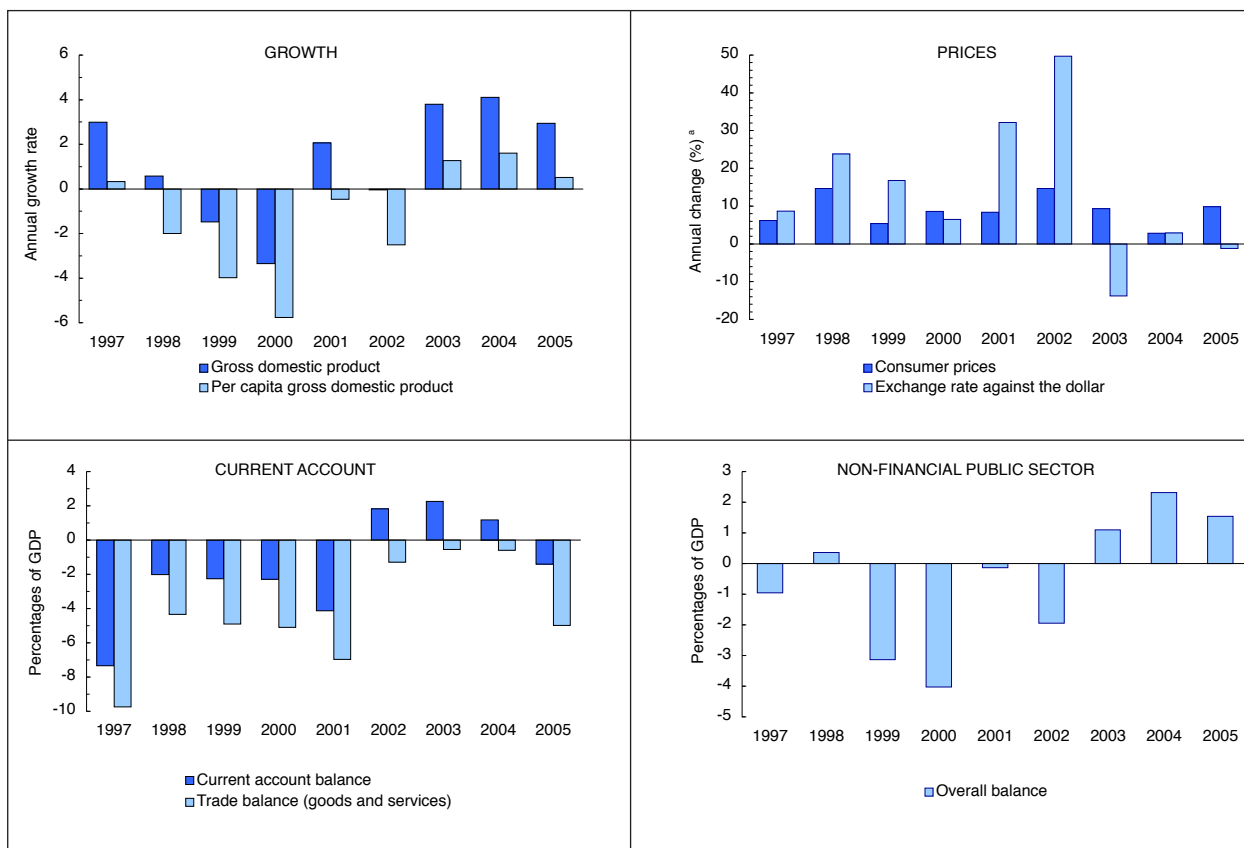
(a) Fiscal policy

As in the previous two years, efforts have continued to implement the fiscal reforms introduced in 2003 and 2004, particularly the Customs Code, the Public Sector Pensions Reform and Sustainability Act, and the Administrative Restructuring and Fiscal Reform Act.

The growth of tax receipts slowed and expenditure rose more quickly in 2005, however. Nevertheless, the central government showed an overall surplus of 0.8% of GDP and a primary balance of 2% of GDP, compared with the 2004 figures of 1.6% and 2.7%, respectively.

The central government's overall fiscal revenue was up by a nominal 10.6% (26.1% in 2004), which was

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

similar to the rise in tax revenue (11%, compared with the 2004 figure of 34%). Despite this slowdown, there was an increase in the number of new taxpayers, which broadened the tax base.¹ Receipts from tax on net income and profits rose by nearly 10%, as against the previous year's 41% increase, while VAT revenue continued to mount significantly (24% and 23.5% in 2005 and 2004, respectively). Despite rising oil prices, fuel tax revenues were down 5.9% owing to a change in the tax on diesel fuel, which was fixed at 600 guaraníes per litre regardless of the sale price, and a cut in the tax rates on gasoline of up to 85 octanes from 34% to 24%. These three taxes together make up 75% of tax revenue.

Total spending increased by 15.4% in nominal terms in 2005, as against 11.4% in 2004. Wages, which

represent 53.6% of current expenditure, were up 11.8% (9.5% in 2004). In 2006, in order to contain spending, the authorities froze the hiring of new staff until August. Current transfers rose by 23.8%, with a sharp increase in outlays on pensions (19.8%), mostly because of bonuses and levelling of pensions. Interest payments on public debt rose by 13.8%. Capital spending was up 14%, but it still represents 23% of total spending, a little over half the amount of spending on personal services.

According to projections published in August 2005 by the Ministry of Finance, the overall fiscal balance for 2006 will show a deficit of 0.66% of GDP and a primary surplus of 0.42%. Achieving that outcome will call for spending to be cut with respect to the budget approved by Congress early in the year.² In May 2005, Congress

¹ The taxation department of the Ministry of Finance compiles the data for the Single Registry of Taxpayers, which is particularly important under the Administrative Restructuring and Fiscal Reform Act, owing to the tax advantages it offers to registered taxpayers.

² To that end, the government may apply the Financial Plan, a legal instrument provided for in the Law on Government Financial Administration, which requires that funds for expenditure should be disbursed only when revenue permits.

also adopted a proposal from the executive branch to issue sovereign bonds totalling 130 billion guaraníes, to finance capital spending and public debt.

Under the Administrative Restructuring and Fiscal Reform Act, personal income tax will be payable for the first time in 2006. The annual tax rate will be 10% for individuals whose monthly incomes are more than ten times the monthly minimum wage (or whose annual incomes exceed 120 monthly minimum wages), and 8% for incomes below that threshold. In the second year, the threshold will be lowered to nine times the minimum wage and it will decrease by one minimum wage every year thereafter until it reaches three monthly minimum wages in 2012.

As for public-sector corporations, the government requested audits of *Petróleos Paraguayos (PETROPAR)*, *Empresa de Servicios Sanitarios del Paraguay (ESSAP)*, *Industria Nacional del Cemento (INC)*, the National Civil Aeronautics Directorate (*DINAC*), the National Navigation and Ports Administration (*ANNP*), and the National Electricity Administration (*ANDE*). These audits revealed large gaps and hidden losses in the corporations' accounts. The report published by the government in June 2006 creates a restructuring plan which includes results-based management, but there are no plans for a significant private-sector stake in the corporations.

(b) Monetary and exchange-rate policy

The Central Bank of Paraguay set an inflation target of 5% for 2005, within a band of 2.5% on either side. At the end of the year, however, the year-on-year inflation rate stood at 9.9%, with an annual average of 6.8%.

In 2005, in response to this inflation, the central bank raised the interest rates of its short-term monetary regulation instruments (central bank debt securities), although long-term rates varied less, which resulted in a flattening of the yield curve on those securities. Accordingly, the weighted mean yield of monetary regulation instruments was 4.1%, despite the 6.7% recorded in December. At the same time, there was a steep rise in the volume being issued, reaching a monthly average of 820 billion guaraníes in 2005. As of May 2006, the average stood at 1.479 trillion guaraníes, representing 58% of M0 (notes and coins in circulation). Monetary regulation instruments were the main factor holding down M0 in 2005.

Nevertheless, monetary aggregates expanded by more than 15% in 2005, except for base money (4.4% year-on-year) and M3 (8.3% year-on-year). M0 grew by 17.6% in

year-on-year terms, M1 by 20.6% and M2 by 16.3%. The early months of 2006, however, saw a slowdown in this year-on-year expansion and the growth rates observed in May were 13.8%, 13.3%, 10.3% and 6.5% for M0, M1, M2 and M3, respectively.

The expansion of M0 was driven mainly by international reserves, which rose from US\$ 1.168 billion in December 2004 to US\$ 1.297 billion in December 2005.

The weighted average for nominal lending rates stood at 26.6% in December 2005, compared with 22.5% a year earlier. In real terms, however, they fell from 19.2% in 2004 to 15.2% in 2005. The weighted average for nominal deposit rates stood at 0.6% in late 2005, lower than the 1.7% recorded in December 2004, which translated into negative real deposit rates of -8.5% in 2005 because of inflation combined with the virtually-zero nominal rates on sight deposits. Interest on time deposits rose from a nominal 5.1% (2.2% in real terms) in December 2004 to a nominal 10.1% (a real 0.2%) in December 2005.

Given the behaviour of interest rates, private-sector deposits and credit to the private sector increased more moderately in 2005. Deposits were up 5.7%; those in local currency rose 14.5%, but foreign-currency deposits declined by 1%.³ This decrease was due in part to the appreciation of the guaraní against the United States dollar, since dollar-denominated deposits increased by 1.2%. Total credit grew by 13.3%, with only a small increase in foreign-currency credit (1.4%), compared with loans in domestic currency, which continued to grow in 2006 at a year-on-year rate of more than 20% (26.5% in 2005).

As regards exchange-rate policy, in 2005 the guaraní depreciated against the Brazilian real despite strengthening against the United States dollar for part of the year, because the real's appreciation against the dollar was greater.

As of the end of 2005, the guaraní had appreciated by 1.2% in nominal terms against the United States dollar (4.9% in real terms). Nevertheless, taking the average value for 2005 against the average for 2004, the currency had depreciated by a nominal 3.4% (0.8% in real terms) against the dollar. This downward trend was due to Paraguay's current-account deficit and the difference between the two countries' inflation rates.

Against the Brazilian real, the year-on-year nominal depreciation of the guaraní was 16% (6.6% in real terms). Given Paraguay's strong trading links with Brazil, the real effective depreciation of the guaraní was 13.7%. The central bank's interventions in the foreign-exchange market were designed to contain this downward trend

³ Year-on-year nominal rates of variation.

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	3.0	0.6	-1.5	-3.3	2.1	0.0	3.8	4.1	2.9
Per capita gross domestic product	0.3	-2.0	-4.0	-5.8	-0.5	-2.5	1.3	1.6	0.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	6.9	1.2	1.3	-7.0	11.6	4.2	8.0	3.9	0.1
Mining	-3.0	-3.8	-0.4	-5.2	-8.3	-9.1	15.6	2.7	7.8
Manufacturing	0.8	-0.2	-1.9	-0.9	-0.6	-1.4	0.7	3.3	2.6
Electricity, gas and water	2.4	1.9	1.7	1.9	1.9	1.1	4.6	3.6	2.1
Construction	-2.5	-0.7	-5.8	-7.8	-1.4	-8.9	14.4	2.1	5.5
Wholesale and retail commerce, restaurants and hotels	-1.2	1.5	-6.0	-3.6	0.0	-1.6	5.5	5.1	3.7
Transport, storage and communications	18.7	2.2	1.3	1.4	2.1	2.0	0.7	9.6	6.5
Financial institutions, insurance, real estate and business services	1.9	-1.9	0.6	-0.7	1.2	0.8	-4.9	2.1	3.3
Community, social and personal services	4.2	0.9	0.8	-0.4	-5.1	-1.1	0.5	2.7	5.2
Gross domestic product, by type of expenditure									
Consumption	4.3	-1.1	-1.1	-4.7	1.4	-6.7	2.3	4.6	4.6
General government	-1.6	1.1	-0.8	-2.6	-8.6	-3.2	-2.0	6.0	7.6
Private	5.0	-1.3	-1.1	-5.0	2.6	-7.1	2.9	4.4	4.2
Gross domestic investment	7.4	-14.4	-14.1	-9.1	11.0	-13.7	8.5	11.9	0.5
Exports (goods and services)	-9.6	5.8	-25.5	8.0	-9.6	15.9	4.4	1.8	2.7
Imports (goods and services)	-3.7	-4.5	-26.2	0.9	-6.1	-6.2	3.8	6.2	4.6
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	26.5	22.7	20.8	18.8	18.7	18.7	19.9	20.8	21.7
National saving	19.1	20.7	18.5	16.5	14.6	20.5	22.2	22.0	20.3
External saving	7.3	2.0	2.3	2.3	4.1	-1.8	-2.3	-1.2	1.4
	Millions of dollars								
Balance of payments									
Current account balance	-650	-160	-165	-163	-266	93	125	82	-105
Merchandise trade balance	-865	-393	-441	-537	-614	-280	-276	-303	-609
Exports, f.o.b.	3 328	3 549	2 312	2 329	1 890	1 858	2 170	2 864	3 393
Imports, f.o.b.	4 192	3 942	2 753	2 866	2 504	2 138	2 446	3 167	4 002
Services trade balance	0	50	82	175	165	214	245	261	237
Income balance	33	6	18	22	16	43	-8	-71	45
Net current transfers	181	177	175	177	167	116	165	194	223
Capital and financial balance ^d	435	177	-148	-181	217	-217	106	186	222
Net foreign direct investment	230	336	89	98	78	12	22	45	113
Financial capital ^e	205	-160	-237	-280	138	-229	84	142	109
Overall balance	-216	17	-313	-344	-50	-124	231	268	117
Variation in reserve assets ^f	206	-23	-104	215	45	84	-301	-179	-129
Other financing ^g	10	7	418	129	5	40	70	-89	13
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	93.3	99.2	96.6	100.0	102.4	106.3	112.5	108.3	118.7
Terms of trade for goods (index: 2000=100)	106.2	108.0	101.7	100.0	100.2	96.7	101.4	104.3	97.4
Net resource transfer (percentage of GDP)	5.4	2.4	3.9	-0.4	3.7	-2.6	3.0	0.4	3.6
Total gross external debt (millions of dollars)	2 029	2 235	2 741	2 869	2 653	2 900	2 952	2 894	2 805
Total gross external debt (percentage of GDP)	22.9	28.2	37.5	40.4	41.2	56.9	53.2	41.6	37.6
Net profits and interest (percentage of exports) ⁱ	0.8	0.1	0.6	0.8	0.6	1.8	-0.3	-2.1	1.1
	Average annual rates								
Employment									
Labour force participation rate ^j	...	57.9	57.3	63.7	59.2	61.2	59.8	63.4	61.8
Open unemployment rate ^k	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0	7.6
Visible underemployment rate ^k	6.3	5.9	5.3	8.2	7.4	8.1	7.8	7.5	6.9
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.2	14.6	5.4	8.6	8.4	14.6	9.3	2.8	9.9
Variation in nominal exchange rate (December-December)	8.7	23.8	16.8	6.5	32.1	49.7	-13.8	2.9	-1.2
Variation in average real wage	-0.4	-1.9	-2.1	1.3	1.4	-6.4	-2.0	-2.7	1.1
Nominal deposit rate ^l	...	...	20.3	15.4	16.0	21.7	15.5	5.7	6.1
Nominal lending rate ^m	27.8	30.5	30.2	26.8	28.3	34.3	30.5	21.2	15.3

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
Non-financial public sector									
Total income	32.6	33.6	33.0	34.4	35.7	32.7	31.9	33.9	34.9
Current income	31.6	32.9	32.2	33.1	35.0	32.6	31.8	33.9	34.7
Capital income	1.0	0.7	0.8	1.2	0.8	0.1	0.0	0.1	0.1
Total expenditure ⁿ	33.5	33.2	36.1	38.4	35.9	34.6	30.8	31.6	33.3
Current expenditure	23.9	24.5	23.6	30.5	29.3	28.9	26.2	26.6	28.3
Capital expenditure	9.6	8.7	12.5	7.9	6.5	5.8	4.9	5.2	4.9
Overall balance	-1.0	0.4	-3.1	-4.0	-0.1	-1.9	1.1	2.3	1.5
Debt of non-financial public sector									
Domestic	23.2	23.5	33.5	35.3	44.0	63.0	46.9	41.7	34.8
External	6.3	3.2	3.3	4.1	6.4	8.2	5.0	4.1	3.0
Overall	16.9	20.3	30.2	31.2	37.6	54.8	42.0	37.6	31.8
Money and credit^o									
Domestic credit ^p	...	-4.5	-6.7	-7.2	-5.8	-7.2	-9.1	-10.9	-11.8
To the public sector	...	5.3	1.1	0.8	2.7	4.2	4.2	2.6	2.2
To the private sector	...	-0.3	-1.5	-2.0	-2.3	-2.4	-3.4	-4.6	-3.9
Other	...	-9.6	-6.4	-5.9	-6.1	-9.0	-10.0	-8.8	-10.1
Liquidity (M3)	27.2	27.9	28.6	30.5	31.5	29.5	27.5	25.9	25.8
Currency in circulation and local-currency deposits (M2)	16.7	14.7	13.5	13.9	13.5	12.3	11.8	12.6	13.7
Foreign-currency deposits	10.6	13.2	15.1	16.7	18.0	17.2	15.7	13.4	12.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^j Economically active population as a percentage of the working-age population; nationwide total. ^k Unemployment and underemployment rates as percentages of the economically active population; urban total. ^l Weighted average of effective interest rates on time deposits. ^m Weighted average of effective interest rates on loans, excluding overdrafts and credit cards. ⁿ Includes net lending. ^o The monetary figures are annual averages. ^p Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

against the dollar and the real. As a result, the real effective exchange rate ended the year practically unchanged on a year-on-year basis. The interventions took place mostly in the second half of the year.

(c) Other policies

In early June 2006 Paraguay concluded a new agreement with IMF that will remain in force until 2008. The agreement is based on five pillars: (i) a solid macroeconomic programme; (ii) public-sector reform; (iii) reform of the financial sector; (iv) a reform programme to promote growth; and (v) a social security network.

The Development Finance Agency (AFD) was created

in April 2006 to perform second-tier banking functions, channelling public-sector credit to intermediate financial institutions. This involved the merger of three existing public-sector bodies: the Rural Development Fund (FDC), the Industrial Development Fund (FDI) and the Technical Unit for Programme Execution of the Central Bank of Paraguay (UTEP-BCP). It is expected that the creation of AFD will lead to improved development of the medium- and long-term credit market in order to meet the needs of the productive sector. The reform of first-tier banking, provided for in the agreement with IMF, is still awaiting approval by Congress. The National Development Bank continues to operate in that capacity, and the new agreement provides for a clean-up of its balance sheet.

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	4.6	4.0	4.6	3.5	2.6	3.9	5.2	0.3	...	...
Merchandise exports, f.o.b. (millions of dollars) ^c	413	476	425	313	438	429	425	395	451	...
Merchandise imports, f.o.b. (millions of dollars) ^c	544	616	744	753	612	688	855	1 096	1 126	...
International reserves (millions of dollars)	1 001	1 071	1 180	1 168	1 188	1 273	1 275	1 297	1 354	1 412 ^d
Real effective exchange rate (index: 2000=100) ^e	109.2	103.2	105.6	115.5	120.7	119.6	117.5	117.0	114.3	108.3
Consumer prices (12-month percentage variation)	3.0	5.5	6.7	2.8	4.4	6.1	7.6	9.9	11.6	8.4
Average nominal exchange rate (guaraníes per dollar)	6 062	5 815	5 916	6 104	6 290	6 231	6 056	6 127	6 043	5 689
Nominal interest rates (annualized percentages)										
Deposit rate ^f	6.2	6.4	5.4	4.9	2.1	5.8	8.0	8.7	8.5	9.6 ^d
Lending rate ^g	25.0	23.1	19.4	17.2	15.6	15.7	15.2	14.7	15.5	16.9 ^d
Interbank interest rate ^h	9.9	7.4	4.8	4.1	4.3	3.9	4.8	6.1	7.5	10.2 ^d
Domestic credit (variation from same quarter of preceding year) ⁱ	18.4	44.0	50.2	27.1	36.4	23.6	8.5	4.7	4.9	0.2 ^d
Non-performing loans as a percentage of total credit ^j	18.6	17.4	14.9	10.4	10.3	10.0	8.7	6.5	5.5	5.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c The figure for 2005 includes reported trade only. ^d Data to May. ^e Quarterly average, weighted by the value of merchandise exports and imports. ^f Weighted average of effective interest rates on time deposits. ^g Weighted average of effective interest rates on loans, excluding overdrafts and credit cards. ^h Weighted average of interest rate on monetary regulation instruments. ⁱ Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^j Refers to total credit extended by the banking system.

3. The main variables

(a) Economic activity

GDP growth stood at 2.9% in 2005, below the 2004 figure of 4.1%. This reflected expansion in livestock output, commerce and communications, and a fall in crop production. This last activity slumped by 5.8% because of production losses in a number of crops affected by the drought, particularly cotton (-40%), maize (-26%), sugar cane (-17%), rice (-18.4%), cassava (-13%) and tobacco (-5.6%). Soybean production increased by 11.3% to 3,988,000 tons, with a 5.6% improvement in yield.

Drought is expected to affect the farming season for the third year in a row in 2005-2006. The early soybean harvest suffered fairly badly, but the mid-season and late crops are expected to improve the final production figure.

The livestock sector enjoyed significant growth of

18% in 2005, in response to strong domestic and foreign demand, benefiting activities connected with meat packing. On the other hand, manufacturing industry grew by only 2.6% (3.3% in 2004), while construction expanded by 5.5%, compared with the 2004 figure of 2.1%.

The communications sector also trended strongly upward (12%) thanks to the expansion of mobile telephony, with higher investment in the sector and increasing sales. Commerce was up by 3.6% but was hit by Brazil's restrictions on merchandise from Ciudad del Este. From November 2005, however, it enjoyed a significant recovery.

On the demand side, general government consumption remained the strongest driver of economic growth (7.6%), followed by private consumption (4.2%). Gross fixed capital formation swelled by 4.8%, close to the 2004 figure of 5%.

(b) Prices, wages and employment

The year-on-year inflation figure for 2005 was 9.9%, as against 2.8% and 9.3% for 2004 and 2003, respectively. The increase was mainly caused by factors such as rising oil prices, which are reflected in higher transport fares; increased prices for beef and beef substitutes, owing to rising domestic and external demand; and, to a lesser extent, higher prices for fruit and vegetables.

At the same time, greater liquidity in the market caused by growth in monetary aggregates, especially since mid-2005, may have contributed to rising prices. The central bank's measure of core inflation (X1) stood at 8.8%, although it does not exclude the prices of meat and other perishable foodstuffs.⁴

Inflation maintained its upward trend in the early months of 2006. Cumulative inflation to June 2006 stood at 3.7%, with the monthly inflation rate gradually decreasing.

In April 2006, the authorities announced a 12% hike in the minimum wage, in response to cumulative inflation of 10% since the previous review in April 2005. It is unlikely, however, that this measure will have much impact on inflation, given the small percentage of workers who will benefit. Given the degree of informality in the Paraguayan economy, the minimum wage (about US\$ 210 per month) serves more as a wage ceiling for the least skilled private-sector workers, since employers consider it excessively high and often ignore it. In the public sector, however, the minimum wage is used as a point of reference.

There was a significant fall in the open unemployment rate, from 7.3% in 2004 to 5.8% in 2005. Despite this, the total national employment rate declined from 58.8% in 2004 to 58.2% in 2005, and the participation rate declined from 63.4% to 61.8%. There is therefore no evidence of job creation; this is explained in part by lower economic growth. There was a small increase in underemployment, from 24.2% in 2004 to 25.1% in 2005, part of which reflected the rise in underemployment in urban areas (from 26.8% to 29.4%).

(c) The external sector

Paraguay's balance-of-payments current account deficit in 2005 stood at US\$ 105 million (1.4% of GDP), resulting from the US\$ 609 million trade deficit (7.9% of GDP), which was partially offset by surpluses on the other components of the current account balance.

Goods exports rose by a nominal 18.5%, while imports swelled by a nominal 26.4%. The terms of trade were poor for Paraguay in 2005; according to central bank data, they fell by 26.6% in annual average terms. This was caused partly by lower average international prices for soybean (-14%) and cotton (-6.7%), together with an average 42% hike in oil prices. On the other hand, rising prices for meat, exports of which rose by a nominal 57% and made up 15% of total registered exports, helped to slow the downturn in the terms of trade.

Positive balances on the services account (US\$ 237 million), income account (US\$ 45 million) and current-transfers account (US\$ 223 million) compensated in part for the heavy trade deficit.

Net foreign direct investment (FDI) picked up by 151% in 2005, with a net inflow of US\$ 113 million. The incoming resources went mainly to agribusiness (particularly to multinational corporations involved in soybean production), telecommunications (especially mobile communications) and financial services. The United States was the largest investor in Paraguay, followed by Brazil and Luxembourg.

The capital and financial account (including errors and omissions) showed a surplus of US\$ 222 million (2.9% of GDP), despite the central government's external debt payments. External debt stood at US\$ 2.271 billion, 5% below the December 2004 level. Most of Paraguay's external public debts are medium- and long-term liabilities and its creditors are multilateral bodies and official bilateral entities.

At the end of 2005, the overall balance of payments showed a surplus of US\$ 117 million (1.5% of GDP). Reserves increased by 1.7% of GDP and exceptional financing was 0.2% of GDP.

⁴ The Central Bank of Paraguay's X1 measure of core inflation excludes fruit and vegetables, regulated services and fuels.

Peru

1. General trends

The Peruvian economy expanded by 6.4% in 2005, well exceeding initial expectations, to close the period 2000-2005 with an average growth rate of more than 4% per annum. A highly favourable external climate contributed to a steep rise in exports, resulting in an unprecedented surplus, equivalent to 1.3% of GDP, on the balance-of-payments current-account. The economic policy implemented in the last few years has brightened the expectations of economic agents and fuelled domestic demand. Thus, all the components of aggregate demand outstripped the previous year's rates of growth without generating inflationary pressure; at the end of the year, the consumer price index showed a moderate rise of 1.5%. Buoyant economic activity contributed to a significant improvement in the fiscal balance. Formal employment rose significantly but its impact on the labour market overall was limited and the unemployment rate rose slightly to 9.6%, while poverty levels remained high.

Growth expectations for 2006 are based on the continuation of good external conditions and a buoyant performance from domestic demand components, which should sustain an annual expansion rate of almost 6%. On the other hand,

the dissatisfaction with living standards expressed by broad groups of society during the presidential and legislative elections has heightened the challenges faced by the new administration taking office at the end of July.

2. Economic policy

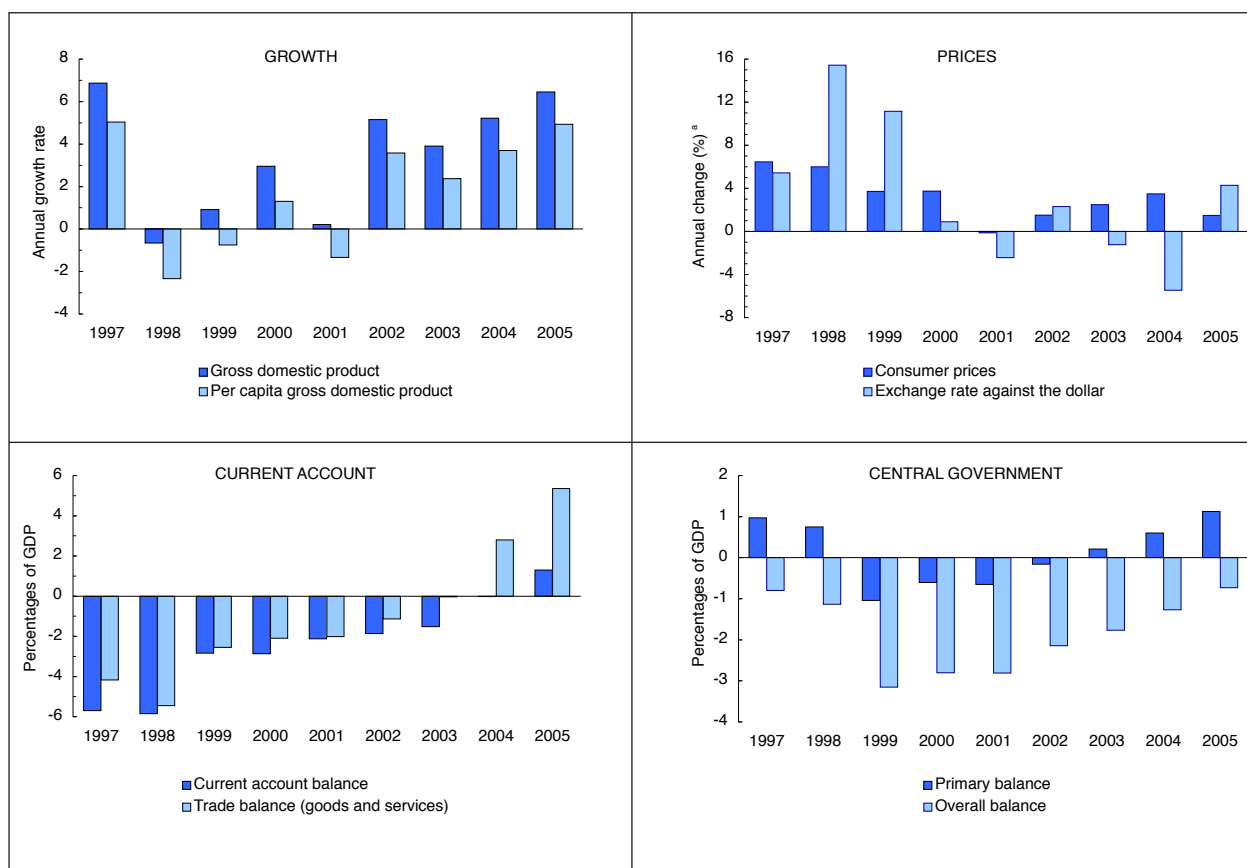
The authorities took advantage of the propitious conditions to drive ahead their strategy to reduce the Peruvian economy's vulnerability by narrowing the fiscal deficit, restructuring the public debt and reducing it in GDP terms, building up international monetary reserves and stimulating the de-dollarization of the financial system.

In addition, economy policy helped to maintain stability in key prices, such as consumer prices and the exchange rate, and to boost economic growth in the short term (through relatively low rates of interest, for example) and the long term (with the signature of a free trade agreement with the United States, which the Peruvian parliament approved in June).

(a) Fiscal policy

The fiscal situation of 2005 and early 2006 was notable for a strong increase in income, mainly because of economic expansion, the favourable prices being fetched by export goods and headway on administrative improvements to the coverage and efficiency of tax collection. These factors helped to boost the receipts of the general sales tax from 6.8% of GDP in 2004 to 7.0% in 2005 and income tax receipts from 3.8% to 4.3% of GDP. The implementation of the new temporary tax on net assets raised a sum equivalent to 0.4% of GDP. These gains were more than enough to offset fiscal income

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
^a December-December variation.

lost through the reduction in the excise tax on fuels and general government revenues expanded from 17.6% to 18.4% of GDP.

Thanks to the steep rise in income, the government was able to increase spending more than had initially been thought possible and, at the same time, easily met its targets for the primary and overall balance. General government expenditure rose by 11.1% in nominal terms, with the largest jumps in capital expenditure (13.1%) and non-financial current expenditure (11.8%). Nevertheless, gross fixed investment by the public sector remained historically low (2.9% of GDP, compared with an average of 4.6% in 1993-1999). Among other causes for the low investment, there were problems in implementing projects which were to be funded using resources made available locally and regionally through the decentralization process begun in 2002. The non-financial public sector (NFPS) closed the year with a primary surplus of 1.6% of GDP (compared to 1.0% in 2004 and an original target of 1.2% for 2005) and an overall deficit of 0.3% of GDP

(as against a 1.1% deficit in 2004 and a target of 1.0% for 2005). This deficit was covered entirely by financing raised on the domestic market.

The government took a number of steps to lessen fiscal spending vulnerabilities. The reform of the public employees' pension system (decree-law 20.530 on the "cédula viva") prohibited the entry of new beneficiaries to the scheme and imposed ceilings on pensions. Peru also rescheduled its debt with the Paris Club and paid liabilities owed to the Japan Peru Oil Company (JAPCO), which reduced the external public debt burden and improved the profile of its servicing commitments. In absolute terms, public debt dropped slightly from US\$ 30.9 billion to US\$ 29.8 billion. The external public debt was partly replaced by bonds issued on the domestic market and decreased from the equivalent of 34.3% of GDP in December 2004 to 29.6% a year later, while domestic debt rose from 9.0% to 10.2% of GDP.

Thanks to good export prices and buoyant economic activity in early 2006, fiscal revenues have continued to

expand apace (27% in real terms in the first five months), which has enabled a fresh improvement in the fiscal balance, despite a 12% real increase in spending.

In the light of this, the government adjusted its medium-term programming and 2006 is expected to yield an NFPS primary surplus of 1.9% and a deficit of 0.2% on the overall balance.

(b) Monetary and exchange-rate policy

In order to strengthen the credibility of its commitment to curb inflation, in 2002 the Central Reserve Bank of Peru established a scheme of inflation targets. In the years that followed, price increases came within the range established in this scheme (between 1.5% and 3.5%), notwithstanding temporary deviations in both directions. A relatively stable exchange rate helped to achieve the inflation targets.

Although inflation was kept in check throughout the reporting period and in some months even came in below the floor of the target range, in December 2005 the government began a policy of monthly half-percentage-point increases in the benchmark rate of interest, which thus rose from 3.0% to 4.5% in May 2006. The rationale for this policy lay in the price pressures that might result from the upswing in economic activity combined with the lagged impact of monetary policy.

The exchange rate became more volatile in mid-2005, having maintained a very stable trend towards slight appreciation hitherto. First came a real depreciation, followed by a period of volatility with no clear trend. This was partly attributable to investment strategies, especially on the part of institutional investors, and to the uncertainty surrounding the electoral process. The authorities responded by selling hard currency and issuing dollar-indexed deposit certificates. The interest rate hikes also averted any widening of the gap with respect to international rates of interest in a context of political uncertainty, which could have augmented downward pressure on the new sol.

As a yearly average, the two opposing trends evident throughout 2005 practically balanced each other out: the real bilateral exchange rate against the dollar dipped by 1.7%, while the real effective rate rose by 0.6%. A comparison between the end of 2004 and the position 12 months later shows that, in real terms, the new sol depreciated by 6.8% against the dollar and by 4.7% against a basket of the currencies of its main trading partners.

At the start of 2006 the downward trend stopped and the bilateral exchange rate dropped by 3.5% between December 2005 and May 2006.

Liquidity in the banking system was high, with the averages for 2004 and 2005 showing rises of 28.6% in M2 and 13.0% in M3 (including dollar deposits). Owing to stiff competition in the sector and large financial spreads, not all interest rates rose, despite the tighter monetary policy. Indeed, the median fixed lending rate declined from an average of 18.7% in 2004 to 17.9% in 2005 and 17.2% in the first semester of 2006. Interest rates in dollars followed international trends, with the median fixed lending rate increasing from 9.2% in 2004 to 9.8% in 2005 and 10.5% in the first semester of 2006.

With the economic outlook positive and funds available, the financial system's credit to the private sector expanded at a year-on-year rate of 17.5% (December 2005). Local currency lending was particularly buoyant, up from 29.3% of total credit in December 2004 to 33.3% 12 months later and 36.3% in May 2006. Bank lending in the form of consumer and mortgage loans was the fastest-growing type, although business loans also expanded at two-digit rates. The credit arrears of multiple banks also continued to decline, from 3.7% in December 2004 to 2.1% in May 2006.

(c) Other policies

In April 2006 Peru signed a free trade agreement with the United States. This was approved by the Peruvian parliament in June and awaits ratification by the United States Congress. Another such agreement was signed with Thailand and negotiations were conducted with a view to increasing trade relations with Chile, Mexico and Singapore.

Concessions were granted for a variety of infrastructure works (for example, the Tumbes water and sanitation system and the construction and maintenance of the inter-ocean highway) and for the operation of La Granja copper mine and the Bayóvar phosphate mine.

A proposal to reorganize the country's administrative and territorial structure in order to make the existing decentralization scheme more efficient was rejected in a national referendum.

Lastly, the authorities launched the pilot phase of the programme "Juntos" which consists of conditional direct transfers linked to health care and education of children from poor households.

Table 1
PERU: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	6.9	-0.7	0.9	3.0	0.2	5.2	3.9	5.2	6.4
Per capita gross domestic product	5.0	-2.3	-0.7	1.3	-1.3	3.6	2.4	3.7	4.9
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	5.0	-0.3	11.0	6.8	-0.1	6.1	1.2	3.2	4.6
Mining	9.0	3.7	13.1	2.4	9.9	12.0	5.4	5.2	8.1
Manufacturing	5.3	-3.5	-0.7	5.8	0.7	5.9	3.2	7.4	6.5
Electricity, gas and water	12.7	6.2	3.0	3.2	1.6	5.5	4.2	4.6	5.3
Construction	14.9	0.6	-10.5	-6.5	-6.5	7.9	4.3	4.7	8.4
Wholesale and retail commerce, restaurants and hotels	7.5	-2.6	-0.6	3.4	0.7	3.6	3.3	5.5	5.2
Transport, storage and communications	5.6	-1.0	2.1	2.6	-0.4	3.7	4.9	6.4	8.5
Financial institutions, insurance, real estate and business services	8.3	0.5	-0.9	2.3	-1.2	5.0	4.1	3.9	6.5
Community, social and personal services	2.8	0.4	3.9	1.7	0.0	3.8	4.8	3.9	5.4
Gross domestic product, by type of expenditure									
Consumption	4.8	-0.5	0.0	3.6	1.2	4.1	3.3	3.5	5.2
General government	7.6	2.5	3.5	3.1	-0.9	0.2	3.8	4.1	9.2
Private	4.5	-0.9	-0.4	3.7	1.5	4.6	3.2	3.5	4.7
Gross domestic investment	14.9	-2.3	-13.6	-2.7	-7.7	5.8	3.9	7.9	7.2
Exports (goods and services)	13.1	5.6	7.6	8.0	7.4	6.9	6.3	14.7	13.9
Imports (goods and services)	12.2	2.3	-15.2	3.8	2.7	2.8	3.6	10.6	9.9
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	24.1	23.6	21.1	20.2	18.7	18.9	18.7	18.8	18.5
National saving	18.4	17.8	18.3	17.3	16.5	17.0	17.2	18.8	19.8
External saving	5.7	5.9	2.8	2.9	2.1	1.9	1.5	0.0	-1.3
	Millions of dollars								
Balance of payments									
Current account balance	-3 367	-3 321	-1 464	-1 526	-1 144	-1 063	-935	-10	1 030
Merchandise trade balance	-1 678	-2 437	-655	-411	-195	292	836	2 793	5 163
Exports, f.o.b.	6 825	5 757	6 088	6 955	7 026	7 714	9 091	12 617	17 247
Imports, f.o.b.	8 503	8 194	6 743	7 366	7 221	7 422	8 255	9 824	12 084
Services trade balance	-786	-657	-663	-705	-890	-941	-854	-843	-913
Income balance	-1 822	-1 204	-1 112	-1 410	-1 101	-1 457	-2 144	-3 421	-5 011
Net current transfers	920	977	966	999	1 042	1 043	1 227	1 461	1 791
Capital and financial balance ^d	5 421	2 080	602	1 384	1 568	2 030	1 459	2 336	498
Net foreign direct investment	2 054	1 582	1 812	810	1 070	2 156	1 275	1 816	2 519
Financial capital ^e	3 367	498	-1 210	575	498	-125	184	520	-2 021
Overall balance	2 055	-1 241	-862	-142	423	968	525	2 326	1 528
Variation in reserve assets ^f	-1 493	1 142	985	440	-275	-852	-516	-2 352	-1 628
Other financing ^g	-562	99	-122	-298	-148	-116	-9	26	100
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	90.7	91.7	101.5	100.0	97.8	95.6	99.8	101.3	101.9
Terms of trade for goods (index: 2000=100)	115.5	103.4	100.8	100.0	95.6	98.4	102.2	111.3	119.4
Net resource transfer (percentage of GDP)	5.1	1.7	-1.2	-0.6	0.6	0.8	-1.1	-1.5	-5.6
Total gross external debt (millions of dollars)	28 864	30 142	28 586	27 981	27 196	27 873	29 587	31 117	28 605
Total gross external debt (percentage of GDP)	48.8	53.1	55.4	52.5	50.4	48.8	48.1	44.7	36.0
Net profits and interest (percentage of exports) ⁱ	-21.8	-16.0	-14.5	-16.6	-13.0	-15.8	-19.9	-23.5	-25.8
	Average annual rates								
Employment									
Labour force participation rate ^j	63.3	65.4	66.9	64.4	66.7	68.4	67.4	68.1	67.1
Open unemployment rate ^k	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4	9.6
Visible underemployment rate ^k	14.5	11.6	11.3	11.3	11.7	10.7	8.8	8.6	8.4
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.5	6.0	3.7	3.7	-0.1	1.5	2.5	3.5	1.5
Variation in wholesale prices (December-December)	5.0	6.5	5.5	3.8	-2.2	1.7	2.0	4.9	3.6
Variation in nominal exchange rate (December-December)	5.4	15.4	11.1	0.9	-2.4	2.3	-1.2	-5.5	4.3
Variation in average real wage	-0.7	-2.0	-2.1	0.8	-0.9	4.6	1.6	1.1	-1.9
Nominal deposit rate ^l	...	...	...	...	...	3.5	2.9	2.4	2.7
Nominal lending rate ^l	...	...	...	...	...	22.3	20.2	18.7	17.9

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
General government									
Total income	16.1	16.1	15.0	15.2	14.5	14.5	15.1	15.2	16.0
Current income	16.0	15.8	14.7	14.9	14.4	14.4	14.9	15.1	15.9
Tax revenue	14.2	14.0	12.7	12.3	12.5	12.1	13.0	13.3	13.7
Capital income	0.1	0.3	0.3	0.3	0.2	0.2	0.2	0.1	0.1
Total expenditure	16.9	17.2	18.1	18.0	17.3	16.7	16.9	16.5	16.7
Current expenditure	13.2	13.9	14.7	15.2	15.1	14.7	14.9	14.6	14.8
Interest	1.8	1.9	2.1	2.2	2.2	2.0	2.0	1.9	1.9
Capital expenditure	3.7	3.4	3.4	2.8	2.2	2.0	1.9	1.8	1.9
Primary balance	1.0	0.7	-1.0	-0.6	-0.7	-0.2	0.2	0.6	1.1
Overall balance	-0.8	-1.1	-3.2	-2.8	-2.8	-2.1	-1.8	-1.3	-0.7
Central government debt	32.6	43.6	49.1	46.1	45.2	46.8	47.3	43.3	39.8
Domestic	0.0	6.3	9.7	9.6	10.5	10.2	10.0	9.0	10.2
External	32.6	37.3	39.4	36.5	34.7	36.6	37.3	34.3	29.6
Money and credit^m									
Domestic credit ⁿ	9.8	13.8	14.9	14.9	14.8	13.6	12.8	12.4	12.2
To the public sector	-9.2	-9.8	-9.3	-7.1	-5.6	-4.7	-4.5	-4.2	-4.4
To the private sector	24.6	30.2	33.3	31.8	30.9	29.7	28.5	26.9	26.2
Other	-5.6	-6.7	-9.0	-9.8	-10.5	-11.4	-11.2	-10.3	-9.6
Liquidity (M3)	21.5	23.3	25.2	25.0	25.4	25.4	24.5	23.0	23.5
Currency in circulation and local-currency deposits (M2)	7.0	7.6	7.4	7.3	7.7	8.5	8.8	9.3	10.8
Foreign-currency deposits	14.5	15.7	17.8	17.7	17.8	16.9	15.7	13.7	12.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^j Economically active population as a percentage of the working-age population, Lima metropolitan area; 1997-2000, urban total. ^k Unemployment and underemployment rates as percentages of the economically active population, Lima metropolitan area. ^l Average rate, constant structure. ^m The monetary figures are annual averages. ⁿ Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

In 2005 economic growth (6.4%) exceeded the previous year's figure thanks to a buoyant performance from all the components of aggregate demand. Exports of goods and services expanded particularly strongly (13.9%), thanks to favourable conditions in the international markets, as did gross fixed capital formation (13.4%), which amounted to 18.8% of GDP at current prices, although this was still well below the levels seen between 1994 and 1999. Be that as it may, both public and private investment saw significant upswings in 2005. Private consumption also picked up (4.7%, compared with 3.5% in 2004) on the back of a rise in employment and the expansion of credit, while public consumption increased by 9.2%, thanks to

rising fiscal income. The terms of trade improved by the equivalent of 1.2% of GDP.

A buoyant performance was rendered across the board on the supply side. With the exception of fishing, which posted a rise of only 1.2% after an expansion of over 30% in 2004, all branches of activity bettered their 2004 performance. Particularly good performers were construction (8.4%), driven by infrastructure projects, construction of shopping centres and residential schemes; mining and hydrocarbons (8.1%), fuelled by high prices and the start-up of new metal mining projects, as well as the operation of the Camisea gasfield; and manufacturing (6.5%), which was buoyed by the good performance of non-traditional exports and domestic demand. Services expanded by 5.4% and commerce (5.2%) benefited from

Table 2
PERU: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	5.0	3.6	5.2	7.2	6.1	5.9	6.2	7.3	6.8	...
Merchandise exports, f.o.b. (millions of dollars)	2 747	2 853	3 389	3 607	3 724	4 052	4 523	4 924	4 566	...
Merchandise imports, c.i.f. (millions of dollars)	2 131	2 423	2 545	2 732	2 660	3 022	3 156	3 248	3 390	...
International reserves (millions of dollars)	9 951	10 441	10 741	12 176	13 116	13 380	13 209	13 599	13 892	13 832 ^c
Real effective exchange rate (index: 2000=100) ^d	103.1	101.9	99.9	100.3	100.9	100.4	101.3	105.3	103.7	103.8
Unemployment rate	10.6	9.5	8.9	8.7	11.3	9.7	9.3	8.0	9.0	...
Consumer prices (12-month percentage variation)	2.8	4.3	4.0	3.5	1.9	1.5	1.1	1.5	2.5	1.8
Average nominal exchange rate (new soles per dollar)	3.47	3.48	3.40	3.30	3.26	3.26	3.27	3.39	3.34	3.29
Average real wage (variation from same quarter of preceding year)	...	1.5	...	0.7	...	0.9	...	-4.7	...	...
Nominal interest rates (annualized percentages)										
Deposit rate ^e	2.4	2.4	2.4	2.5	2.7	2.7	2.7	2.8	3.0	3.5
Lending rate ^e	19.3	18.8	18.6	18.1	18.5	18.2	17.8	17.2	17.1	17.3
Interbank interest rate	2.5	2.5	2.6	3.0	2.9	3.0	3.0	3.1	3.8	4.5
Sovereign bond spread (basis points)	343.0	439.0	323.0	220.0	239.0	206.0	138.0	205.6	187.0	169.0
Stock price index (in dollars, December 2000=100)	293.5	245.4	272.8	294.9	313.3	303.5	381.8	366.1	415.9	497.2
Domestic credit (variation from same quarter of preceding year) ^f	15.8	7.1	5.3	8.7	0.4	5.4	11.6	18.9	27.7	26.1 ^g
Non-performing loans as a percentage of total credit ^h	5.8	5.1	4.6	3.7	3.6	3.0	2.7	2.1	2.1	2.1 ^g

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1994 prices. ^c Data to April. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e Average rates. ^f Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^g Data to May. ^h Refers to total credit extended by full-service banks.

rising household consumption and an upturn in tourism. After a contraction in 2004, the agricultural sector was up by 4.6%, thanks to improved weather conditions and a strong expansion in livestock in response to higher demand.

In the first four months of 2006 the Peruvian economy expanded by 5.9%. For the year as a whole ECLAC forecasts GDP growth of 5.8%, reflecting slower growth in export volumes, partly offset by higher domestic demand. The change of government is not expected to have any repercussions for economic performance in the second semester.

(b) Prices, wages and employment

At the end of 2005 inflation came in at 1.5%, at the floor of the authorities' target range. This represented a drop of two percentage points with respect to 2004, attributable to decreases in a number of agricultural prices that had been pushed sharply upwards that year by climatic factors.

The impact of rising fuel prices in the international markets was cushioned by a series of cuts in the excise tax on fuels and by the use of the fuel price stabilization fund, which came into operation in 2004. In 2005 these measures, at a combined fiscal cost of some US\$ 300 million, kept the rise in fuel prices to 6.9%.

Leaving aside these factors, prices varied little and 2005, like 2004, ended with core inflation at 1.2%. Contributing to this was strong competition in a number of markets, as well as exchange-rate stability during most of the year.

Inflation rose slightly in early 2006, again because of weather conditions impacting on the supply of some agricultural products, but returned to low levels towards mid-year, with a year-on-year rate of 1.8% in June, while core inflation stood at 1.3%.

Wages did not exert inflationary pressure in 2005, since formal employment wages and salaries were down by 1.0% and 1.8%, respectively. The minimum wage was increased by 8.7% as of January 2006.

Formal job creation continued to expand, increasing

by 4.5% on average in 2005 and 6.2% in the first five months of 2006. The main poles of formal employment creation were in agribusiness and mining areas but, in contrast to previous years, formal employment also expanded strongly in Lima (3.8% on average in 2005, gathering momentum in the second semester of 2005 and early 2006). This gain in formal employment fed into an improvement in the employment profile, rather than significant net generation of new jobs, since in 2005 Lima's employment rate fell from 61.6% to 60.7% and unemployment rose from 9.4% to 9.6%. At the start of 2006 the labour situation showed clear signs of an upturn, with an increase in the employment rate and a drop in the rate of unemployment (from 10.8% in the first five months of 2005 to 9.2% a year later).

(c) The external sector

The balance-of-payments current account closed 2005 with an unprecedented surplus of 1.3% of GDP. Strong contributors to this performance were buoyant merchandise exports, which were up by US\$ 4.6 billion to over US\$ 17 billion, and, to a lesser extent, larger transfers of remittances. With a slightly smaller increase in imports (US\$ 2.25 billion), the balance of trade in goods closed with a surplus of 6.5% of GDP. Transfers derived from factor income rose by US\$ 1.6 billion to 6.3% of GDP, thanks to rising export revenues.

Mining exports did particularly well, increasing by 40% to reach almost US\$ 10 billion, mainly thanks to improved prices for copper, gold, zinc and molybdenum, although the export volumes of several of these products also increased. Non-traditional exports also climbed strongly (23%), with increases in all the main branches.

Reflecting the upturn in investment, capital goods were the fastest-growing imports (30%). The rise in imports of inputs (23%) was due in part to climbing fuel costs, while higher household consumption contributed to increased imports of consumer goods (16%).

Conditions remained favourable for many export products in the first few months of 2006, although limits on the possibility of increasing export volumes in some cases (such as mining) meant that in the first four months year-on-year export growth declined to 26%. Nevertheless, for the year as a whole exports are expected to exceed US\$ 20 billion. Imports continued to be driven by investment and consumption, and expanded by 21%. In the first quarter of 2006 the balance-of-payments current account recorded a modest deficit of 0.8% of GDP, mainly as a result of increased transfers of factor income, facilitated, in turn, by strong export revenues.

The capital and financial account closed with a surplus of US\$ 500 million. Foreign direct investment (FDI) rose to over US\$ 2.5 billion, which was the highest figure since 1996. The strategy of reducing the external public debt (prepayment of US\$ 1.555 billion in Paris Club debt and of US\$ 758 million in debt owed to JAPECO) resulted in large outflows of capital. Part of these prepayments was funded by the issuing of two sovereign bonds for a total of US\$ 1.15 billion, for which the government took advantage of the narrowing of risk spreads from an average of 349 basis points in 2004 to 200 in 2005. As a result, total external debt dropped from 44.6% of GDP at the end of 2004 to 36.0% a year later, mainly thanks to the reduction in public debt. The surplus on the overall balance helped to increase the central bank's net international reserves by US\$ 1.47 billion in 2005 and by a further US\$ 320 million in the first semester of 2006.

Uruguay

1. General trends

In 2005 the Uruguayan economy recorded GDP growth of around 6.6%. In terms of volume, GDP regained the level recorded in 1998, the year before the crisis of 1999-2003 broke out. The manufacturing industry continued to expand at a rapid rate, together with the commerce and services sectors.

The rise in production was mainly due to increased external demand, with exports up by 16.8% compared to the previous year. Investment was up by 10.1% and gross fixed capital formation by 23.8%. The coefficient of investment in the economy was 13.2%, rather lower than the previous year's figure of 15.9%.

As employment rose by a meagre 1.4%, the unemployment rate came down by just 0.9% to an annual average of 12.2%, or two percentage points above the pre-crisis level. The proportion of people living in poverty diminished by 2.8% over the year, to 29.8% of the urban population, while indigence levels were down slightly, from 3.9% in 2004 to 3.5% in 2005.

The authorities maintained the general thrust of macroeconomic policy in their efforts to restructure financial and public spending affairs. A reform of the tax system, intended to enhance efficiency and equity, was submitted to parliament. Nevertheless, given continued

financial restraints, rigorous debt and expenditure management have been required in order to maintain fiscal sustainability.

The Uruguayan economy continued to perform well, apart from some friction with its main trading partners in MERCOSUR. Since the beginning of 2006, these problems have affected some of the most dynamic sectors, especially transport and tourism. A serious drought that has persisted in much of the country has caused mounting difficulties in the agricultural and livestock sectors and in energy generation.

Growth of over 5% is projected for 2006, while the terms of trade are expected to deteriorate, mainly because of rising oil prices. Inflation is expected to be within the authorities' target range of between 4.5% and 6.5%. The primary fiscal surplus will probably reach 3.7% of GDP at the end of the year, while the global deficit will rise to 1.1% of GDP.

2. Economic policy

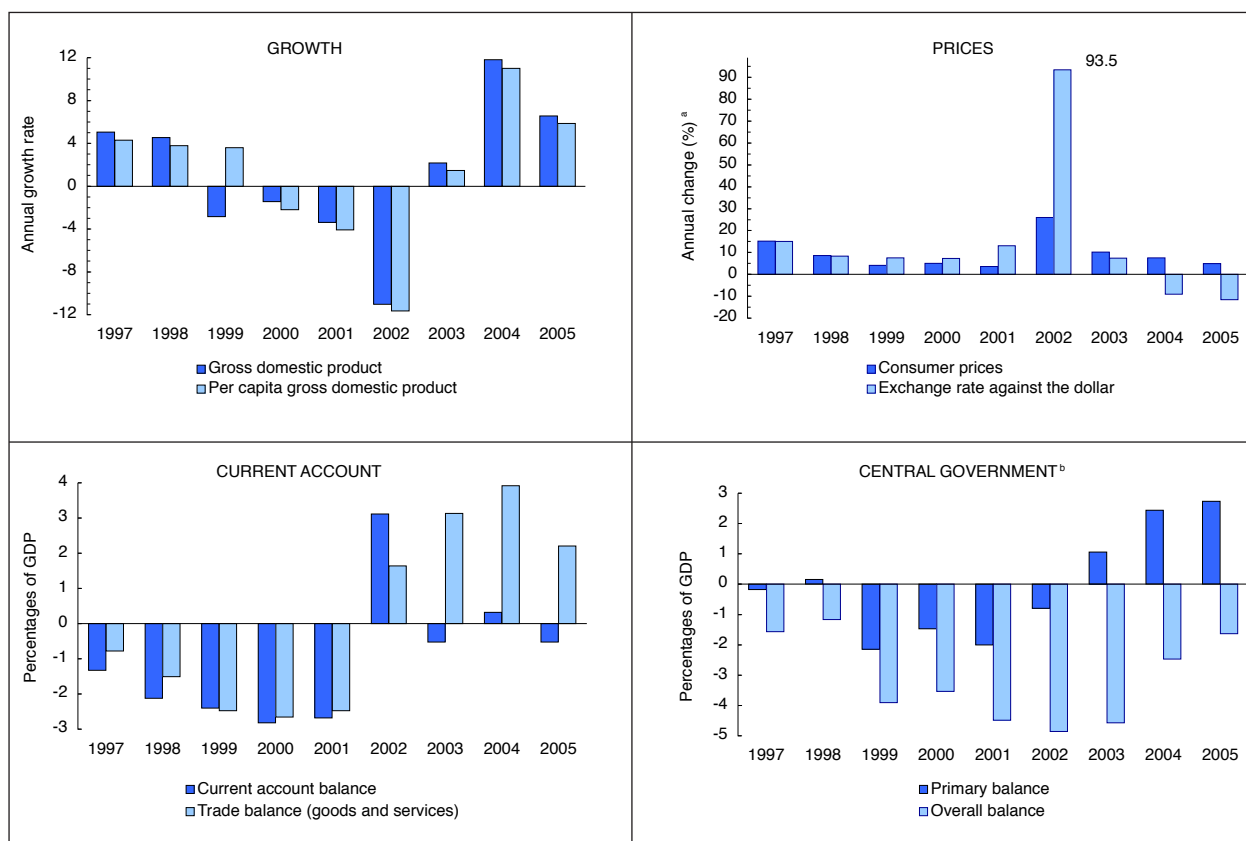
(a) Fiscal policy

In 2005, Uruguay posted a primary fiscal surplus for the non-financial public sector of 3.9% of GDP and a global deficit of 0.6% of GDP. At the end of 2005, the total income of the non-financial public sector amounted to 28.9% of GDP. In 2006, the overall deficit has continued to narrow and the 12-month moving average for April was equivalent to 0.2% of GDP. The fiscal situation has benefited from the decline in debt servicing payments,

which amounted to 4.3% of GDP in the 12 months to April 2006, compared to 5.0% recorded in 2004.

In the 12 months ending in February 2006, income increased by a real 4.2% year-on-year, while expenditure rose by 6.4%. Fiscal income was consistent with the expansionary phase of the business cycle and tax receipts increased thanks to the higher degree of formalization of the economy and the improvement of oversight mechanisms. Collection by the Social Security Fund increased by 11.6% in real terms in the year ending in

Figure 1
URUGUAY: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

^b In 1999 the accounting methodology changed.

April 2006 and the receipts of the Tax Administration Department continued to grow steadily, posting a real year-on-year increase of 6.7% in the 12 months to February 2006.

In real terms, a breakdown of expenditure shows an increase of 4.9% in current primary spending and similar increases in government payroll and procurement. Transfers to the private sector increased by 6.6% owing to the rise in social benefits. Public investment rose by almost 20% in the period, led by public enterprises, whose investment in fixed assets jumped by 38%.

Interest payments on the public debt continued to decline in real terms and in relation to GDP, as a result of debt restructuring operations, the prepayment of debts to a number of international agencies and the narrowing of emerging-market spreads, among other factors. In the 12 months ending in February, the amount paid in interest declined by 7.3% in real terms, or by 20.5% if the debt of the central bank is included.

Gross public debt amounted to almost US\$ 12 billion in December 2005 (69.6% of GDP), which was

an increase of over US\$ 600 million in relation to the previous year. The authorities took advantage of the liquidity in the international markets to launch several bond issues in 2005 and early 2006, for a total of close to US\$ 1.5 billion. This enabled Uruguay to restructure its portfolio of creditors in order to reduce its liabilities with some of the multilateral lending agencies, thus improving its debt maturity profile and reducing interest payments. Net external debt declined to 54.9% of GDP at the end of 2005.

(b) Monetary policy

Throughout 2005, the central bank gradually shifted its monetary policy, as part of its policy of inflation targets. The target range of annual inflation for 2006 has been set at 4.5%-6.5%, and the central bank estimates that a 12.6% year-on-year expansion in the monetary base in the last quarter of 2006 would be consistent with this target.

The M1-to-GDP ratio grew from 5.1% in December 2004 to 5.8% in December 2005 and to 6% in February

2006. One of the instruments the central bank uses to expand the money supply is the net purchase of foreign currency, which amounted to US\$ 588 million in the year ending in March 2006.

Interest rates on local-currency securities issued by the central bank remained low, standing at 3.8% in March 2006, while average maturities lengthened from 91 to 116 days. The rates on local-currency deposits in the market continued to decline, reaching an annual 1.5% in the first quarter of 2006. The foreign-currency deposit rate was somewhat lower, at 1.8% in February 2006. Annual lending rates in local currency were down from 32.1% in February 2005 to 17.2% in the same month of 2006, while those denominated in foreign currency climbed to 7.1% in February 2006.

Local-currency deposits continued to expand. In 2005 they showed a real variation of 19.2% and increased as a proportion of total deposits in the financial system, from 10.5% in 2004 to 13.6% in 2005. Foreign-currency deposits posted a real increase of 1.7% in the same period and declined to 86.4% as a proportion of total deposits at the end of 2005.

In real terms, in the 12 months to February 2006, local-currency credit increased by 14.5%, while foreign currency credit held steady. In 2005 loans in local currency

posted growth of 80% over the low recorded in 2003, after the banking crisis of 2002, while those in foreign currency were flat. Both levels continued to be lower than those for 1998, the year before the crisis.

(c) Exchange-rate policy

Uruguay maintains a floating exchange rate in a market heavily influenced by the public sector's foreign-currency purchases. In nominal terms, the Uruguayan peso appreciated against the dollar by 11% in 2005 and by a further 4.4% in January-April 2006. In real terms, the local currency appreciated by 9.8% in 2005 but posted a year-on-year depreciation of 1.6% at the end of March 2006.

(d) Other policies

Trade policy has been a particular focus of attention in the framework of the government programme for 2005 and 2006. Regional difficulties have led the government to redouble its efforts to expand exports to markets outside the region, while steps are also being taken to negotiate trade agreements with the United States, China, India, New Zealand and South Africa, among other countries.

3. The main variables

(a) Economic activity

After a recovery sustained since 2003, in 2005 the Uruguayan economy regained the levels of production experienced prior to the crisis that began in 1999. The favourable performance in 2005 was driven by the industrial sector, which grew by 9.5% and accounted for 1.7 percentage points of the 6.6% increase in GDP. This was followed in order of impact by the sector of commerce, restaurants and hotels, which expanded by 11.6% and accounted for 1.4 percentage points of GDP, and transport and communications, with annual growth of 10.9% and a 1.3 percentage point share in GDP.

Activity expanded in almost all the other branches of industry in 2005, more rapidly in the case of those oriented towards the external sector. The most dynamic subsectors were foods and beverages, chemical products, rubber and plastic products and transport equipment. Expansion in the commerce, restaurants and hotels segment reflected growth in commerce, which more than compensated for the meagre results in the other two

industries. Telecommunications posted a strong upturn, owing to growth in mobile telephony. Agricultural and livestock production showed a rise of 3.2%, driven by livestock activities. Construction picked up momentum, thanks to private investment in housing (mainly in resort areas of the east of the country) and the beginning of works to build two cellulose pulp plants.

(b) Prices, wages and employment

The consumer price index (CPI) was up by 4.9% in 2005, in the context of a slight acceleration of the inflation rate. In the year ending in April 2006, the CPI registered a cumulative variation of 6%. The sectors showing the largest variations were furnishings, household goods and domestic services (11.2%), transport and communications (6.7%), housing (6.3%) and medical care (5.9%). Although wholesale prices were down by 2.2% in 2005, they rose by 2.6% in the year ending April 2006.

The labour market remained quite flat, only partially responding to the successive upturns in economic activity.

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Annual growth rates^b								
Gross domestic product	5.0	4.5	-2.8	-1.4	-3.4	-11.0	2.2	11.8	6.6
Per capita gross domestic product	4.3	3.8	3.6	-2.2	-4.1	-11.7	1.5	11.0	5.8
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-6.1	5.2	-7.5	-3.0	-7.1	5.1	10.6	10.6	3.2
Mining	22.1	29.4	-5.8	-8.8	-5.2	-37.6	14.1	7.2	4.4
Manufacturing	5.9	2.3	-8.4	-2.1	-7.6	-13.9	4.7	20.8	9.5
Electricity, gas and water	6.7	11.5	-0.1	5.0	1.7	-0.6	-7.4	1.8	6.5
Construction	2.4	9.8	8.9	-11.1	-8.7	-22.0	-7.1	7.5	4.7
Wholesale and retail commerce, restaurants and hotels	8.8	2.4	-3.4	-5.3	-3.2	-24.5	-1.0	21.3	11.6
Transport, storage and communications	6.0	4.5	3.7	1.5	0.3	-9.1	3.1	11.5	10.9
Financial institutions, insurance, real estate and business services	5.4	6.8	6.4	2.2	1.7	-0.9	-5.3	-1.7	-3.4
Community, social and personal services	3.4	2.7	-0.5	-0.6	-2.3	-3.3	0.7	3.2	1.4
Gross domestic product, by type of expenditure									
Consumption	5.4	6.4	-1.3	-1.4	-2.1	-15.9	1.1	10.5	2.5
General government	2.3	4.0	0.6	-0.3	-2.9	-9.3	-4.8	2.5	2.5
Private	5.9	6.8	-1.5	-1.6	-2.0	-16.9	2.0	11.8	2.5
Gross domestic investment	8.3	12.1	-9.8	-13.0	-9.1	-34.5	18.0	22.0	10.1
Exports (goods and services)	13.0	0.3	-7.4	6.4	-9.1	-10.3	4.2	27.6	16.8
Imports (goods and services)	13.2	7.6	-5.8	0.1	-7.1	-27.9	5.8	26.5	8.8
	Percentages of GDP								
Investment and saving^c									
Gross domestic investment	15.2	15.9	15.1	14.0	13.8	11.5	12.6	13.1	13.2
National saving	13.9	13.7	12.7	11.1	11.1	14.6	12.1	13.4	12.6
External saving	1.3	2.1	2.4	2.8	2.7	-3.1	0.5	-0.3	0.5
	Millions of dollars								
Balance of payments									
Current account balance	-287	-476	-502	-566	-498	382	-58	43	-88
Merchandise trade balance	-704	-772	-896	-927	-775	48	183	153	-69
Exports, f.o.b.	2 793	2 829	2 291	2 384	2 139	1 922	2 281	3 145	3 758
Imports, f.o.b.	3 498	3 601	3 186	3 311	2 915	1 874	2 098	2 992	3 826
Services trade balance	536	436	377	394	316	153	167	365	439
Income balance	-193	-198	-34	-61	-68	109	-491	-588	-578
Net current transfers	74	59	50	27	30	72	82	113	120
Capital and financial balance ^d	687	831	675	833	824	-4 310	1 092	263	884
Net foreign direct investment	113	155	238	274	291	180	401	315	605
Financial capital ^e	574	676	437	559	533	-4 490	691	-52	279
Overall balance	400	355	173	267	326	-3 928	1 033	306	796
Variation in reserve assets ^f	-392	-515	-11	-222	-278	2 328	-1 380	-454	-620
Other financing ^g	-8	160	-162	-45	-49	1 600	347	149	-175
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) ^h	108.5	107.0	98.3	100.0	101.2	117.0	150.3	151.8	137.0
Terms of trade for goods (index: 2000=100)	110.2	116.7	106.2	100.0	103.8	104.8	107.4	108.4	101.5
Net resource transfer (percentage of GDP)	2.2	3.5	2.3	3.6	3.8	-21.2	8.5	-1.3	0.8
Total gross external debt (millions of dollars) ⁱ	4 945	5 467	8 261	8 895	8 937	10 548	11 013	11 593	11 441
Total gross external debt (percentage of GDP) ⁱ	22.8	24.4	39.5	44.3	48.1	85.9	98.4	87.7	68.1
Net profits and interest (percentage of exports) ^j	-4.6	-4.8	-1.0	-1.7	-2.1	4.0	-15.9	-13.7	-11.3
	Average annual rates								
Employment									
Labour force participation rate ^k	57.7	60.5	59.3	59.6	60.6	59.1	58.1	58.5	58.5
Open unemployment rate ^l	11.5	10.1	11.3	13.6	15.3	17.0	16.9	13.1	12.2
Visible underemployment rate ^l	5.2	4.7	6.5	10.3	13.0	15.3	16.0	13.7	15.0
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	15.2	8.6	4.2	5.1	3.6	25.9	10.2	7.6	4.9
Variation in producer prices, local products (December-December)	13.3	3.3	-0.3	9.5	3.8	64.6	20.5	5.1	-2.2
Variation in nominal exchange rate (December-December)	15.1	8.3	7.6	7.3	13.1	93.5	7.4	-9.1	-11.6
Variation in average real wage	0.2	1.8	1.6	-1.3	-0.3	-10.7	-12.5	0.0	4.6
Nominal deposit rate ^m	19.1	14.6	13.8	12.0	14.7	43.8	28.1	...	...
Nominal lending rate ⁿ	54.9	58.7	63.9	59.4	58.3	92.0	121.0	50.3	39.0

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 ^a
	Percentages of GDP								
General government ^o									
Total income	18.8	19.5	20.9	20.3	20.8	21.2	21.4	21.6	21.6
Tax revenue	15.6	16.1	17.2	16.9	17.4	17.6	18.6	18.5	18.5
Total expenditure	20.4	20.7	24.8	23.9	25.3	26.1	26.0	24.1	23.2
Current expenditure	18.5	18.5	22.2	22.0	23.4	24.7	24.7	22.6	21.9
Interest	1.4	1.3	1.8	2.1	2.5	4.1	5.6	4.9	4.4
Capital expenditure	1.9	2.2	2.6	1.9	1.8	1.4	1.3	1.5	1.3
Primary balance	-0.2	0.2	-2.1	-1.5	-2.0	-0.8	1.1	2.4	2.7
Overall balance	-1.6	-1.2	-3.9	-3.5	-4.5	-4.9	-4.6	-2.5	-1.6
Debt of non-financial public sector	27.8	28.6	30.9	35.9	46.7	106.0	100.4	78.9	69.6
Domestic	4.1	4.6	7.7	8.6	15.6	25.4	18.8	15.2	14.7
External	23.7	24.0	23.2	27.3	31.1	80.6	81.6	63.7	54.9
Money and credit ^p									
Domestic credit ^q	...	...	...	...	45.2	50.1	38.0	23.7	15.9
To the public sector	...	...	...	...	6.8	8.9	18.1	13.8	8.9
To the private sector	...	...	...	...	67.9	73.6	51.4	35.6	27.1
Other	...	...	...	...	-29.5	-32.4	-31.6	-25.7	-20.2
Liquidity (M3) ^r	...	39.6	52.8	69.6	81.7	84.9	76.0	72.0	59.3
Currency in circulation and local-currency national (M2) ^r	...	10.9	11.1	11.3	11.0	8.6	8.2	8.1	8.9
Foreign-currency deposits ^r	...	28.7	41.8	58.4	70.7	76.3	67.8	63.8	50.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1983 prices. ^c Based on figures in local currency expressed in dollars at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f A minus sign (-) denotes an increase in reserves. ^g Includes the use of IMF credit and loans and exceptional financing. ^h Annual average, weighted by the value of merchandise exports and imports. ⁱ As of 1999, the figures refer to the new official series for the total debt and are not comparable with the previous figures. ^j Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. ^k Economically active population as a percentage of the working-age population, urban total. ^l Unemployment and underemployment rates as percentages of the economically active population; urban total. ^m Average rate for fixed-term deposits for six months or less. ⁿ One-year non-readjustable cash loans in local currency to families. ^o As of 1999 the accounting methodology was changed. ^p The monetary figures are annual averages. ^q Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^r Up to 2000, the source used was IMF. As of 2001 the source was the Central Bank of Uruguay.

Although the 1998 level of production was recovered in 2005, employment was three points lower, at an annual rate of 51.4% compared with 54.3% in 1998, and unemployment was even higher (12.2%, as against 10.1% in 1998). In 2005 the unemployment rate went down by 0.9 percentage points in relation to 2004, owing to a slight increase in employment (1.4%).

Real wages accumulated an increase of 4.6% in 2005, reflected in a 6% expansion in total wages, which rose to about 27 points of GDP. The real average wage index for the year ending in April 2006 showed a cumulative growth rate of 5.4%. Wages and allowances increased more in the public than in the private sector (5.8% and 4.6%, respectively). A noteworthy development in 2005 was the re-establishment of Wage Councils, which are a mechanism of tripartite collective wage bargaining in different occupational and industrial groups.

(c) The external sector

The current account balance posted a small deficit of US\$ 88 million in 2005, reflecting the swing in the

trade balance from a surplus of 1.2% of GDP in 2004 to a deficit of 0.4% of GDP in 2005. Given that the physical volume of exports expanded more than that of imports, the trade deficit was attributable to worsening terms of trade. Measured in dollars, exports of goods were up by 19.5% in 2005, owing to higher external demand, the availability of livestock goods and competitiveness gains by national goods. Beef exports expanded by 22.4%; milling, wood and dairy products also posted a very good export performance. The main destination markets were the United States (22.3%), Brazil (13.6%) and Argentina (7.5%).

Imports grew considerably in 2005 (by 25% measured in dollars), mainly owing to increased economic activity and higher oil prices. Intermediate inputs (including oil) accounted for most of the change (14 percentage points). Imports of capital goods also climbed strongly. The rise in imports was somewhat smaller in the year ending in April 2006, at 21.8%. In the first four months of 2006, oil and electricity imports have risen significantly, in view of a persistent drought which is affecting the generation of hydroelectric power.

Table 2
URUGUAY: MAIN QUARTERLY INDICATORS

	2004				2005 ^a				2006 ^a	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) ^b	13.9	12.0	12.5	9.4	6.1	7.9	6.3	6.0	7.2	...
Merchandise exports, f.o.b. (millions of dollars)	590	751	789	801	714	900	880	911	836	...
Merchandise imports, c.i.f. (millions of dollars)	662	737	817	899	915	902	990	1 072	1 123	...
International reserves (millions of dollars)	2 240	2 241	2 347	2 508	2 092	2 521	2 539	3 074	3 111	3 280 ^c
Real effective exchange rate (index: 2000=100) ^d	159.2	155.3	148.7	144.7	140.8	138.3	136.5	132.4	136.3	136.3
Unemployment rate	13.9	13.1	13.3	12.1	12.1	12.3	12.3	12.1	...	...
Consumer prices (12-month percentage variation)	8.4	9.6	9.6	7.6	5.5	4.1	3.9	4.9	6.5	6.7
Average nominal exchange rate (pesos per dollar)	29.53	29.72	28.76	26.80	25.33	24.71	24.32	23.53	24.18	23.93
Average real wage (variation from same quarter of preceding year)	-1.9	-1.3	0.5	2.4	4.6	4.4	4.8	4.6	5.4	...
Nominal interest rates (annualized percentages)										
Lending rate ^e	53.2	50.8	51.0	46.2	44.5	41.6	35.0	34.8	33.7	32.7
Sovereign bond spread (basis points)	560.0	693.0	491.0	373.0	429.0	400.0	...	...	...	...
Domestic credit (variation from same quarter of preceding year) ^f	-24.8	-16.2	-30.5	-29.3	-28.7	-31.9	-17.3	-14.5	-17.8	-7.9 ^g
Non-performing loans as a percentage of total credit ^h	28.8	22.0	21.6	19.3	20.8	19.8	20.7	19.2	19.6	18.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary figures. ^b Based on figures in local currency at constant 1983 prices. ^c Data to May. ^d Quarterly average, weighted by the value of merchandise exports and imports. ^e One-year non-readjustable cash loans in local currency to families. ^f Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. ^g Data to April. ^h Refers to total credit extended by commercial and private banks and commercial establishments.